JANUARY 1963 ECONOMIC REPORT OF THE PRESIDENT

HEARINGS

BEFORE THE

JOINT ECONOMIC COMMITTEE
CONGRESS OF THE UNITED STATES

EIGHTY-EIGHTH CONGRESS

FIRST SESSION

PURSUANT TO

Sec. 5(a) of Public Law 304

(79th CONGRESS)

JANUARY 28, 29, 30, 31, FEBRUARY 1, 4, 5, AND 6, 1963

Printed for the use of the Joint Economic Committee

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JANUARY 1963 ECONOMIC REPORT OF THE PRESIDENT

MONDAY, JANUARY 28, 1963

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

The committee met at 10 a.m., pursuant to call, in room AE-1, the Capitol, Senator Paul H. Douglas (chairman of the Joint Economic Committee) presiding.

Present: Senators Douglas, Sparkman, Proxmire, and Pell; Representatives Patman, Reuss, Griffiths, Curtis, and Kilburn.

Also present: William Summers Johnson, executive director; John R. Stark, clerk; James W. Knowles, senior economist; William H. Moore, Roy E. Moor, and Donald A. Webster, economists.

Chairman DOUGLAS. The committee will be in order.

The committee has decided that radio and television will be permitted, with the consent of the witnesses.

Gentlemen, we are very glad, indeed, to welcome you. We are all very much interested in the report of the President and we are very happy to have both you, Mr. Heller, and you, Mr. Ackley, with us this morning.

I understand you, Mr. Heller, will present the testimony. When will you be joined by Mr. Lewis?

STATEMENT OF WALTER W. HELLER, CHAIRMAN, COUNCIL OF ECONOMIC ADVISERS; ACCOMPANIED BY GARDNER ACKLEY, MEMBER

Mr. HELLER. Mr. Lewis will be coming in in about 2 to 3 months. He has to finish off his obligations at Indiana.

Chairman DOUGLAS. Will you proceed, then, Mr. Heller?

Mr. HELLER. Mr. Chairman, if I may, I would like to begin by presenting the prepared statement that you see before you.

It is a pleasure to appear again before the Joint Economic Committee and a privilege to open your hearings on the 1963 economic report. In a sense, our testimony today is a sequel to our appearance before your committee last August during your summer hearings on the economy. At that time, while acknowledging the impressive advances that had been made in the first 18 months of recovery, we said the following:

> We are examining the economic outlook today because the current expansion has not been as vigorous as all of us hoped and most of us expected. The expansion has slowed down in 1962 and we must be alert to the danger that the current recovery, like its immediate predecessor, will not carry us to full employment.

We examined the record of the 1961–62 expansion against the background of "our unsatisfactory economic experience of the past 5 years" and explored with you "the basic case for easing the net drain on the economy," exerted by our individual and corporate income taxes. We concluded our statement by stressing—

the need for forethought on the tax adjustments which are needed to remove barriers to the expansion and full utilization of the great potential of the American economy.

Essentially, then, our testimony today takes up where we left off last summer; namely, to consider how the economy can consolidate its gains of the past 2 years and not only continue, but accelerate, its advance—in other words, to examine the policies which could help the economy achieve its full potential for production and progress, and thereby not only loosen but break the grip of the economic lethargy which took hold of the economy 5½ years ago.

Although the Economic Report, in accord with the dictates of the Employment Act of 1946, deals at length with the economic record, the outlook, and the President's economic program for 1963, it may be helpful to the committee to summarize the discussion in the perspective of the major lines of U.S. economic policy today.

In pursuit of the multiple goal of full employment of our resources, faster growth of our economic potential, continued stability of prices, and progress toward balance-of-payments equilibrium—always within the framework of the free market and greater equality of opportunity—economic policy today is channeled into three major lines of action:

1. Measures to stimulate and generate more rapid growth of productivity through investment in modern and expanded plant capacity, in research and development to speed the advance of technology, and in education to upgrade skills and knowledge.

2. Measures to stimulate and generate higher levels of demand, stronger markets for both consumer goods and investment goods.

3. Measures to readapt manpower and other productive resources to the demands of a dynamic economy; that is, measures to build a bridge between growing productivity, which releases manpower, and growing demand, which absorbs manpower.

These are, of course, not independent but interlocking lines of action; measures that provide the incentive and initiative for investment also add to demand; measures that bolster markets add incentives for investment; measures that readapt manpower add to its productivity. But each of the three categories serves as a focus for a variety of policy measures and also serves, therefore, as a useful focus for discussion.

INVESTMENT AND PRODUCTIVITY

To attain several of our key economic objectives—faster growth in productive potential, long-term price stability, and sustained improvement in our balance-of-payments position—requires a high rate of investment, primarily in equipment and plant, but also in technology and research and in the mental equipment of human beings. Providing the strong incentives and markets which motivate risk-taking and effort—which, in turn, underlie high rates of investment and productivity growth—is a prime concern of economic policy today.

In the early postwar period, stimulants to capital spending abounded: great shortages in the Nation's supply of capital equipment had grown out of depression and war; great advances in technology were waiting to be converted into productive process, plant, and equipment; greatly expanded consumer markets had to be matched with greatly expanded plant capacity.

And in the face of world dollar shortages and reconstruction needs, the balance-of-payments deficit served as an instrument of foreign economic policy, not as a restraint on domestic policy. Rising prices and labor costs, while disturbing domestically, did not seem to stem world demand for U.S. products. The setting, in short, was one of strong pressures for capital spending—especially for expansion—and limited concern for the international competitive impact of domestic cost and price developments.

But the past 5½ years have seen a great change. Investment has lagged, growth has slowed down, and rising foreign competition and currency convertibility have exposed our international flank. The importance and urgency of measures to stimulate modernization, mechanization, improved technology, innovation—in a word, to raise productivity and lower unit costs—have increased correspondingly.

From 1947 to 1957, U.S. growth averaged nearly 4 percent a year in terms of total gross national product and 2.1 percent in gross national product per capita, in constant prices. From 1957 to 1962, these growth rates dropped to 3.0 percent and 1.2 percent. Even the growth of potential output has been lower in the past 5 years than the growth of actual output in the previous decade: since 1957 potential has grown at 3.5 percent per year for total gross national product and 1.7 percent for gross national product per capita. And growth in private gross national product per manhour—one of the most inclusive definitions of productivity—slowed from 3.6 percent per year in the earlier period to 2.7 percent per year in the recent period.

This slowdown is clearly associated with a drop in business fixed investment from 10 to 11 percent of gross national product in the earlier period to only 9 percent in the later period. Even though such investment increased from an annual rate of $45.2 billion in the first quarter of 1961 to $50.8 billion in the fourth quarter of 1962—both in 1962 prices—the 1962 level barely matched that of 1957, although real gross national product was 16 percent larger.

Increased productivity and faster growth are, of course, grounded not only in physical investment, but in the less tangible—yet no less real—investment in research and development and education. Out of these grow the technological advances and the higher skills and knowledge which are basic to the long-run growth process.

Thus, the President's programs in the field of education represent an investment which will yield rich returns in more productive and creative manpower. The productivity objective will also be served by new measures to encourage civilian research and development and to make the byproducts of military and space research more readily accessible to civilian industry. In addition to direct support of industrial research and technical information services—including a proposed Federal-State Engineering Extension Service—the President's proposals include a provision permitting the full cost of new machinery and equipment devoted to research and development to be charged off as a current expense for tax purposes. By stimulating a growing number of firms and industries to develop and apply modern technology to their civilian production, these measures will lead to better products and services at lower prices.

To translate new knowledge and new technology into greater productivity and output requires increased business investment in plant and equipment, for higher productivity is realized, in the main, as new equipment replaces old, as new machines and plant substitute new processes and techniques for old.

A central purpose of the President's fiscal program is to strengthen the financial base and increase the incentives for private investors and businesses to enlarge their outlays for plant, equipment, and inventories. Part of this favorable climate must be found in monetary policy—in maintaining monetary and credit conditions favorable to the flow of savings into long-term investment. But most of the positive spur to modernization and expansion is to be realized through tax policy.

We discuss here four steps in the President's tax program in 1962 and 1963 which contribute to this goal.

1. The Congress and the administration in 1962 provided important new tax incentives for productive investment in the form of the investment tax credit and revised depreciation guidelines. These measures provide more than $2 billion of tax savings directly related to plant and equipment investment.

2. The President's 1963 tax program would further lift investment incentives by reducing the corporate tax rate from 52 percent to 47 percent. Small business will receive a special inducement through the reduction of the normal tax rate from 30 to 22 percent—a reduction of nearly 27 percent in the tax liability of corporations with incomes below $25,000.

These rate revisions represent an additional $2.6 billion cut in corporate tax liabilities. Combined with the 1962 changes, they will reduce corporate liabilities by over 17 percent, thus providing not only a large increase in the after-tax rate of return on new investment, but also a large addition to internal funds, a factor of special importance to the investment programs of smaller and more rapidly growing businesses.

3. A number of other provisions of the tax program are also designed to remove barriers to the free flow of investment funds, to sharpen the incentives for risk-taking, and to remove distortions in resource flow. Reduction of the top-bracket rate from 91 to 65 percent, combined with significant reductions in middle-bracket rates, will be particularly effective in freeing venture capital for new investment. Provisions relating to capital gains, to taxation of natural resources, and to the expensing of research and development costs will also have beneficial effects on investment flow.

4. Apart from the various direct measures to encourage investments, the tax program will greatly strengthen the ultimate incentive for increased investment; namely, the markets for the products of industry. As high and rising sales induce higher operating rates, profits rise sharply even at stable prices. When plant capacity is fully utilized and prospects are good for continued high utilization, the incentive effects of the 1962 measures and the lower corporate tax rates will come fully into play.

This leads us directly into the second major channel of economic policy: measures to strengthen total demand.

DEMAND AND OUTPUT

To gain the full benefit of increased productivity, to assure continued growth of our productive potential, and to create the jobs needed to absorb both new workers and workers released by advancing technology requires that measures to increase productivity be coupled with measures to stimulate demand. Thus, the second main line of economic policy is to strengthen markets for the output of our factories, mines, shops, and farms—the products of our workers, managers, farmers, nurses, teachers.

Over the past 2 years—from the first quarter of 1961 to the fourth quarter of 1962—total demand, and hence total output, has grown from $501 to $562 billion, a rise of 12 percent in dollar terms, 10 percent in constant prices, at annual rates.

Public policy contributed to this growth in demand in several ways. The sharply restrictive swing in the Federal budget which slowed the 1958–60 recovery was avoided. In contrast with the $19 billion swing at that time, from an $11 billion deficit—annual rate, national accounts basis—in the third quarter of 1958 to a surplus of $8 billion six quarters later, the deficit in the current recovery moved from $6.3 billion in the first quarter of 1961 to $0.7 billion in the second quarter of 1962, a net change of less than $6 billion. Even in mid-1962, however, a surplus of about $7 billion would have have been produced at 4-percent unemployment.

Monetary policies have remained mildly expansionary. In fact, in contrast with the 1958–60 expansion, when long-term interest rates on U.S. Government bonds rose by more than one-third, such rates changed little or actually declined during the 1961–62 recovery. And the money supply grew by an annual rate of 2.3 percent in this recovery, against 1.2 percent in the earlier recovery.

With the aid of these facilitative policies, recovery moved at a swift pace in 1961, and there was reason to hope that the economy would break out of the sluggishness which had characterized its performance since 1957. But the pace of expansion slowed in 1962, as the rise in total demand averaged only $6 billion per quarter in contrast with over $12 billion per quarter in 1961. At the end of 1962, total demand still fell short of potential output by $30 to $40 billion and unemployment remained at 5.6 percent.

For 1963, a rate of increase in demand similar to that in 1962 is foreseen—a gain that would bring GNP for the year to $578 billion—viewed as the midpoint of a $10 billion range——

Chairman DOUGLAS. May I interrupt a minute, Dr. Heller?

Mr. HELLER. Yes.

Chairman DOUGLAS. Does that assume a tax reduction, or does it assume that there would be an increase in the absence of a tax reduction?

Mr. HELLER. This assumes that a tax reduction would take place in the latter half of the year, and the impact of that, while not a major factor in terms of the actual addition to the forecast, would be felt to some extent in anticipation.

Of this gain, State and local governments will contribute about one-sixth and the Federal Government another one-sixth, largely for space and defense; small gains should be registered, particularly in the second half of the year, by business investment; residential construction is expected to hold roughly steady; consumer incomes and thus consumer purchases will rise modestly.

But this prospect, which includes some stimulus from tax reduction later in 1963, will not appreciably reduce unemployment and narrow the demand gap by the end of the year—only in 1964 and 1965 will the impact of the proposed tax program be reflected in large increases in demand and consequent reduction in unemployment.

Apart from tax reduction, one finds no prospect of a sustained rise in demand which might carry the economy within striking distance of its productive potential. Although consumers are not "saturated" with durable goods, they have been spending their slowly growing incomes in a normal manner and have built up no abnormal backlog either of needs or financial resources. Housing has held up unusually well, but offers little added stimulus until the later sixties, when a wave of new families should provide the basis for a sustained boom in residential construction.

State and local governments have had to strain their resources to maintain the rapid and steady growth of their expenditures, and little change of pace is in prospect. The business investment situation has already been reviewed. There is no shortage of opportunities for modernization and cost cutting, but the spur of fuller use of existing capacity is essential if these opportunities are to be exploited more rapidly than in the past few years. And investment for expansion awaits evidence of growing markets, and the promise of their continued growth.

Under these circumstances, it is clear that a major new stimulus to consumers and investment demand is needed. Removal of the excess fiscal burden imposed by our tax system—a burden born of war and bred in an environment of postwar inflation—is the core of the President's tax program.

Most of the impact of tax reduction on demand will be felt in two stages, the first—of over $5 billion—effective July 1, 1963, and most of the remaining $3 billion effective July 1, 1964—after taking into account the reforms to go into effect January 1, 1964. In other words, under the President's program, individual income taxpayers would find their annual stream of disposable income enlarged by between $7 and $8 billion within the next 18 months—or, if Congress were to act by July 1, within 12 months of the enactment of the program. Their total reduction would be $8.6 billion, excluding capital gains revisions. Net corporate tax reductions totaling $2.4 billion—excluding capital gains revisions—would be put into effect in stages between January 1, 1963, and January 1, 1965.

These are permanent reductions in tax rates. Every weekly payroll, every monthly salary bill, every quarterly dividend disbursement will add more than before to consumer purchasing power. Another way to put it would be to say that less would be taken out of every paycheck, less would be taken out of every salary, less would be taken out of every dividend for Federal income tax purposes.

Some consumers will spend it all as they live from paycheck to paycheck. Others may even overspend it as they use it to take on larger installment payments to buy new durable goods. Some will save it all, or at least use it for a time to repay existing debts. Some will save it for a vacation trip or a college education for their children.

I might say to Mrs. Griffiths that that may sound like the answer to her questionnaire that she put to her constituents last summer.

Thus, what any individual consumer will do with this tax saving is difficult to predict. But what consumers in the aggregate will do is clearly predictable. Consumer spending of disposable income is one of the most regular and predictable relationships that our economic records supply. Since 1950, the saving rate—on an annual basis—has varied within the narrow range from 6.0 to 7.9 percent of disposable income; consumption has varied from 92.1 to 94.0 percent.

Thus, if tax reduction adds a billion dollars to consumer disposable incomes, we can predict what will happen to the great bulk of that billion dollars: It will be spent on consumer goods and services.

The rise in disposable income resulting from the President's tax program will have two parts—the direct reduction in individual income tax liabilities, and the enlarged flow of dividends resulting from corporate income tax reduction. For purpose of illustration, we take these two parts as $8 billion and $0.5 billion.

The actual amounts in the President's program are slightly larger, but these are convenient numbers for illustrative purposes. Of this increment of $8.5 billion of disposable incomes, about $8 billion will be added to the flow of consumer spending.

This additional $8 billion of consumption is not something that happens just once. It is repeated period after period. Thus, before long, the rate of production of consumer goods will be stepped up by at least $8 billion to meet the expanded flow of demand. Thus, GNP rises above what it would otherwise have been by $8 billion of additional output. But the increase in demand does not stop there.

This $8 billion of expanded GNP creates $8 billion of expanded gross receipts by business. Some part of it is immediately claimed by Federal, State, and local governments as higher excise, sales, income, and payroll taxes. Part goes to corporate profits, and some of that is retained in enlarged corporate saving.

These parts typically add up to about 46 cents of every added dollar of GNP, leaving about 54 cents in the hands of consumers in the form of wages, salaries, farm and professional income, earnings of unincorporated businesses, rents, interest, dividends.

Since consumers will save a small fraction of the increment, roughly 50 cents of each added dollar of GNP gets respent on added consumer goods and services. Thus, the $8 billion of initial additions to GNP creates a further flow of about $4 billion of added purchases of consumer goods, and again of added GNP. This, in turn, leads to a further increase of spending of about $2 billion, another round of about $1 billion, and so on.

The cumulative total of all of these increases is a permanent enlargement of GNP amounting to roughly $16 billion. This is the pure "consumption multiplier" effect of tax reduction. It measures what would happen if nothing changed except consumption expenditures.

But, as we have already indicated, investment will be affected, too, in several ways: By the direct effect on incentives and the flow of investment funds; through the effect of the tax reforms in removing artificial barriers to investment; and through the enlargement of markets and the resulting pressures to build inventories and expand capacity. It is difficult to estimate the amount of the investment increment and its timing. But this much is entirely clear from inspection and analysis of long-standing economic interrelationships: The effect is positive, and it is substantial.

Finally, the added investment, whatever its amount, also brings a chain of further increases in consumption. The higher incomes earned in producing capital goods are also respent, and generate incomes in producing consumer goods which are, in turn, respent. Ultimately, each added billion dollars of investment will bring along with it an addition of another billion of consumer demand.

The ultimate effect of the proposed tax reductions is thus far more than the $16 billion of added consumption that we started with. Precisely how much more we hesitate to estimate. But it is reasonable to expect that the combined effects of added consumption and investment can close, or nearly close, the gap between potential and actual output, and restore high levels of employment—not at once, but within a year or so from the time when the full impact of the tax program is felt.

This process of demand expansion which we have briefly described is set forth in some detail on pages 45–51 of our report. In addition, we have prepared two charts which present this process in a more graphic way, and which we would be glad to explain if the committee should wish.

Mr. Chairman, I suggest we do that after completion of the statement, if that is in accord with your wishes.

Chairman DOUGLAS. That will be fine.

READAPTING RESOURCES TO CHANGING DEMAND

Mr. HELLER. An economy that is rapidly growing, an economy in which individuals and businesses keenly pursue their economic advantage wherever it may lead, an economy which responds dynamically to new technological and marketing opportunities and to new currents in world trade; such an economy is continuously destroying as well as creating job and profit opportunities.

Many of us have, perhaps, come to take continuous economic change for granted. But a brief look to history shows what startling changes have occurred and are occurring.

In 1940, 17 percent of our civilian labor force was in agriculture; in 1962 only 7 percent. In 1940, about 55 percent of our workers were engaged in the production of goods as opposed to services; in 1962, only 40 percent were so engaged. In 1940, women were only 25 percent of the labor force; in 1962, 34 percent. In 1940, the unskilled and semiskilled manual and service workers were almost one-half of all workers; in 1962, such workers made up about two-fifths of those employed.

By way of contrast, the professional and technical category has increased from about 7½ to 12 percent, and is still increasing in importance, and will continue to do so.

This look at the facts should remind us not only that change does occur, but that adaptation does proceed. Our principal engine for adaptation is a labor market in which workers are free to move from place to place and shift from one occupation to another, and in which workers and their employers are free to adapt the nature of work and the nature of workers' skills to market needs. Such adaptation is facilitated by high levels of basic training and by the flexibility of youth. In this connection, one should note that our labor force is growing and will grow at such a rate that a full one-third of our labor force in 1970 will consist of persons who will have entered it since 1960.

But not all of this process of readaptation can be left to the workers and their employers. We must expand our ability to readapt our human and physical resources to accelerating change.

The Congress has already pointed the way for such readaptation by the Area Redevelopment Act, the Manpower Development and Training Act, and the retraining and relocation provisions of the Trade Expansion Act of 1962. These beginnings should be followed by vigorous administration and appropriately enlarged efforts which experience may indicate are needed. They should be accompanied by new programs to improve the flow of information about existing and prospective job opportunities, and by the passage of a Youth Employment Opportunities Act to foster methods for developing the potential of untrained and inexperienced youth and to provide useful work experience.

Along the same lines, the President's tax program proposes a more liberal treatment of moving expenses designed to promote mobility. Proposals with respect to capital gains taxation, stock options, and the reduction of top bracket rates all promote mobility of capital and management.

A more effective system of adaptation and readaptation in the labor market will mean that the expanded demand which flows from the tax program will be less likely to run into manpower bottlenecks and thus less likely to cause any inflationary pressures in the Nation's labor markets. It will mean an easier transition from the high levels of unemployment of recent years to more satisfactory levels.

Successful readaptation of labor and the expansion of employment opportunities will, in turn, remove much of the pressure for restrictive practices by labor and employer groups and thereby contribute to expansion of capacity to produce.

As we point out in our report on pages 23 to 25, careful study does not suggest that the current level of unemployment can be explained by any recent decrease in the adaptability of our labor force, nor by any unusual acceleration in the rate of worker displacement. The evidence is to the contrary. The problem of structural adaptation would not be crucial if we were content to stay where we are—with a large margin of involuntarily idle manpower and excess capacity running to waste. But to do so would run counter not only to the dictates of the Employment Act of 1946, but to the spirit and traditions of the American people.

Hence, we must pursue vigorously all three channels of policy—expansion of productivity, expansion of demand, and improvement of our system of readaptation. This balanced development can set the stage for one of the most exciting expansionary periods in our economic history. We have the manpower, we have the technology, we have the business and farming know-how to give a dramatic demonstration to ourselves and to the world of our free economy's productive power and its efficiency and ability to promote the general welfare.

PRICES AND INTERNATIONAL COMPETITIVENESS

Emphasis on policies for expansion implies no lack of attention to the goals of price stability and the balance-of-payments equilibrium. Indeed, built into the three main lines of policy we have discussed are important contributions to these goals.

The setting for expansionary action is now unusually favorable from the standpoint of prices and costs. Five years of virtual stability of wholesale prices and of virtually constant unit labor costs have dissipated the inflationary psychology of earlier postwar years. Competition—including international competition—is keen. World raw material supplies are abundant and prices steady or declining.

Nevertheless, it has to be recognized that expanding demand, as it pushes the economy toward full utilization of resources, may begin to encounter bottlenecks and shortages which could cause wage costs and prices to edge upward. This might threaten our hard-won balance-of-payments gains. But the administration's program couples expansion of demand with increased incentives for modernization, cost cutting, and innovation; in a word, for higher productivity and lower costs. In doing so, it enables the economy to push closer to full utilization while preserving price stability and promoting our international competitiveness.

The President's tax program is phased in a deliberate effort to avoid any possibility that too rapid expansion of demand might create bottlenecks or speculation which would impair our price stability. Moreover, our flexible monetary policy instruments are readily at hand to meet any unexpected threat that might appear. But once we achieve high employment, one cannot gainsay the fact that our continuing problem of maintaining reasonable price stability will be more difficult than it has been in the past 5 years.

It is for this reason that the President has reaffirmed the importance of sound wage and price policies and that the Council has again summarized its wage-price "guideposts" and renewed its invitation for continuing widespread public discussion of the issues which they present.

CONCLUSION

We conclude this statement by reminding ourselves and the committee that the year 1963 offers to the Nation an unmatched opportunity to act wisely and decisively to apply the mandate of the Employment Act. Rarely has the choice for economic policy been so clearly posed as between—

A policy of inertia which can at best perpetuate the unsatisfactory performance of the past 5 years and increasingly expose us to the risk of another in the "melancholy series of recessions" that have repeatedly interrupted our prosperity and growth; and

A policy of action to expand our employment and output toward the goals so clearly stated in the Employment Act.

The President's tax program would assure these objectives in a way which places maximum reliance on private initiative and free competitive enterprise. Rather than employing idle resources through expanded Government purchases, the tax program encourages private business to employ today's idle resources and tomorrow's new influx of resources in responding to the expanded wants of consumers and investors.

Structural tax reforms and sharpened individual incentives will create a new interest in innovation, in cost cutting, in efficiency, thus strengthening competition. Small business and large business, consumers and investors, workers and farmers can harness private gain to public good.

As so frequently in the past, we are sure that the Joint Economic Committee, through its hearings and reports, and through the leadership which its members exercise in the Congress and in the Nation, will play a major role in insuring that the great tax debate of 1963 will be an intelligent and constructive one.

Chairman DOUGLAS. Thank you very much, Mr. Heller.

I want to commend you for the very excellent description which you give of the effect of the so-called multiplier, and in which you point out that a tax cut, by adding total monetary purchasing power, will result in a much greater increase in the gross national product than the amount of the cut.

This theory was first launched, or at least the arithmetic of this theory was first launched, by Mr. R. F. Kahn, years ago, in an article which he wrote for the Economic Journal in June 1931.

I notice you have some charts, which apparently have just been unveiled, describing this. I wonder if you would explain the arithmetic of the multiplier.

Mr. HELLER. Mr. Chairman, may I ask Mr. Ackley, who has worked with these charts, indeed they are his conception, to explain them?

Chairman DOUGLAS. Certainly.

Mr. ACKLEY. Perhaps it would be easier if I can get over here where I can point to them.

Chairman DOUGLAS. I hope this will be considered as part of your presentation and the time will not be deducted from members of the committee or from the chairman.

Mr. HELLER. As you note, Mr. Chairman, there is a three-page appendix, so to speak, to the statement, which covers this explanation.

(The explanation and Chart No. 1 follow:)

EXPLANATION OF CHARTS ON EFFECTS OF TAX REDUCTION

The President's program would make tax reductions effective in stages between July 1963 and January 1965. But to simplify matters, the charts assume that all reductions would become effective at once.

In chart I, the first bar on the left shows the two sources of higher consumer incomes: An estimated $8 billion from individual tax reduction, and an estimated one-half billion dollars of added dividends after taxes based on these dividends. (The additional dividends would undoubtedly begin to be paid only somewhat more slowly; but to simplify the chart, we assume them paid at once.) The second bar shows this as an increment of $8.5 billion in disposable income. The third bar shows this added income divided between added saving—about one-half billion dollars—and added consumption—about $8 billion. This added consumption would be repeated each period so long as the tax reduction was in effect. In turn, the added consumer buying would generate increased production of consumer goods, in the amount of $8 billion per period. This, of course, is an addition to GNP.

Chart II shows what typically happens to every added dollar of GNP—how it is divided among added taxes, added corporate retained earnings, and added disposable income. In turn the added disposable income is divided between consumption and personal saving. On the average in a period of expansion, each added dollar of GNP typically generates another 50 cents of extra consumer spending.

Returning now to chart I, the successive columns shaded in red show the growth of consumer spending over successive periods of time after the tax reduction goes into effect.

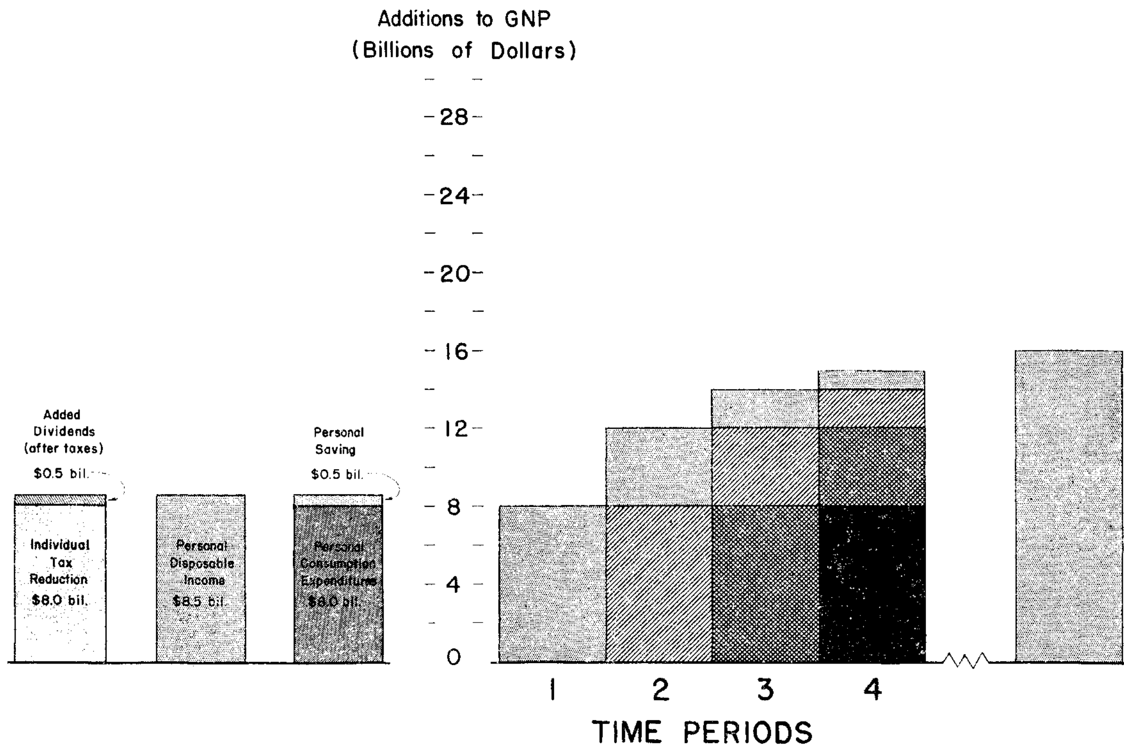
In the first period, consumer spending and GNP have grown by only the initial $8 billion. But in the second time period, consumer spending and output of consumer goods is higher not only by the $8 billion resulting directly from tax reduction, but also by $4 billion resulting from the previous period's increment of consumer spending. This $4 billion of respending in turn generates new disposable incomes, and, after a further lag, some $2 billion more of consumer spending. Thus, in period 3, consumer spending is $8 billion higher as a result of tax reduction applied to the base level of GNP, $4 billion respent from period 2's $8 billion, and $2 billion respent from period 2's $4 billion. Thus the rate of GNP in period 3 will be $14 billion above the base level. In period 4, it will be $15 billion higher; in period 4 (not shown) $15½ billion; and it will level off at $16 billion higher, as shown in the last column, which gives the ultimate effect. This is the pure "consumption multiplier" effect of tax reduction. It shows what would happen if nothing changed except consumption.

But investment will be affected, too. To illustrate the investment effect, we have shown a possible pattern of investment response in green on the upper part of chart I. The amount of this response is chosen arbitrarily. We have shown it rising over time, but have not indicated how far or fast it would continue to rise or where it might taper off. This is clearly an additional impact on GNP. But it is not the end of the matter. The higher incomes earned in producing capital goods are also respent, and generate incomes earned in producing consumer goods which are in turn respent. This is indicated by new bands of red at the top of the chart, representing further consumer goods production. Ultimately each added billion dollars of investment will bring along with it an addition of another billion of consumer demand.

Thus the ultimate effect of tax reduction on GNP will be considerably more than the pure consumption effect. How much more it will be depends on how large an investment response is obtained.

CHART 1

EFFECT OF TAX REDUCTION ON CONSUMPTION AND GNP



Mr. ACKLEY. Mr. Chairman, chart 1 shows, in the first three bars, the tax reduction which is the basis for the impact on gross national product and on total demand.

On the left we have shown a bar consisting of $8 billion worth of individual income tax reduction and about a half billion dollars worth of additional dividends which would result from the reduction in corporate tax rates and would be received by individuals—after taxes on these additional dividends.

This becomes, then, in the second bar, an increment of additional disposable income to consumers of $8.5 billion.

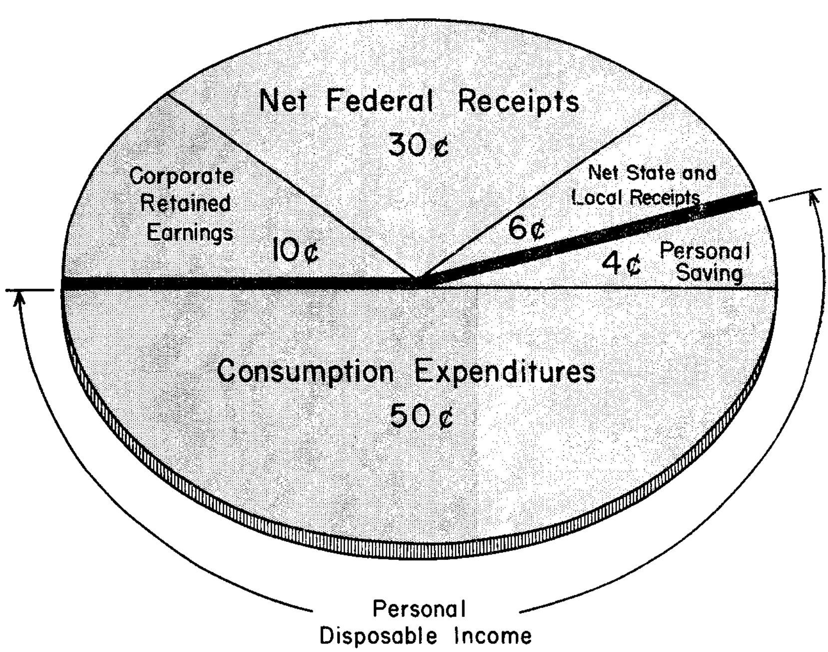
In the third bar, we show that increment of income divided between, roughly, $8 billion of additional consumer expenditures, and one-half billion dollars of additional personal savings.

This $8 billion of additional consumer expenditure has its continuing impact on markets for consumer goods, and, obviously, quickly will result in the generation of an increased rate of production of consumer goods at a rate $8 billion higher than previously. Thus, we have a flow of additional consumption expenditures, and additional output of consumer goods, directly resulting from the tax reduction, itself.

(Chart No. 2 follows:)

CHART 2

DISTRIBUTION OF AN ADDITIONAL DOLLAR OF GNP



Mr. ACKLEY. The effect of additional production of consumer goods is to create additional gross national product. The addition to gross national product creates additional gross receipts for business firms, which are available both to pay taxes and to pay incomes. Of an addition to gross national product, not of the existing level of gross national product but of an addition to gross national product, the division is typically something like this: About 30 cents of it is taken by additional Federal net receipts. This is largely increased taxes, but, to a small extent, it is reduced transfer payments in the form of unemployment insurance and so on. About 6 cents goes to increase the revenues of State and local governments. About 10 cents is added to corporate retained earnings.

This leaves roughly 54 cents added to personal disposable income. Applying the customary saving ratio leaves roughly 50 cents of additional consumer expenditures generated by an initial increase of $1 in gross national product.

That brings us back to chart 1, in which we show over a series of time periods the impact of the additional consumer expenditures. In the first layer we have successive additional consumer expenditures of $8 billion, resulting from the additions to consumer disposable income of $8.5 billion. But this isn't the end of it, as our statement suggested. Each addition to gross national product creates additional consumer incomes which are respent. So that each increment of gross national product gives rise in the next period to an increment of $4 billion of additional consumer spending. This additional consumer spending of $4 billion creates an additional output of $4 billion additional consumer disposable incomes of about 54 percent of that, and additional consumer spending of $2 billion, of $1 billion, and so on.

So we have, moving through time, an increasing stream of consumer expenditures and an enlarged flow of gross national product which would very quickly level out, as you can easily see, at an increased level of gross national product of $16 billion, exactly twice the initial increment.

Chairman DOUGLAS. Mr. Ackley, this works out to the Kahn formula that the multiplier is equal to the reciprocal of the percentage of leakage; is that right?

Mr. ACKLEY. One minus the marginal percentage to consume gross national product.

Chairman DOUGLAS. So with the percentage of leakage of 50 percent, you have roughly the recipocal of one minus five, and you get a multiplier of 2.

Mr. ACKLEY. That is correct.

Representative CURTIS. This is merely a model. Does it have any relation to an actual situation?

Mr. ACKLEY. Could I complete the chart?

Representative CURTIS. I would like to have an answer before you continue. You use a figure of $8 billion which is conveniently related to something that is being proposed now. But this is pure theory, am I not correct? I want to be sure what we are talking about.

Mr. ACKLEY. It is theory in the sense that it attempts to generalize from the facts of economic experience, which is what all theory does.

Representative CURTIS. In other words, you could have used a $16 billion figure or a $4 billion equally as well.

Mr. Ackley. Yes. We are talking about a tax reduction of $8 billion. That is why that was used.

Representative Curtis. But as far as reality is concerned, that is false, because you make it happen all at once. That is not the proposal. That is why I want to make it very clear at this point that this model has no reference to an actual situation. It is merely to advance a theory.

Chairman Douglas. If I may say, the significant part of the model is the size of the multiplier, and Mr. Ackley's computation of the multiplier is equal to approximately 2.

Representative Curtis. All I want to do is understand what the model is. If we were to apply this model, for example, to the President's proposal, it would have to be altered considerably. His proposal is not an $8 billion figure, but a staggered program over a period of time.

I just want to clear the air.

Mr. Ackley. I should have mentioned that in the beginning, that we have assumed here for purposes of simplicity that it would all come into effect at once. As a matter of fact, there is another simplifying assumption which is made, and that is that the dividends would be received simultaneously with the reduced individual tax liabilities.

Mr. Heller. Mr. Chairman, may I note in Mr. Ackley's answer that when he said it was theory, it was a generalization from experience. It is grounded in the actual experience of what consumers do with additions to their income, from detailed studies of what they do with their additions to income.

Representative Curtis. Let me ask you this, Dr. Heller: In 1930, was that saving figure 3 percent?

Mr. Heller. Yes, in the thirties.

Representative Curtis. So you are assuming something, although you know it changed, beginning in 1957. We will get into that later.

I just want to get these assumptions out in the open.

Chairman Douglas. May I say to my good friend that the lower the percentage of savings, the smaller the percentage of leakage, and, therefore, the larger the multiplier.

Mr. Heller. That is correct.

Representative Curtis. The gentleman from Illinois misinterprets my question. I am not trying to argue one way or another. I am trying to establish the assumptions. I mentioned the 3 percent rate of the 1930's because it was a very different figure from the rather constant figure he used since 1950. I understand that one of the themes in your Economic Report is that something unusual has happened since 1957, although not in the savings area.

Mr. Heller. Mr. Chairman?

Senator Proxmire. I was going to ask a further question on the chart, Mr. Chairman.

Mr. Heller. I want to make a second point, if I may, that while it is true that these reductions in the President's program of roughly $8 billion relating to disposable income are made in stages, this is a very close approximation of the final effect on consumer incomes of the President's program, and it is a permanent reduction.

So looking at the total program, it will result, if enacted, in this $8 billion increase in disposable income, give or take a few hundred million.

Representative CURTIS. I want to thank you, Dr. Heller, because that is what I was trying to get at, whether this was actually going to be related to reality. Now you have explained that you think it largely is.

That is subject to debate. But I wanted to know what the chart was, first.

Chairman DOUGLAS. Now if I may go back on my own time. I would like to ask Dr. Roy Moor of our staff to put on the board some charts which I asked him to prepare.

Senator PROXMIRE. Could I ask a question about the chart before you do that?

Chairman DOUGLAS. Yes.

Senator PROXMIRE. The net Federal receipts of 30 cents for each dollar of increase in GNP is far higher than anything I have seen before.

If we relate the size of Federal receipts to the GNP, as I understand it is quite a bit smaller than one-third, about one sixth would be much closer to it. I am wondering if you can supply the committee with the working papers on which you base this 30 cents figure. That does seem to me to be way out of line. You can do that at a later date.

(The following was later received for the record:)

The figure of approximately 30 cents of added net Federal revenues for every dollar of added gross national product (GNP) can be derived by considering the major components of net Federal revenue that are affected by a change in GNP: Corporate profits taxes, individual income taxes, indirect business taxes, social insurance contributions, and transfer payments.

1. *Profits taxes*.—Perhaps the single most crucial element in the calculation is the increase in corporate profits (to which corporate profits tax rates apply) associated with an increase in GNP. All studies show corporate profits to be highly sensitive to the change as well as the level of GNP. A typical formulation embodying these effects is that contained in the model presented to this committee by Gary Fromm, of Harvard University and United Research, Inc., and published by the committee in part IV of Inventory Fluctuations and Economic Stabilization, May 1962.

It is also clear from these studies that the magnitude of the profits share of added GNP (and thus of the multiplier) varies somewhat, depending on the speed and the extent of the change in GNP that is contemplated. Our calculations relate to approximately the kind of movement which would be involved in going from the expected mid-1963 GNP to the GNP associated with full employment, over a period of roughly 2½ years. For a movement of this magnitude and speed, we estimate the profits share of added GNP as about 30 percent—somewhat higher than this at first and somewhat lower during the later stages. Applying the successively declining corporate tax rates to the added profits produces an added corporate profits tax of about 12 cents for each added dollar of GNP.

2. *Individual income taxes*.—More than 65 percent of added GNP would go to increase personal income less transfers. This share would be slightly lower at first, slightly higher later. In turn, this would yield—at new tax rates—8 to 9 cents of increased individual income tax collections for each dollar of added GNP.

3. *Indirect business taxes*.—These would constitute about 2 to 3 cents of each added dollar of GNP.

4. *Social insurance contributions*.—These would rise by 3 to 4 cents for each dollar of added GNP.

5. *Reduced transfer payments*.—Finally, the reduction in transfer payments must be added to the increased revenues described above, to obtain the effect on net Federal revenues. We estimate that each dollar of added GNP in moving

toward full employment would reduce Federal transfer payments, principally unemployment insurance, by about 3 cents.

6. *Summing up.—*

	Cents
Added profits taxes	12
Added individual income taxes	8½
Added indirect business taxes	2½
Added social insurance contributions	3½
Reduced transfer payments	3
Total	29½

Mr. ACKLEY. I am sure we could, Senator Proxmire. Could I comment for a moment on that, however?

Senator PROXMIRE. Certainly.

Mr. ACKLEY. We are talking here, as we must in this connection, with the impact of an additional dollar of GNP during a period of expansion.

The fraction of an addition to gross national product which goes into Federal revenues in a period of expansion is much higher, of course, than the average at any given time, or the average fraction that you would get over a period of gradual growth.

We are talking here of the movement up toward full employment. The primary reason this is so high is that, in such a period, corporate profits take a larger-than-normal fraction of the increment of gross national product, and the high rate of taxation applied to corporate profits is one reason why this percentage is as high as it is.

Chairman DOUGLAS. I asked Dr. Roy Moor to prepare his estimates of what the multiplier would be, and to do so without consultation with the Council of Economic Advisers. I asked him to work this out arithmetically both for the multiplier, so far as consumption is concerned, and also consumption plus probable added investments or the stimulus to consumption from the additional investment created by the original increase in consumption.

I will ask him if he would put the charts on the board and then explain them.

Mr. HELLER. Mr. Chairman, may I interrupt to say that the hidden part of our chart deals with that second stage of investment and further induced consumption.

Chairman DOUGLAS. This chart deals purely with consumption. Mr. Moor, would you put your figures on the board, please?

Mr. MOOR. This is a table we have done that is very similar to the graphic presentation given by the Council earlier. Let me jump ahead immediately to the types of assumptions we made. We started with an original tax reduction of $8 billion, and we have assumed three general types of leakages.

Hypothetical increase in consumption demand from 1-year tax cut

[In billions of dollars]

Period	Tax Reduction	Increases in GNP	Increase in nonpersonal income (15 percent of GNP) [1]	Increases in personal income	Increases in personal tax (20 percent of personal income) [2]	Increases in disposable income	Increases in personal savings (7 percent of DPI) [3]	Increases in GNP
I	----------	----------	----------	----------	----------	8.00	0.56	7.44
II	----------	7.44	1.12	6.32	1.26	5.06	.35	4.71
III	----------	4.71	.71	4.00	.80	3.20	.22	2.98
IV	----------	2.98	.45	2.53	.51	2.02	.14	1.88
V	----------	1.88	.28	1.60	.32	1.28	.09	1.19
VI	----------	1.19	.18	1.01	.20	.81	.06	.75
VII	----------	.75	.11	.64	.13	.51	.04	.47
VIII	----------	.47	.07	.40	.08	.32	.02	.30
IX	----------	.30	.05	.25	.05	.20	.01	.19
X	----------	.19	.03	.16	.03	.13	.01	.12
Total (approximate)	----------	20.24	3.04	17.20	3.44	21.76	1.52	20.24

Assumes no change in—
(1) Demand for imports.
(2) Private investment or Government expenditures.
(3) Distribution of income.
(4) Effective tax rates after tax reduction.

[1] The multiplier analysis only considers increases in personal consumption. Increases in GNP going into nonpersonal income (such as corporate retained earnings) will not lead to increased consumption and thus must be subtracted. In 1960 nonpersonal income constituted about 20 percent of GNP. The 15-percent figure used in the table assumes that increases in corporate profits will be reflected in substantially increased dividends, a type of personal income.

[2] While individuals obtain increases in personal income, part of these increases are lost through increased individual taxes and therefore are not available for increased consumption. The average increase in personal taxes associated with increases in personal income during the 3 recovery periods, 1954–55, 1958–59, and 1960–61, was 14 percent.

[3] To determine final increases in consumption demand from increases in personal income, personal savings must be subtracted from the increases in disposable income. For the 3 recovery periods 1954–55, 1958–59, and 1960–61, the average increase in personal savings associated with increased disposable income was 6.2 percent.

Mr. Moor. The first of these is that a certain portion of the $8 billion with each turnaround will go into incomes of business rather than individuals. That is, largely into corporate retained earnings. We have assumed 15 percent. That may be a little low, although it is interesting to note that in the 1960–61 period the increases in personal income were actually greater in aggregate terms than the increases in GNP.

The second leakage we have assumed is the leakage to personal taxes. There we have assumed a larger figure than the Council has assumed, 20 percent of personal income. Since this would go into individual taxes, it would not be available for consumption.

The third leakage is into personal savings, and here our assumption is very similar to the Council's. We have assumed 7 percent.

Following this out, therefore, the $8 billion tax reduction goes to individuals in the first instance. This is our assumption, with some part of that taken out in personal savings, and the initial increase in GNP, according to this approach, is $7.4 billion. But that $7.4 billion becomes increased income. Some of that increased income is in nonpersonal form. Therefore, in terms of personal consumption, this should be subtracted out.

Then some portion of the increase in personal income goes into taxes, and of the disposable income left after taxes, some portion goes to personal savings. The remaining amount is reflected in increased consumption.

This table, like the chart, takes no account of the effects of increased consumption in stimulating investment.

Chairman DOUGLAS. The total increase in consumption is approximately $20 billion?

Mr. MOOR. Which would be about 2½ times.

Chairman DOUGLAS. Instead of two. What about the secondary effect? A large portion, of course, of this increase in consumption will be produced with existing invested capital, but part of the increased consumption will require additional capital.

Do you have an estimate of that?

Mr. MOOR. This is more difficult to predict. The lower part of chart 3 is very similar to the Council's chart, the part representing induced consumption, or the amount of increases in consumption coming about from the tax reduction, amounting to a little over $20 billion, once the total flow has worked itself out.

We then further assumed that a feedback into investment of about five-eighths of the increased consumption, with a lag. So if you have an increased consumption of $7.5 billion, roughly, we assumed that in the second period at least some business firms would have to react by ordering additional capital equipment. "Guess estimating" at that, we said it would be about five-eighths of the initial increase in consumption.

Continuing that, the aggregate increase in consumption in the second period is a little over $12 billion, so we took five-eights of that, and so on. Our total estimate came out with an increase in aggregate demand, both from consumption and investment, of around $33 billion.

Chairman DOUGLAS. What you call the second factor is generally known as the accelerator factor as distinguished from the multiplier factor, and the classic article on this was written in 1917, by J. M. Clark, "Business Acceleration and the Law of Demand," in the Journal of Political Economy, I believe, in March.

Mr. MOOR. I was told that by the Senator. I didn't know.

If one wanted to push this one step further, there presumably would be some stimulative effect from these increases in investment, a playback on the multiplier.

Chairman DOUGLAS. You get a total multiplier, therefore, of approximately 4?

Mr. MOOR. The total increase in GNP from both the consumption and investment side might be 3.5 or near 4.

Mr. HELLER. Mr. Chairman, may Mr. Ackley now go to our third chart which does the same thing as your second chart?

Senator SPARKMAN. Mr. Chairman, before these charts are disposed of, I have a question. May I ask: Those periods, 1, 2, 3, and on out to 12, do they correspond to years? You used that in both charts.

Mr. MOOR. The initial problem, as Mr. Curtis indicated a few minutes ago, is how this $8 billion initially begins to pump itself out. The Council has made an estimate, I believe, that 50 percent of the stimulus would reflect itself in 1 year.

CHART 1

Hypothetical Increase in Consumption Demand from 1-Year Tax Cut

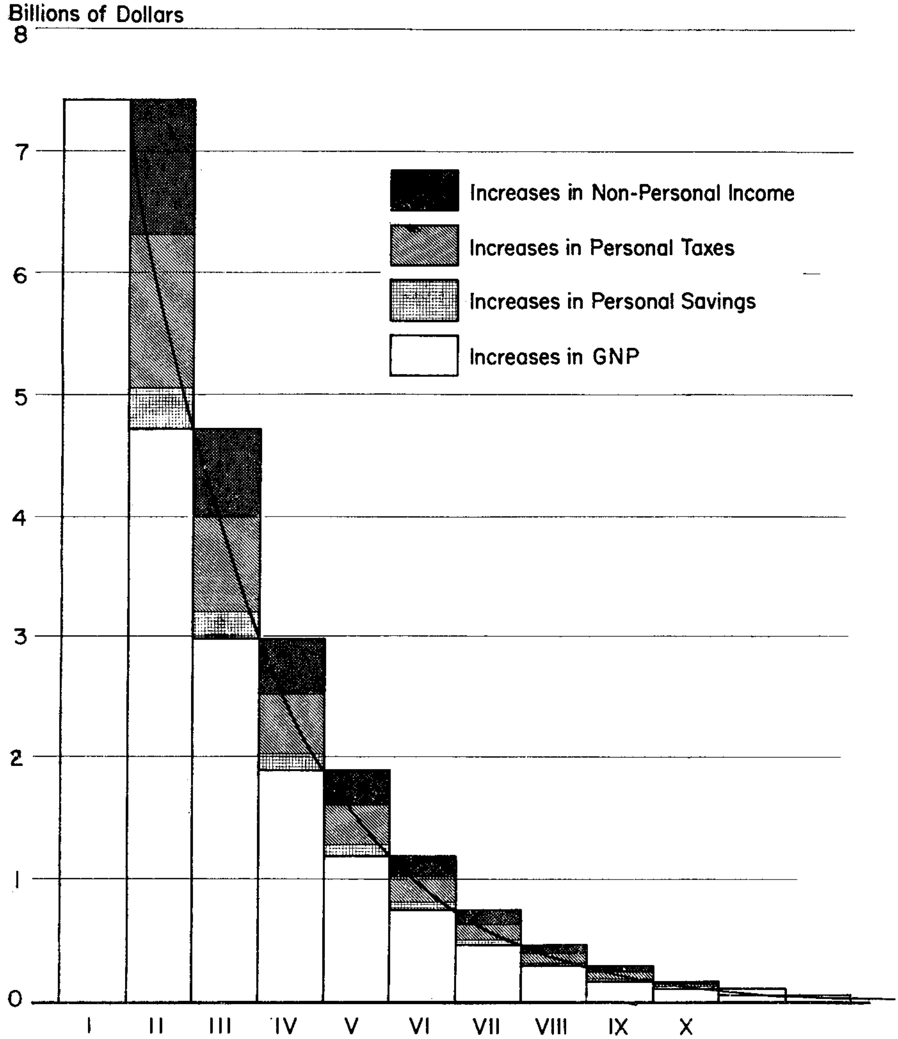


CHART 2

Hypothetical Increases in GNP from Permanent Tax Reduction

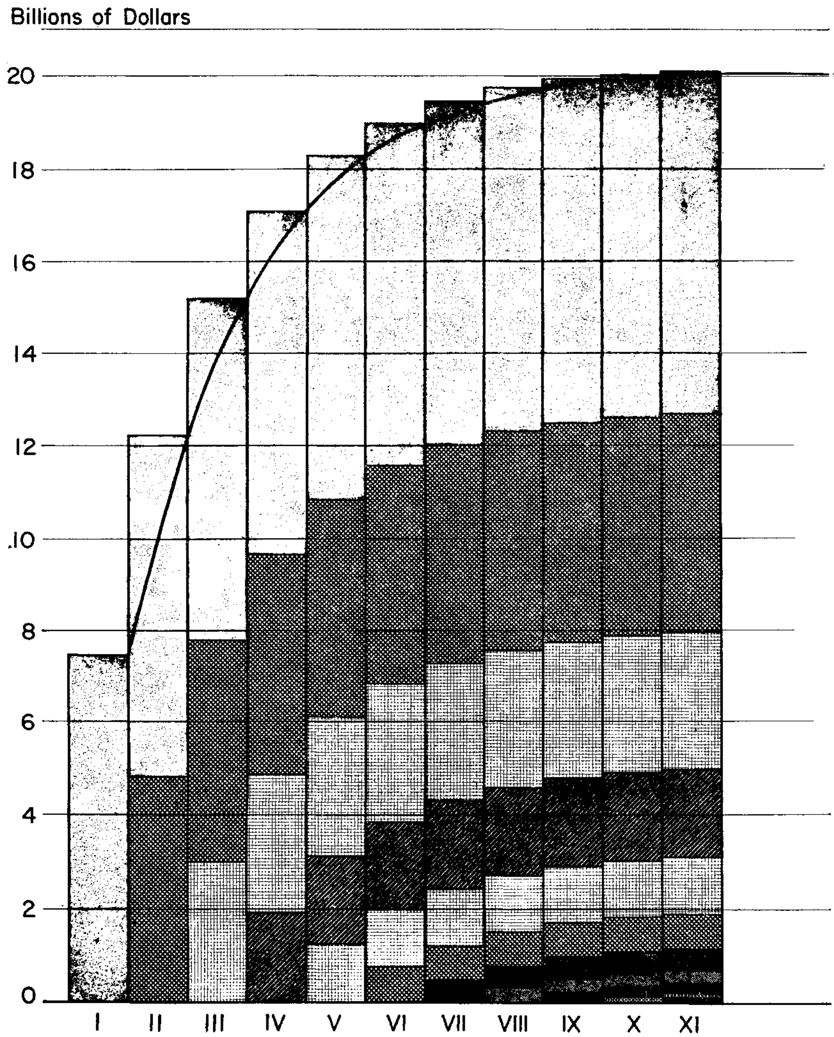
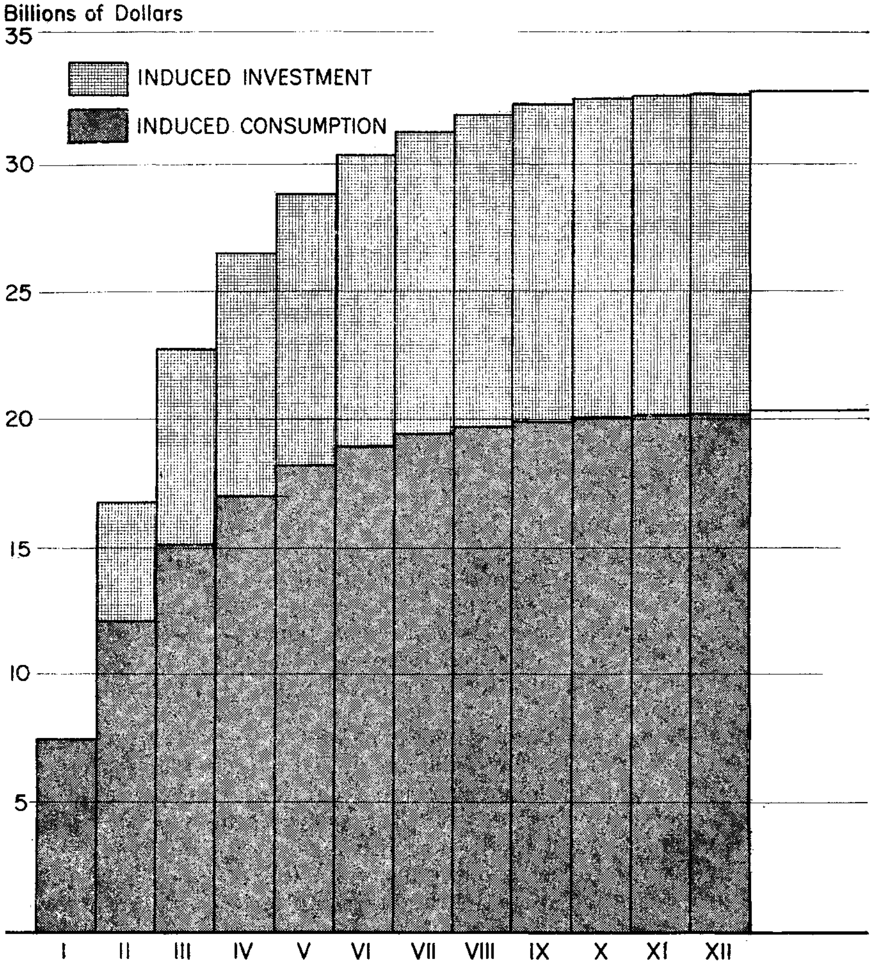


CHART 3

Hypothetical Example of Economic Stimulation in both Induced Consumption and Investment from a Tax Cut



*Assumes 5/8 response of Investment to increased consumption, with one period lag.

**Ignores secondary effects on consumption of increased investment.

Another way to do this is to assume that these periods are quarter-years, at annual rates. That is, of the $8 billion, every day there will be increases in income and increases in consumption that, if totaled through a year, would amount to $8 billion, and businessmen begin to react and so on.

These periods might be viewed as quarters of years at annual rates, although that may be a little optimistic in terms of how fast it gets out.

Senator SPARKMAN. It would seem to me that there would have to be a definite time that you would assume that the whole impact would be felt, that you couldn't just assume one of those periods to be a quarter and that the impact is felt there, if you are going to have continuity on your chart.

Mr. MOOR. If one were to start with our initial assumptions of an $8 billion tax reduction all at once, and this is, as was pointed out, not the administration's program, if that were true you might expect that the full effects would be felt in, say, 3 or 4 years.

Chairman DOUGLAS. Mr. Ackley, you may proceed with your other chart.

Mr. ACKLEY. Chart 3 is based on Chart 1, Mr. Chairman. We have been somewhat less bold than Mr. Moor in our willingness to attempt to estimate quantitatively the investment effects of the expansion of demand, but we have tried to indicate in an illustrative way the fact that rising demand would also lead to an increase in investment. We have superimposed on the previous chart some bars indicating a possible development of investment expenditures.

We have also shown something which Mr. Moor only referred to, but which was not on his chart, and that is the fact that whatever increment occurs of investment spending itself has a multiplier effect. The additional incomes earned in producing additional capital goods will be received by consumers and respent in the same way as the additional incomes earned in the production of consumer goods.

So each increment of investment might be expected to generate additional consumption, and each increment of consumption still further additional consumption, and so on. These increments are shown on the tops of the other bars, beginning in period 3.

Thus the total impact of GNP, whose size we did not venture to estimate precisely, is surely much larger than the pure consumption multiplier effect alone.

Chairman DOUGLAS. Congressman Curtis.

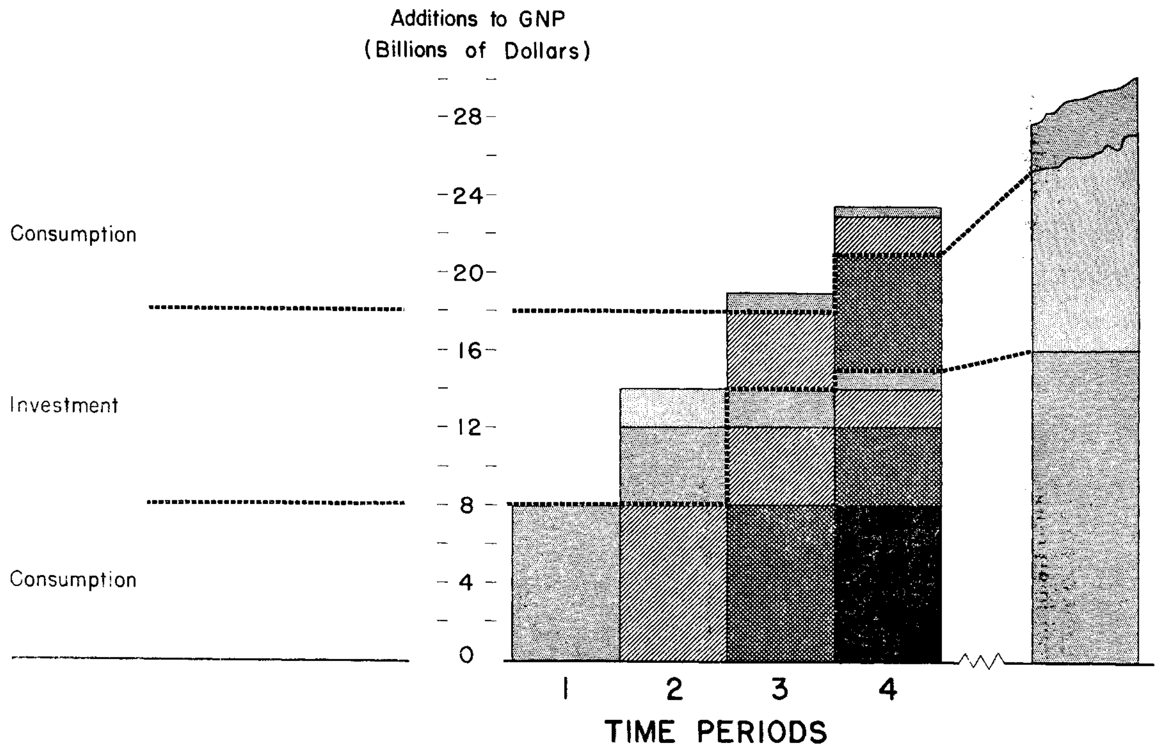
Representative CURTIS. First, let me join in the remarks that the Chairman of the Council made as he closed his statement. I, too, hope the Joint Economic Committee will play a major role in assuring that the great tax debate of 1963 will be an intelligent and constructive one.

But what I want to point out is that until now the affirmative is still making its case. This is the first 10 minutes the loyal opposition has been given.

We have had a series, almost an avalanche, of three Presidential messages: On the state of the Nation, the budget, and the tax program. All sing the same theme. Now we have the President's Economic Report. We received the budget on January 17, the Economic Report on January 21, and tax message on January 24.

CHART 3

EFFECT OF TAX REDUCTION ON CONSUMPTION AND GNP INCLUDING STIMULUS TO INVESTMENT



Frankly, it is a hard job to go through all of this material. But I am trying. The loyal opposition lacks sufficient staff to study this carefully.

I am hoping that our side will get some time, even in the press. The people must be made aware of the other opinions. I have prepared a speech that I am putting into the Record today which is a preliminary statement of an opposing position. I hope to take the floor Thursday to provide an opportunity for those to debate that opening statement.

I think it is important that we have debate because some of the basic premises upon which this whole economic theory is based are in dispute.

We must review these premises if we are going to discuss the necessity of a tax cut and its ultimate effect on the economy.

Mr. Heller, isn't it true that our growth rate for the past 100 years has averaged a little less than 3 percent? It is somewhere around 2.9 percent, depending on how you measure it.

Mr. HELLER. Mr. Curtis, the figure since 1900 is about 3 percent.

Representative CURTIS. I thought it was from 1860. Do you know whether there are figures back to 1860?

Mr. HELLER. I think some fragmentary estimates have gone back beyond 1900, but they are not often used.

Representative CURTIS. The reason I raise the point is that the base of your theory, as well as the President's is the economic gap. You assume that our economy isn't growing as fast as it could, and that the growth rate should be around 4.5 percent.

Is that right?

Mr. HELLER. Mr. Curtis, the background is only partly the matter of the slowdown in our rate of growth. We had a rate of growth in the early postwar period of about 4.3 percent. Our actual rate of growth in the past 5 years has been about 3 percent; our potential about 3.5 percent.

The other part of it, though, is simply the underemployment of our existing manpower and industrial capacity.

Representative CURTIS. You are begging the question.

Mr. HELLER. I didn't mean to.

Representative CURTIS. I am trying to get this into context. If the 1860 to 1960 figure is about that, and I think it is, we have expanded economically. We have probably grown more rapidly than any other economy.

If the average rate turns out to be around 3 percent, it becomes a serious question as to why you think the rate should suddenly become different for the sixties. Are you possibly suggesting that your gap theory is in error.

As I have suggested before, what you identify as tired blood I consider as growing pains.

Let me ask you this question: Why have you picked the year 1957 as a separation point? Your estimates go from 1947 to 1957, and 1957 to 1962. Why is 1957 chosen?

Mr. HELLER. The year of 1957 was a clearcut turning point in which a gap opened up in our utilization of resources that has simply never been closed.

Representative CURTIS. But, Dr. Heller, you beg the question. I am trying to find out if there really is a gap. I will tell you what is peculiar about 1957, and I think you will agree. It was a peak.

If you had taken 1958, you would have a different picture. Why didn't you use 1946 to 1956? You would have an entirely different picture, would you not?

Mr. HELLER. In our comparisons—not all of which have, by the way, been centered on 1957 but some of them on 1953, some of them on 1955, some of them on 1957. We have been careful to take comparable stages, usually peaks, in the business cycle.

We have not made comparisons from, say, the trough of one cycle to the peak of the next, or the peak of one to the trough of the next, because that would be manipulation. You have to take similar positions in the business cycle and that is what we have done.

Representative CURTIS. That is the question. Have you, really? Is 1962 a comparable cyclical period to that of 1957? Previously, the Council used 1953 as the take-off point.

I pointed out that that was a war year, and certainly not an accurate starting-off point. In this sense I think there has been manipulation of the base periods chosen.

What needs to be done is to establish why you think 1957 is a fair takeoff point. Maybe you can, but don't do it by arguing that this is when the gap started. We are trying to find out if it did occur.

I know you are familiar with Dr. Arthur Burns' paper, in which he pointed out that, using your model to establish the gap but a different base of a 4-percent unemployment, you would reach different conclusions.

Mr. HELLER. However, it is from Dr. Burns' National Bureau of Economic Research that we take our comparable points in the business cycle. Last year we made our comparisons between the postwar period up to 1955, Mr. Curtis, and then from 1955 on to the next peak.

At the present time, the reason we are using the 1962 comparison with the 1957 peak is that we had a recovery that, as you know, went very fast in 1961 and then tapered off in 1962 into what we may call a rising plateau. We have been comparing that plateau with the very similar 1957 situation, which seems like a reasonable comparison.

Representative CURTIS. But 1957 was not a plateau.

Mr. HELLER. A brief plateau before it turned down into the recession of 1957–58.

Representative CURTIS. This is an area in which I think you must bring forward your working papers so that we can debate, rather than beg the question. In all of these documents, the use of the periods 1957 to 1962 and 1947 to 1957 has not been justified. In the past I questioned the use of 1953.

At that time, every argument pointed out that it was in error.

Let me ask one question about disposable income since my time is rapidly running out.

At higher levels of disposable income, as anticipated with a tax cut, does the percent of income saved increase? Or, to put it another way, does the marginal propensity to save increase as income increases?

If so, does the 93 percent average spending pattern hold true for the increase in disposable income resulting from a tax cut?

I have been trying to find out what the savings rate was during the 1920's or other previous periods. I know the 1930's would be unfair. It was around 3 percent then. What makes you think the 1950 period is normal? Have you compared it with other periods in our economic advancement? To the 1920's? To the 1910's?

This is important. You use this as a very basic assumption.

(The following was later received for the record:)

It is apparent from almost any index we choose that the rate of U.S. economic growth was considerably higher in the earlier years than it has been in the later years of the postwar period. This change obviously did not occur all at once at a single point in time, but developed in the mid-1950's. Choice of a single year for the "turning point" can hardly be avoided when making comparisons between the earlier and the later years.

In selecting some single dividing year, we must obviously take account of purely cyclical considerations. Clearly, we do not wish to use a recession year, and this eliminates 1954 and 1958. This leaves 1953, 1955, 1956, and 1957. As the table below shows, it does not make a great deal of difference which of these years we choose as the dividing point—in any case the growth rate in the earlier period is substantially above that in the latter.

[In percent]

Period	Average annual rate of growth		Period	Average annual rate of growth	
	GNP in constant prices	Total employment		GNP in constant prices	Total employment
1947–53	4.8	1.6	1947–56	4.1	1.4
1953–62	2.7	.9	1956–62	2.8	.8
1947–55	4.3	1.3	1947–57	3.9	1.3
1955–62	2.7	1.2	1957–62	3.0	.9

The year 1953 might be eliminated on the ground that it was a year of very high, perhaps over-full employment (unemployment rate 2.9 percent). This leaves 1955, 1956, and 1957. Choosing 1957 as the breaking point is conservative, and minimizes the extent of the divergence between the earlier and later years. Choice of 1955 or 1956 would be equally defensible, and would make the contrast between the early years of rapid growth and the later years of slow growth even more dramatic.

It is clear that, choosing any of these years as a dividing point, the economy has not been growing as fast in recent years as it did earlier. Choice of 1957 as the dividing point is quite independent of any "gap" analysis.

Mr. Heller. As to the first part of your question, one of the things we have tried to do in the report, Mr. Curtis, was to point out that when income rose and fell in the postwar years, it seemed to have no impact on the saving rate. In other words, it seemed to be a very steady kind of saving rate, whether it rose or fell in response to tax changes, for example.

Representative Curtis. But in relation to gross national product in 1961–62, we had an increase, didn't we?

Mr. Heller. In 1961–62 actually we had a slight decrease in the saving rate out of income.

Representative Curtis. I was relating it to GNP.

Mr. Heller. In a recovery period people try to spend a higher proportion of their income and the saving rate typically drops off in such a period. The saving rate did shrink a bit in this recovery period as well as in earlier ones.

Representative Curtis. I was struck by the fact that even during these post-World War II recessions disposable personal income continued to increase.

The savings rate did fluctuate a bit. But that bears directly on the question of whether we are correct in identifying weak consumer purchasing power and demand as the basis of an alleged weakness in our economy.

Mr. HELLER. Perhaps the other comment that should be made, apropos of the comparison of the postwar period with the prewar periods, is that basic institutions in the economy have changed.

That is to say, we have, for example, introduced a very widespread social security system; Government expenditures as a whole are a considerably larger percentage of gross national product; we have built in certain stabilizers in the economy.

As a result, the experience of the pre-World War II period must be reinterpreted, so to speak, before we would regard it as applicable to a postwar period in which our basic economic institutions have been very substantially altered to sustain higher levels of demand, to sustain an economy which, if not immune from recession, is at least immune from the shattering kind of depression that we had in the 1930's.

Representative CURTIS. That exercise might be very valuable in identifying what is happening. I don't think we would want to return to those days, but maybe we would if we looked at them closely.

Chairman DOUGLAS. Mr. Patman.

Representative PATMAN. Dr. Heller, I, too, congratulate you and the Council on a very informative report and the interesting way in which you have presented it here this morning.

Mr. HELLER. Thank you, Mr. Patman.

Representative PATMAN. However, there is a point on which your report leaves me confused.

In most places where you talk about tax cuts, which imply an increase in public debt, you talk in terms of stimulating employment and production. But on page 54 of your report, where you talk about the possibility of the banking system purchasing some of this public debt, you talk in terms of inflation.

I had been under the impression that what tends to cause inflation is a condition of full employment, or near full employment, and not the method by which you reach that condition.

Am I wrong in this analysis of inflation, Dr. Heller?

Mr. HELLER. Let me put it this way: the fundamental assumption which underlies your question, namely, that when you have unutilized resources, unutilized manpower, unutilized industrial capacity, the force of expansionary fiscal and monetary policy expresses itself in higher output and more jobs rather than in higher prices is quite correct.

The speed with which any expansionary action is taken, of course, is one factor in whether you incur inflationary dangers; that is to say, if you were to put an enormous charge into the economy all at once, you might run into bottlenecks even at less than full employment levels.

However, fundamentally, I would agree that expansionary action coming from monetary policy and expansionary action coming from fiscal policy, insofar as the domestic economy is concerned, should have no difference in their inflationary or expansionary impact.

Representative PATMAN. Thank you, sir.

Last July before the House Banking Committee, and again last August before this committee, Chairman Martin, of the Federal Reserve Board said that if there were any increase in the deficit, he would take the position that the deficit would have to be financed out of savings, not out of bank-created money.

Over last year, the Fed has had the banks in a position where they have $300 to $400 million of net-free reserves, for the most part.

My question is this: If Mr. Martin did carry out his threat to prevent the banks from increasing their holdings of governments, he would have to put them in a position where they would have to have virtually no net-free reserves, would he not, Dr. Heller?

Mr. HELLER. The impact of the financing of a deficit that would grow out of the present economic situation, plus the tax program, will depend in considerable part, on what the Federal Reserve System does to the reserves of the banking system. When we look at the relationship between monetary policy and fiscal policy in this period, we have to look at it in terms very largely of the impact on reserves. If the reserve position is kept easy, then the banking system can absorb part of the Government debt. It may not necessarily purchase this debt directly—it did not do so in 1962—but it may make it easier for others to do so.

If the reserve position is tightened up, of course, the banking system would be in a very tight position and not in a good position to absorb the Federal debt that would arise out of the program.

Representative PATMAN. I wish you would answer more clearly the latter part of my question. In order for him to carry out this statement, if he actually expects to carry it out, and I am afraid he might, would he not have to reduce that $300 or $400 million down to practically nothing?

Mr. HELLER. What I was trying to say was that I don't want to put a specific reduction in the works here in answering your question. But he would have to tighten those reserves, you are quite right, in order to carry out that. I don't know whether Mr. Ackley wishes to comment further on that point.

Representative PATMAN. Would you like to, Mr. Ackley?

Mr. ACKLEY. I would only add that if there were no expansion in the total volume of reserves available to the commercial banking system, then, obviously, the increased financial demands that accompanied an expanding economy would have to be met with a constant supply of money, and this would have some effect in tightening interest rates and tightening the availability of credit—not necessarily a large effect, but, necessarily, some effect.

To avoid such tightening there would have to be some expansion in reserves at the same time that the expansion of demand occurred.

Representative PATMAN. I believe that the Federal Reserve people have been trying to reach some understanding with foreign central bankers concerning coordination of monetary policies and avoiding undue runs on the dollar.

Would it be improper for you to say whether or not there is any understanding between the Federal Reserve and the administration which would assure you that the Federal Reserve will not wipe out the effects of the tax cuts?

Mr. HELLER. Mr. Patman, there has been quite close consultation with Mr. Martin on the part of both the President and the Secretary of the Treasury, the Director of the Budget, and the Chairman of the Council. I believe that the dangers inherent in an unduly restrictive monetary policy, the dangers inherent in terms of offsetting the impact of a tax reduction, for example, are very thoroughly understood.

I think that the actions of the Federal Reserve in the past year and a half or 2 years in maintaining at least a mildly expansionary monetary policy throughout the recovery, are a reflection of the understanding within the administration concerning the necessity for a balanced and coherent expansionary policy. If you put it in terms of an explicit agreement to do explicit things, no such understanding exists. But I believe that the issues are well understood and have been discussed between Mr. Martin and other members of the administration.

Representative PATMAN. There is no wink or nod, or anything like that, then, involved in it? You just don't know what will happen? Or an unconversational understanding?

Mr. HELLER. Well, the Federal Reserve is a relatively independent agency, and it is difficult to predict at any given time what they will do. However, they are operating, it seems to me, within a general understanding of the requirements of the economic situation.

Representative PATMAN. Would you concede that, if Mr. Martin did carry out his threat, if it was a threat, to wipe out the effects of a tax reduction, it would be devastating to the administration's plan?

Mr. HELLER. Indeed, if such a monetary policy were carried through, it would be devastating. That is a good part of the subject matter of our exploration in chapter 2 of our annual report, on methods of financing the current deficit, which discusses the various ways in which the monetary policy could facilitate or thwart fiscal policy.

Representative PATMAN. I am very anxious to see the Federal Reserve work with the administration as it did years ago when we kept our interest rates on the national debt down to 2 percent over 12 of the hardest years in history. It never went above 2 percent on Government bonds and no Government bonds went below par, which I think was a pretty good record.

I think, if we had maintained the Roosevelt and Truman rates—and I want Mr. Curtis to hear this—if we had kept the Roosevelt and the Truman rates, we would be paying $5 billion a year on the national debt instead of $10 billion this year.

Chairman DOUGLAS. Senator Sparkman.

Senator SPARKMAN. Dr. Heller, I want to add my word of commendation to you for a very fine statement which you have presented. I think it is as good a statement as could be prepared on this subject.

Mr. HELLER. Thank you.

Senator SPARKMAN. It is very explanatory and I commend you for it. There are some questions in my mind, and there have been ever since the proposed tax reduction was announced. I naturally would like to see a tax reduction, and I think that would be true of people generally throughout the country. But I think there is a genuine concern as to whether or not the tax reduction will work in the manner predicted.

Your statement has well explained why the predictions were made and on what basis they are now made. I recall that, in 1954, we gave a tax reduction and, also, if I remember correctly, the tax incentive for the purchase of new plant and new equipment. I think that was in the act of 1954.

Mr. HELLER. Accelerated depreciation; yes, sir.

Senator SPARKMAN. Yes; and we had a considerable upturn in the economy the following year and the year after that. Then, as I understand your statement, there was a brief plateau in 1957, following which we had a recession, a dip that I presume could be accountable in large part for the largest single deficit we have ever had in peacetime in this country, $13 billion, I believe, or $12.8 billion.

Mr. HELLER. $12.4 billion on an administrative budget basis and $13.1 billion on a cash basis in fiscal 1959.

Senator SPARKMAN. Well, we shall say $13 billion. I have heard the statement made many times that that was the outgrowth of the tax reduction of 1954.

Is there any merit in that statement?

Mr. HELLER. That the recession was the result?

Senator SPARKMAN. Yes, that what we did was to overbuild, and we now have a great deal of idle capacity in this country as a result of having overbuilt following that program in 1954.

Is that true?

Mr. HELLER. There is no question but that in 1955 to 1957 there was a very considerable investment boom. There is also agreement, I believe, that some of that boom, by no means all of it, could be attributed to the accelerated depreciation provisions.

However, a very large part of it was attributable to the fact that we had not yet closed the gaps that had been opened up in our capital equipment by depression and by war. We still had very large backlogs of demand for plant and equipment, for new capacity, which had to be satisfied in that first postwar decade.

Some people turn it the other way around, Senator. They say that part of our problem is that we did not put in another tax reduction around 1957. Gabriel Hauge, the other day, in a symposium we had in New York, said that he regretted that the Eisenhower administration had not put in a further tax reduction "6 years ago." The 1954 reductions had been successful in stimulating the economy.

Senator SPARKMAN. Isn't it true that since 1957 we have had excess plant capacity?

Mr. HELLER. Yes; we have.

Senator SPARKMAN. Or at least unused plant capacity.

Mr. HELLER. Unused plant capacity because we have had inadequate markets for the products of those plants.

Senator SPARKMAN. And is this a large part of the theory behind this proposed tax cut, that it will step up consumer purchase to the extent that this excess capacity will be utilized?

Mr. HELLER. That is a very substantial part of it, just as the stimulus to investment in the reductions in corporate rates and top bracket rates are an important part of the program. Investment incentives have already had the benefit of 1962 actions on the investment tax credit and revision of depreciation guidelines.

The major emphasis in the program this year, in dollar terms, and in the distribution of tax reduction between corporate and individual taxes is on the strengthening of consumer markets for the output of new plant and equipment.

Senator SPARKMAN. I thought that considerable emphasis was being placed on plant investment in the charts.

Mr. HELLER. That is a result of the fact that at the same time that you reengage your unusued resources, you, of course——

Senator SPARKMAN. Start needing more?

Mr. HELLER. That is one of the characteristics of getting to full employment, that you push against your existing capacity and stimulate your rate of growth by bringing more capacity into production.

Senator SPARKMAN. Do you think that it is designed in such a way as to avoid a boom in plant investment or an overbuilding of new plant, new equipment, so as to avoid an excess capacity?

Mr. HELLER. I think economists are well advised not to pretend omniscience in these matters, Senator.

Senator SPARKMAN. I realize that.

Mr. HELLER. But as far as the balance of the program is concerned, this underlying $8.5 billion, which is a close approximation of the final effect of the program, provides a foundation of increased market demand that can support a very substantial increase in capacity over the years, given the secondary and the tertiary effects and the normal growth in economic demand.

Senator SPARKMAN. As I recall in your statement, you brought out the fact that we have had relative stability, pricewise, for the last 4 or 5 years.

Mr. HELLER. That is correct, sir.

Senator SPARKMAN. Can this program be handled so as to preserve that stability, or is inflation a real threat as a result of this?

Mr. HELLER. As we noted in our statement, Senator Sparkman, we believe, and we think that the facts support us, that the program that the President has proposed could be introduced without danger of inflation.

This is based on two fundamental propositions: One is that there are so many unused resources at the present time that the impact of this program will go into more jobs, more production, and more income and not into higher prices.

The second proposition is that there are many forces continuing to make for price stability. For example, world raw material prices are favorable, increased competition in world markets promotes price stability, and we might add, as a third factor, that the program, itself, will stimulate cost cutting. In other words, it will stimulate a better cost basis for continued price stability and international competitiveness.

Senator SPARKMAN. I have just 1 more minute, Dr. Heller. I have several questions, but here is one that I will ask, which I think you can answer immediately.

When is it projected that we shall reach a balanced budget under this program?

Mr. HELLER. The judgment that Secretary Dillon gave was essentially the one that we would agree with, namely, that it will be on into the fiscal year 1966 or 1967 before the revenue line is likely to cross the expenditure line. We think that that point will come earlier with the tax cut than without it, because of its stimulative effect on the economy.

Senator SPARKMAN. Thank you, Mr. Chairman.

Chairman DOUGLAS. Senator Proxmire.

Senator PROXMIRE. I would like to join at least my Democratic colleagues in commending you on the message. There are a couple of things in it that I think are particularly good. I like your emphasis on developing human skills, and stressing the necessity for providing the capacity to adapt to our rapidly developing and changing technology.

Mr. HELLER. Thank you, Senator.

Senator PROXMIRE. I also like the idea of changing the corporate tax structure and turning it upside down so that the basic tax is 22 percent instead of 30. This is mighty helpful to small business.

It is one thing that a lot of us in Congress have supported for a long time. As you have pointed out, this is something that I think is going to stimulate the small business section of our economy a great deal.

There are a couple of things that disturb me quite a bit. I am inclined to share Congressman Curtis' alarm in terms of this analysis of the gap in our resources. I think Congressman Curtis' skillful questioning did bring out the fact that you are basing this not so much on historical records of growth, the percentage growth, and I think you are wise in not doing it, but on the fact that we have 4 million people out of work, and we have our factory capacity about 83 percent utilized.

My question is: Why don't we ever have any emphasis on recognizing the possibility of diminishing the supply side of our employment equation? The fact is that if we did not have social security today, we would have 16 million people out of work, because people on social security would all be looking for jobs. Either that or on relief. They would need some more income to keep alive. Social security has reduced our unemployment greatly.

Why can't we at least think of the possibility of earlier retirement? Labor unions, with considerable force, have argued for a 35-hour week, which has almost no support in Congress, and which I can see has a lot of difficulties in terms of cost and so forth.

Why isn't there any consideration, either in this report or very much emphasis in the President's report, on the opportunity for earlier retirement, No. 1, and No. 2, trying to persuade our young people to stay in school longer, perhaps by mandatory school-leaving age at a higher rate, 17 years instead of 14, 15, or 16 years, which it is now?

Mr. HELLER. Senator Proxmire——

Senator PROXMIRE. This, incidentally, would greatly reduce also at the other end of the scale the unemployment pool.

Mr. HELLER. Senator Proxmire, I think this has to be answered in two parts, one applying particularly to early retirement, and to artificial reductions of the workweek, which is also implicit in your question. The other is to the proposal to lengthen the period of schooling, and so on.

As a general proposition on the human side, the objective is to provide jobs for those who are able and willing to work, who are seeking work, simply in terms of human fulfillment. And many surveys, both in this country and in Canada over the years, have shown that people prefer—in terms of their own psychological drive, let alone their economic drives—to work, rather than not to work.

Senator PROXMIRE. The option is not available to our older people. I think I have shaken a million and a half hands in Wisconsin, mostly at plant gates. The thing that our working people want very much is the opportunity to retire earlier. I can see the difficulties in providing an immediate 60-year retirement with full social security benefits. I think we have to work at this gradually. But why isn't there some consideration to this?

It seems to me that there is real wisdom in the workingman's argument, No. 1, that they would like to retire while still young enough to enjoy it, and if they do retire they open a job for someone else. But if you are 60 years of age, and you have been working at a job for 40 years, you don't have the option to retire and you have to wait until 65, or 62 with reduced benefits.

Mr. HELLER. This figure was reduced in Congress the year before last, to 62. I think that the general principle of option and free choice, which is fundamental to our market system, is a good one.

At the same time, anything that would artificially induce people to withdraw themselves from the labor market, more or less against their wishes, or that would artifically cut hours below those which they would like to work, would deprive them of freedom of choice and, at the same time, deprive the country of a major resource that we need in terms of economic growth, in terms of national security, in terms of leadership in the free world.

We are very loath to see measures taken that would deprive us of this source of growth in our economic strength.

Senator PROXMIRE. But isn't the principal basis for growth, real growth that we need, not a matter simply of reducing consumers' taxes so they can go out and buy more automobiles, television sets, refrigerators, or maybe another house, but isn't the real basis for growth the development of human skills, so that people will devote more time to education, and more effort to education? This is generally a public effort.

It is true that we can provide incentives for individual education, but if we are going to really make this economy of ours grow, we have to build it on the basis of increased human skills, not on the basis of just having people have a few more consumer satisfactions.

Mr. HELLER. That is why I was dividing my answer into two parts. I thought when you suggested the longer period of schooling for people at the lower end of the age groups, that this works very much in the right direction as far as the taproot of economic growth is concerned.

Senator PROXMIRE. It works both ways. It diminishes the unemployment, and we have a million dropouts every year, many of whom cannot find work. The single largest group of unemployed is the age group 14 to 19 years, and it has been largest for years, and it will be a million and a half in a few years.

We can drastically diminish that and give them constructive training. The results where that is tried is striking. In Milwaukee, we spend 4½ million for vocational education. Philadelphia, three times as big, spends one-seventeenth of what we spend. We have 5-percent dropouts in Milwaukee, the best record of any big city in the country, and the national average on high school dropouts is 40 percent.

It seems to me that here is a good way, a constructive and economical way of reducing unemployment, and providing the basis for growth, without this kind of endless deficit financing, which is very hard for me to accept on the basis of my traditional bias.

Mr. HELLER. I would like to say, Senator, that I agree entirely that the investment in the education and training of youth offers a very large payoff, and this is something that is not simply an assumption. Very careful studies of the payoff on education show that it is one of the best investments we can make, and that it makes the kind of contribution that you suggest to the unemployment problem.

I am not sure it makes the contribution to the Government spending problem that you suggest. In other words, education and training to upgrade labor skills, knowledge, and wisdom is a very expensive process.

Senator PROXMIRE. There is a big payoff, though, too. A lot of us argued that the GI bill of rights resulted in increased Government revenues from the people who received the additional education, who earn more money and pay more taxes.

Mr. HELLER. I would agree, but in the intermediate period, of course, you have to incur an increase in Government expenditures.

Senator PROXMIRE. It seems to me that this is the sort of constructive deficit which is more hopeful than the deficit of just decreasing income taxes.

Mr. HELLER. I am not inclined to disagree with the objective that you state. In fact, I very much agree with it. At the same time, unless we have the consumption that pushes against our productive capacity, we are not going to get the growth in our overall productive potential that we otherwise would have. So it isn't just consumption, per se. It is consumption for growth, if you will.

Senator PROXMIRE. I have one more question.

A year ago President Kennedy, in addressing the Congress, talked about the period of 10 months of growth that we had, which was less than we have now, and said:

> To plan a deficit under such circumstances would increase the risk of inflationary pressures, damaging alike to our domestic economy and our international balance of payments.

If that was a true and accurate statement at that time, why is it not an even truer and more accurate statement now, since we have had, as he said this year, 22 months of uninterrupted recovery, we have a lesser unemployment problem, we have a better utilization of resources, somewhat better? Why this sudden and dramatic and drastic shift, just turning around his position entirely?

Mr. HELLER. I am happy to comment on that, although somewhat unhappy as to its implications concerning our economic forecast of a year ago. The President's statement last year was made in the light of the administration's forecast of a continued, brisk recovery in 1962, one which would be carrying us on the path toward full employment by mid-1963.

To have superimposed on that path a substantial Government deficit would have offered some threat of inflation along the lines that the President was mentioning. It has turned out that the economy did not expand at that rate, and both the budget message and the Economic Report of a year ago said that if it did not expand vigorously, then a deficit would become a cushioning factor to underemployment of our resources. So the statement can be readily reconciled. The anticipated developments which underlay that statement did not in fact materialize.

Given the underutilization of resources, and the fact that our gap, between actual and potential output has not narrowed in this past year, it is entirely appropriate to have expansionary policy in the form of a tax cut, a tax cut which is designed to provide an expansionary push. The deficit isn't the object of the exercise. It is the reduction of the drag on people's incomes and people's incentives.

Senator PROXMIRE. My time is up, Mr. Chairman.

Chairman DOUGLAS. Mr. Reuss.

Representative REUSS. Mr. Heller and Mr. Ackley, I, too, want to join with my colleagues in praising your excellent report, and particularly the final exhortation to the members of the Joint Economic Committee who are in agreement with its general analysis to go out and try to convince their colleagues in Congress to carry out its recommendations.

Mr. HELLER. Thank you.

Representative REUSS. My first question is: Suppose we do that, and suppose, armed with these charts and the general analysis, we are extremely persuasive, and suppose Congress concludes that anything worth doing at all is worth doing well, and notes that the tax reduction program designed to carry out this analysis will produce an $11.9 billion deficit in the upcoming fiscal year, but will not reduce at all the very serious 5.6 percent unemployment we have; suppose Congress, therefore, concludes that instead of the tax cut recommended, it is going to put into effect a tax cut as of January 1963 which will have a more immediate impact, and specifically which will bring unemployment down to around 5 percent, or possibly even better, by the end of 1963, and which would, by so doing, hasten the happy day of a balanced budget from 1966 or 1967 to an earlier year? What would be bad about that?

Mr. HELLER. Mr. Reuss, what you are talking about is more or less pushbutton tax legislation which, of course, has never been characteristic of the congressional process, and understandably so.

Representative REUSS. We could make the tax decrease retroactive to January 1, 1963.

Mr. HELLER. In a sense, of course, the President's program does provide for tax cuts retroactive to January 1, both explicitly in that corporate tax change, and implicitly in the individual income tax change in that the cut will be reflected in a reduction of liabilities for the year as a whole.

In other words, when you fill out your 1963 income tax return, it will be a reduction in tax liabilities for the year as a whole.

Representative REUSS. But the whole thing, if it is done, will still result in as large a percentage of unemployment next December as we have now.

Mr. HELLER. You are posing, really, a different question, and that is, Why not have a larger part of the program go into effect on January

1, creating, at least temporarily, a larger deficit? The answer to that is in part economic, in part psychological, which can be, I suppose, broken down into both economic and political aspects.

The economic part of the answer is that there are many people, as we are well aware, who fear the size of the deficit, per se, even though economic logic and past experience indicate that the deficit can be managed without inflation. These people, in terms of the psychological factor of business confidence, in terms of consumer confidence, will influence the impact tax reduction will have on the economy. Likewise, there are those abroad who—although not in the majority, as evidenced by the fact that we have been urged by our colleagues in the OECD to undertake expansionary policy in their interest as well as ours—there are many who would fear an excessive deficit and this might have implications for our balance-of-payments position. I think this is part of the explanation of the rather moderate schedule of tax reductions.

Also—although you have partly cut the ground out from under this second part of my answer by suggesting that we might aim at 5 percent unemployment by the end of the year—if we were to try to do it all at once, to move, say, to 4 percent unemployment within a year, this would call for an increase in GNP that we have experienced in only 1 year in the whole postwar period.

It would involve some risk of the speed of expansion, some risk of running into bottlenecks, and some risk of inflation that we do not incur under this present schedule.

Third, I should finally say that if there were absolutely no such psychological problems as mentioned in the first place, and if there were the possibility of instantaneous action, I think it would be true that one would advocate a larger part of the tax increase to go into effect immediately or at an earlier date.

Representative REUSS. Let me address myself, then, to the two prongs of your answer.

First, I gather that you are not really pressing the second prong, when I say, "Don't settle for 5.6 percent unemployment, try for 5 percent unemployment," you are not suggesting to this committee that our economy would inevitably suffer inflation if we do anything about unemployment at all this year?

Mr. HELLER. I am not.

Representative REUSS. So you are left with one prong, the psychological one, aren't you?

Mr. HELLER. I think the third tine of this fork is not to be ignored either. That is the problem of the congressional process, how fast you can move in that process. That is one that inevitably conditions the recommendation that the President makes. No President lives by economics alone, and no Chairman of the Council, or Council member who is realistic about his role in these matters, would suggest that he should live only by the economic dictates. These have to be blended with the institutional and psychological realities of the situation.

Representative REUSS. Then let's get back to tine 1, which is the point about the size of the deficit. Was there actually a value judgment made by you and your associates that people in this country and abroad could stomach an $11.9 billion deficit without getting upset, yet would somehow have an upset point at, say, a $13 billion budget deficit, even though that $13 billion deficit would, by the tax reduction which caused it, bring about a reduction in unemployment to the order of 5 percent?

Mr. HELLER. Inevitably, in the process of fixing on a program which would yield roughly a $12 billion administrative deficit—and I might note only about a $10 billion cash deficit—judgments of this kind have to be made. The precise limits of that judgment involve, of course, a great many choices and a great many considerations that went into the final decision.

Representative REUSS. Let me ask another question.

On page 59 of your report, on monetary policy, the second paragraph, the last three sentences, you have three very interesting sentences which I will read:

> No country can permanently balance its international accounts by interest rates so high that its productive potential is kept underutilized and its labor force underemployed. Nevertheless, defense of the currency may require vigorous use of monetary instruments, and there can be no doubt that the U.S. authorities are prepared to take whatever steps are necessary to defend the dollar. An expansionary fiscal policy will give them greater freedom to do what has to be done.

This sounds to me as if you are acquiescing in what this week's Business Week says the Federal Reserve is doing. They have an important story saying that the Fed has made the first basic shift in Federal Reserve monetary policy in 2½ years, and is tightening credit.

I wonder whether it wouldn't be better national policy, instead of letting the so-called constraints of the balance of payments underwrite a tightening of credit, which is inevitably going to hurt growth, to do what the Joint Economic Committee in its reports for the last year and a half has been urging, that we ask our European partners to form an adequate payments arrangement so that normal capital flows between countries do not cause us to have to adopt restrictive monetary policies.

I wonder if that wouldn't be a better approach. Yet I note with regret that you don't say anything about that, and, instead, you seem to adopt the line that the way to defend the dollar is to raise interest rates.

Mr. HELLER. Let me respond to the several parts of that question.

First, I should say that we feel that balance-of-payments considerations and gold outflow considerations do place a floor, in a sense, under what expansionary monetary policy can do. We have stressed, however, both in our annual report and in testimony before this committee on repeated occasions that we don't believe that interest rates should be one iota above that floor set by these international economic considerations, because of the deleterious effect that that would have on domestic expansion.

Yet if we did encounter an unexpected run on the dollar, surely one of the instruments that we have most readily available is short-term shifts in the interest rate. We would be extremely reluctant to see that used, but if it involved a choice between defending the dollar or not defending the dollar, of course it would have to be used.

As to the second part of the question, isn't it a better solution to improve our international monetary mechanism to provide protection for such situations? We would agree that one has to proceed on that front simultaneously with strengthening the domestic economy. We have, of course, already made a number of improvements, both through the arrangements made for swaps with other countries' currencies, through the standby credit of the IMF, and so forth, but we would agree that this problem needs continuing attention.

In chapter 4 of our annual report beginning on page 127, we have explored this subject under the heading "Strengthening the International Monetary System. It is true that we reach a somewhat cautious conclusion when we say that "some incompletely resolved problems still face us," but that phrase is meant to cover just the very kind of concern that you are expressing, that we should continue to explore over the longer run the adaptation of the international monetary system to growing world trade and to the temporary imbalances that occur among countries in their gold and balance-of-payments situation. In that respect, we are entirely in agreement.

Representative REUSS. My time is up, but I would express the hope that you would use the power of the Council of Economic Advisers to make interim reports to the Congress, which you have so well used so far in the last 2 years, very soon, to give a little more content to the present language on page 129 in which you say that there are some problems left and "constant attention" and "continuing study" are necessary.

I think you could well come forth with something a little more pointed on that. We will hope that you will. Thank you.

Chairman DOUGLAS. Senator Pell?

Senator PELL. I, too, would like to thank you, Dr. Heller, for a clear and well presented report.

Mr. HELLER. Thank you.

Senator PELL. I think we are all for tax reform. The best idea, I suppose, would be to lower income taxes even further and have no deductions except for calamity. There would be one tax deduction and we would all know where we stood. I think the program which has been presented is a good step in this direction.

I must say, even as a liberal Democrat, I have doubts about whether it is sound policy to accept this continuing series of deficits. I think we would like to see a balanced budget. This worry, I think, is felt throughout the country as well.

I was wondering why in presenting the tax package you did not go further in the area of tax reforms, why you did not propose to step up the estate tax, for instance, which would not directly relate to consumer spending, which is what you are after. Why you did not again seek to establish the "anticheat" dividend and interest withholding tax.

Mr. HELLER. I think Secretary Dillon on Thursday will be able to give you more satisfying answers to that question than I. I will make two comments: (1) That the interest of the country in tax reduction is so great that to overburden the tax reduction with full-scale tax reform would perhaps have lessened its chances and delayed its enactment very considerably.

I think that experience over the past dozen years, if not longer, has demonstrated that reform comes hard, that the dream of a thoroughly comprehensive reform to restore the tax base offset by tax reductions is just that—a dream, if you think of doing it all at once. I make that as the first comment.

As to the second comment, Secretary Dillon's answer, as he gave it yesterday on television, was that the interest and dividend withholding was rejected by Congress, that there was a substitution of a more rigorous requirement of information returns, and he felt it was inappropriate to come back with a recommendation for interest and dividend withholding until there had been some experience under this alternative approach, particularly with the use of machine techniques, and so on.

I think I should rest on that answer.

Senator PELL. I would like to establish to my satisfaction the sound basis for the theory that the tax reduction would produce enough increase in GNP so that the tax revenue will come up to snuff by taking a look at past experience or history.

What other nations have tried this seemingly rather fully grown experiment that I had not even heard of 2 years ago, but which I gather has long existed in theory? What other nations have tried to reduce taxes and thereby hoped to increase the tax revenue in the long haul, and what have been the results?

Mr. HELLER. There are some rather good parallels to the proposed tax program here in the experiences of Germany, of Austria, and of Japan. Naturally, in other countries, given the differences in circumstances, they will not be exactly comparable with the present situation in this country, but I do think it is quite in point to note that Germany had successive tax reductions throughout the 1950's, including a major tax reduction in 1957–1958, in the face of budget deficits, at least budget deficits in terms of our methods of budgetary accounting. Take their July 1958 major tax revision, for example, in which they had a substantial reduction approximating DM 2.2 billion of tax reduction. This was in the middle of a series of deficits of somewhat under DM3 billion in 1957, 1958, and 1959—and they cut back their revenues and increased their deficit and, of course, enjoyed continued, very marked expansion, as well as reachieving a budgetary surplus in 1961.

Senator PELL. Wasn't this the period when the Common Market was rapidly taking shape, and might that not have caused the expansion during the years you mentioned?

Mr. HELLER. Please don't misunderstand me. I am not saying that we can put our finger precisely on that tax reduction and say that this was the cause and all of their expansion was effect. But they did have cuts in 1953, 1955, 1957, and 1958. This certainly had a stimulative effect on the economy.

Senator PELL. Taking into account the fact that the whole economy of Europe was booming in those years, I wonder if you can take an example perhaps further back in history, a time when conditions remained generally static, perhaps even in another part of the world.

Mr. HELLER. I don't have one at my fingertips. I have looked only at the postwar period. It is true, however, that in the 1957 period Germany had had a slowdown in its growth rate, in its growth of national income, and that this picked up again after the tax reduction.

The Austrian case is even more spectacular in a way because they have reduced their taxes very drastically, again and again, incurring deficits in the process, and very substantially expanding their gross national product.

Senator PELL. I wonder if I could ask unanimous consent to have inserted, into the record, a statement by the staff of Dr. Heller, containing the figures that they have drawn upon.

Chairman DOUGLAS. Without objection, that may be done.

(The statement referred to follows:)

RECENT TAX REDUCTIONS IN OTHER COUNTRIES

There are many examples of recent tax reductions in other industrial countries. Three countries—West Germany, Austria, and Japan—have had a series of significant tax reductions during the last decade. In each of these countries reductions in tax rates have been followed by steady increases in tax revenues. Moreover, each of these countries has been characterized throughout the period by rapid rates of economic growth and low or falling rates of unemployment. Although the degree to which tax reduction contributed to prosperity in these nations is uncertain, reduction of the drain of the increased tax revenues as a result of economic expansion has unquestionably had a generally stimulative impact on these economies.

THE FEDERAL REPUBLIC OF GERMANY

Significant tax reductions were put into effect in West Germany in 1953, 1955, 1957, and 1958. The 1955 reduction was a major one, which included a cut in the top-bracket income tax rate from 70 to 55 percent, other cuts down the line in the personal income tax, and a sharp reduction in the corporate tax rate. The 1953 and 1955 tax cuts together represented a gross reduction of DM 8 billion in tax liabilities at then-existing levels of output and income. This represented about one-third of Federal Government receipts in that period and roughly 5 percent of GNP. Yet, the continued rapid expansion of the German economy led to revenues in 1956 well above their 1955 levels.

The 1957–58 tax reduction was also a major one, incorporating such features as the establishment of joint returns and more liberal deduction provisions in the personal income tax, and a small increase in the corporate tax rate accompanied by a cut of over 50 percent in the tax on distributed profits. The gross annual reduction was estimated to be DM2.2 billion—about 7 percent of Federal receipts and over 1 percent of GNP. This reduction was put into effect at a time when the pace of economic activity had slackened in Germany, and in the face of substantial cash deficits of somewhat less than DM3 billion each in 1957, 1958, and 1959. However, the pace of activity picked up and the German cash budget had moved back into surplus by 1961.

AUSTRIA

Austrian tax policy has been very flexible, with reductions in 1954, 1955, 1958, and 1962 far overshadowing earlier increases in 1952 and 1953. In spite of the series of tax reductions, there has been a continuous secular increase in budget receipts—which more than doubled from 1952 through 1960—reflecting rapid and steady economic expansion. Moreover, while budget deficits were registered in every year from 1952 through 1961 with the exception of 1953 and 1954, actual deficits have consistently fallen short of estimated deficits.

JAPAN

With the single exception of 1960, tax reductions have been put into effect in Japan in every year from 1951 through 1962. The estimated gross reduction averaged just over 50 billion yen from 1951 through 1961—or approximately 5 percent of average annual tax revenues.

During 7 of these 11 years, the Japanese ran a cash budget surplus. While Japanese Government expenditures approximately tripled from 1951 to 1961, rapid Japanese economic growth raised revenues—even after tax reduction—enough to cover these expenditure increases.

Senator PELL. As the gross national product goes up, wouldn't the cost of Government go up as well, excepting for defense, because people will demand more services and better roads, comparative benefits for veterans and retired people? I wonder if it wouldn't be a little fallacious to think that Government spending would stay static as the gross national product goes up. Have you considered that?

Mr. HELLER. Yes. We have made no assumption that there would be no increase in Federal expenditures. Those increases under the pressures of defense and space will, of course, taper off.

Senator PELL. I am not talking about defense.

Mr. HELLER. And because of the increase in population and prosperity, when people are more prosperous, they demand more services from Government. There will be some increases in the Federal budget. At the same time, under normal growth circumstances, the revenues of the Federal Government increase by about $5 billion a year without any increases in tax rates. As long as the increases in expenditures are less than those increases in tax revenues—and, of course, the additional stimulus provided would increase this rate of increase in tax revenues markedly—unless the expenditures were to eat that up, then, of course, we still would make a gain toward the balanced budget situation.

Senator PELL. Do you have, Dr. Heller, any rough estimate as to the ideal ratio in an industrial country between the total gross national product and the personal income tax. In other words, what is the optimum level of tax revenue where less doesn't produce enough and where more would have its diminishing effect?

Mr. HELLER. It is extremely hard to arrive at this optimal figure. It is true that we have had the highest ratio of direct to indirect taxation. Somewhat over 60 percent of total revenues—Federal, State, and local—come from corporate and individual and employment taxes. The next highest ratio, I think, is 58, in Germany. Then they tail on down.

But it would be extremely difficult to say what is precisely the optimal rate. We are convinced that our total take as well as our top marginal rates, which are higher than in any other industrialized country of the world, exceed the reasonable rate in terms of impact on the economy.

Senator PELL. Thank you very much.

Chairman DOUGLAS. Mrs. Griffiths.

Representative GRIFFITHS. Thank you, Mr. Chairman.

I would like to advance Senator Pell's question one step further. One of the wittiest of America's writers, Ed Haley, remarked in a column that I saw that one of the difficulties with deficit financing is that it is like getting mixed up with the mob. It is a little hard to break away later on.

Under the circumstances of a continued tax cut, may I ask you what would have to happen before you would recommend a tax increase?

Mr. HELLER. If it turned out that the combination of forces in the economy were such as to generate levels of demand that, in turn, caused inflation, that caused a resumption of the price-wage spiral, but, more importantly, caused demand inflation, then I should think that a symmetrical fiscal policy would have to consider the possibility of tax increases.

We see no such point on the horizon in the light of the national levels of demand in the economy, nor of those levels of demand in combination with the tax reductions that are proposed.

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Representative GRIFFITHS. What would the effect of the tax bill be without the tax increases?

Mr. HELLER. I am not sure I understand your question. Do you mean the $3½ billion?

Representative GRIFFITHS. Where you recommended increases.

Mr. HELLER. Well, the total tax reduction, leaving aside the structural measures, would be $13½ billion. However, if you just selected the structural measures which reduce tax liabilities and let alone those that increased them, it would rise to over $14 billion.

Representative GRIFFITHS. And it could be sustained?

Mr. HELLER. I was directing my comment to the net reduction of $10.2 billion, which is the combination of $8.6 billion of individual tax reductions, $2.4 billion of corporate tax reductions, and an offsetting of $800 million from the capital gains provisions.

I would think that for the foreseeable future, within the next 4 or 5 or 6 years, this should certainly not develop into a situation calling for tax increases. Of course, this bars the possibility of international emergency, which would put us back on some sort of a war footing. Then, of course, all bets are off.

Representative GRIFFITHS. I think you made a very good case for the Nation for our tax reduction, a national case, but I think your problem comes in the way it is stated. On page 11, you point out that the tax decrease would be between $7 and $8 billion, I believe, the total reduction being $8.6 billion, excluding capital gains revisions. You were kind enough to mention a little survey I made. I think that the problem you have is that the individual taxpayer has an economic theory of his own, and it doesn't really fit in with yours. They are looking at taxes as a pretty personal affair. The moment you state to them in place of an $8.6 billion tax reduction, which to every American woman must mean that her share is at least a mink stole or a designer hat, the moment you actually state that it turns out to be that $8.33 that her husband got additionally in his paycheck last week, the far step between the dream and the reality, I think, is the thing that is self-defeating and might be disappointing to the average taxpayer.

Mr. HELLER. This may be so. I do not deny, however, that good things often come in small packages. That is to say, if it is $8 per paycheck—and I don't know whether it is a weekly paycheck—that would be $400 a year.

Representative GRIFFITHS. But if you give it to them on the basis of approximately $200 a taxpayer, it is $8.33 every 2 weeks.

Mr. HELLER. Well, again, $8.33 times 25 is $200 in a year. I think an increase in take-home pay of $200 a year, if it came in the form of a wage or a salary increase, would be cause enough for an increase in the standard of living, either consciously or unconsciously, because most people do live from paycheck to paycheck.

I don't mean to just generalize my own situation, but I think it is fair to say that this money will find its way into the spending stream. On the mink stole, I haven't seen the quotations on them lately, but perhaps the mink stole could be bought for that $200 on the installment plan, using the $8 a week to pay off the installment debt on the stole.

I am not advocating that, but since you brought the example up, I don't think it is entirely persuasive.

Representative GRIFFITHS. Of course, it is very persuasive when I asked the question, "What would you do with a $100 reduction in taxes spread over a period of 12 months?" and I get a reply to a question I didn't ask, and 62 percent of all who reply was, "Don't cut the taxes." That is very persuasive.

Mr. HELLER. Yes, that does indicate, and I think it well worth commenting on that part of your question, an enormous need for public education in the field of economics, economic policy, tax policy.

The interconnections between the individual tax reductions and the creation of jobs and the creation of a more vibrant economy are not nearly well enough understood. Major efforts have to be made along this line. I think it is quite remarkable that the basic puritan ethic of the American people should be such that they want to deny themselves tax reductions (*a*) because of their fears of deficits, and the additions to the national debt; and (*b*) because they do not understand that the tax cuts and their spending, in effect, make this contribution to the national growth and full employment, and offer us the best opportunity to get back to a balanced budget.

Representative GRIFFITHS. I agree with you, and I think emphasis should be placed as you have placed it, on that exact item. But I think it should be brought home more clearly to every single person that in place of this being an $8 billion tax reduction, it is "for you, the individual taxpayer, $100 or $200 spread over a 12-month period." When they understand it exactly that way, unless you couple with it the fact that this is of great value to the Nation, to give them back this money and permit them to spend it, you are apt to receive the same response that I have received: "Well, if that is all it is going to be, please don't bother with it. We need to pay the bills."

So I think it has a very different connotation to the taxpayer from that which it has to us.

Thank you very much.

Chairman DOUGLAS. Thank you.

I would like to ask if the committee would approve our requesting Dr. Heller, if he is willing, to come back at 2:30 this afternoon.

Mr. HELLER. I will be happy to do so.

Chairman DOUGLAS. I will ask unanimous consent, if I may, that the charts of Mr. Ackley, and the tables and charts of Mr. Moor, with the explanatory material, be included at the appropriate points in the record. Without objection, it is so ordered.

We will recess until 2:30 this afternoon.

(Whereupon, at 12:30 p.m. the committee recessed, to reconvene at 2:30 p.m. the same day.)

AFTER RECESS

(The joint committee reconvened at 2:30 p.m., Senator Paul H. Douglas, chairman of the joint committee, presiding.)

Chairman DOUGLAS. The committee will come to order.

FURTHER STATEMENT OF WALTER W. HELLER, CHAIRMAN, COUNCIL OF ECONOMIC ADVISERS, ACCOMPANIED BY GARDNER ACKLEY, MEMBER

Chairman DOUGLAS. Mrs. Griffiths and Mr. Heller, I want to apologize for being a few moments late.

There are two or three questions I would like to ask.

Many people are saying that they would favor a tax cut only if it were compensated for by an equal cut in expenditures.

The question I would like to ask is this: If this were done, would it not take away much of the stimulative effect upon which you count?

Mr. HELLER. Senator, it would take away almost all of the stimulative effect. It is fair to say, however, that in talking about a tax cut, one looks at two aspects of the drag that taxes exert on the economy.

One is the drag on purchasing power, on income, on consumption, and investment demand.

The other is the drag on incentives. It is perfectly true, if you had paired reductions in expenditures and in taxes, you would still gain something on the incentive side, though you would more than offset it on the demand side.

I think you would have to set up these charts on the multiplier in reverse, if you did that.

Chairman DOUGLAS. In other words, the economic stimulus is dependent upon a Government deficit?

Mr. HELLER. The deficit is the inevitable part of the stimulus that arises from the tax reduction. It isn't the object of the exercise, but it does necessarily occur under present circumstances if you are going to cut taxes.

Chairman DOUGLAS. Do you have any confidence that this can be explained to the American people?

Mr. HELLER. Mr. Chairman, we have already discussed the difficulties involved in this explanation briefly with Mrs. Griffiths. The President has pointed out time and time again, and I think this is perhaps the most promising line of developing public understanding on it, that we really do not have a choice today between a budget surplus and no tax cuts and a budget deficit and tax cuts.

It is really a question of whether we are going to continue to slide backward, so to speak, into one deficit after another because of economic slack and economic recession, or whether we take a more active posture, a more positive posture, and enlarge the deficit by tax cuts for the time being in the interest of stimulating the economy and getting back to balanced budgets.

I think if the choice is put that way, it does contribute somewhat to better public understanding of the issue. It is not easy.

Chairman DOUGLAS. Following out the line of questioning which Congressman Patman started this morning, if the Federal Reserve Board insisted that the deficit must be met out of the savings of individuals, would not this divert capital from industry and result in no net increase in monetary purchasing power, and, consequently, no net increase in demand?

Mr. HELLER. If the policy were—and I do not for a moment believe that Mr. Martin would intend this—to raise interest rates to a point where private spending, capital spending in particular, were depressed by as much as the tax cut expanded spending, surely it would be a self-defeating proposition.

Chairman DOUGLAS. There has been discussion in the past as to the best methods of getting out of a recession. Some have advocated public works; some have advocated tax cuts. I have been one of the latter because a tax cut could take effect more quickly than public works.

But is it not true that in the present instance, which is one of trying to eliminate some of the stagnation in industry that public works has a higher muliplier than a tax cut; namely, that the first $8 billion is directly spent for labor and materials, and then you get the secondary effects on top of that so that if the multiplier on the tax cut is 2, it is somewhat higher in the case of public works.

If it is 2.5 for a tax cut, it might be as high as 3 for public works. It it is as high as 4, as Dr. Roy Moor seems to think may be possible, it might be 5. Therefore, public works has a higher multiplier, does it not, than a tax cut?

Mr. HELLER. I think you have stated it very well. The public works are slower to get started, but they do have the assurance of a 100-percent expenditure in the first round. I might ask Mr. Ackley to comment further on that.

Mr. ACKLEY. I think the difference between the two multiplier effects can be exaggerated. If, in fact, the effect of a billion dollars of tax reduction is to increase consumer spending in the first instance by $900 million, the difference in the ultimate effects of the two is that the one is 90 percent of the other.

I think that there is not a difference of 1 in the size of the multiplier. In addition, there is, of course, the incentive effect of tax reduction that you don't get from an expenditure increase. But it is certainly correct that there is a somewhat higher direct multiplier factor applicable to expenditures.

Chairman DOUGLAS. Isn't one of the difficulties with public works the fact that with the Appropriations Committees that we have in the House and Senate, money is likely to go into areas where unemployment is not high, but where seniority is high, and it will not benefit the areas in need?

Well, I don't ask you to reply to that.

Mr. HELLER. We have not run any correlations, let us put it that way.

Chairman DOUGLAS. I have one final question.

Mr. HELLER. May I make one comment, Mr. Chairman, on that?

Chairman DOUGLAS. Certainly

Mr. HELLER. In contrast with what happens to the ordinary public works appropriation procedure, the Public Works Acceleration Act, by law goes into the areas where it is needed most.

I believe this act has had a very salutary effect. As you know, the President is pressing for the remaining $500 million appropriation under that act.

Chairman DOUGLAS. Yes. It is a big improvement.

I have one final question. We hear a lot about the public debt, and certainly I am not enamored of debt, but what has been the ratio of public debt to the gross national product in the last 16 or 17 years?

Mr. HELLER. As we pointed out in our report on page 78, taking the gross Federal debt, the ratio to the gross national product was 123 percent at the close of 1946.

Chairman DOUGLAS. It is about 267 to 220? Was that the ratio?

Mr. HELLER. Your memory is better than mine on that.

Chairman DOUGLAS. I think it was approximately that.

Mr. HELLER. 260 in the total debt. Yes, those are the approximate figures. The ratio of 123 percent has dropped to 55 percent by the close of 1962.

Chairman DOUGLAS. Only a little over half.

Mr. HELLER. That takes it on a gross basis. On a net basis, taking only the Federal debt held by the public, it has dropped from 97 percent to 39 percent.

Chairman DOUGLAS. You have noticed, have you not, the reports of the House Committee on Government Operations which give the value of real property owned by the Government in terms of original cost?

Mr. HELLER. We note that in our report on page 82.

Chairman DOUGLAS. As I understand it, they show a value in terms of original cost of land and buildings and other property owned by the Government of approximately $298 billion as of last July.

Mr. HELLER. Yes.

Chairman DOUGLAS. This is original cost. If one were to take reproduction cost or market value, even allowing for depreciation, the value of real and personal property owned by the Government would probably be greater than $298 billion, would it not?

Mr. HELLER. Yes, it would.

Chairman DOUGLAS. Mr. Curtis.

Representative CURTIS. I want to return to those charts.

Is the multiplier effect you are assuming based on the present tax structure? How will the proposed tax structure change it? Wouldn't your multiplier effect be altered in that process?

Mr. HELLER. May I ask Mr. Ackley to respond to that?

Mr. ACKLEY. Yes. The multiplier effect moves inversely with the size of the so-called leakages, and the lower the tax rates the higher the multiplier effect. Actually, our estimates did attempt to take account of the new proposed schedule of tax rates, rather than the existing ones.

Representative CURTIS. So your multiplier is a theory, too? In other words, you have not used the present tax structure? The multiplier assumes the effects of the new tax structure.

Mr. ACKLEY. It tries to use the relevant relationships; yes, sir.

Representative CURTIS. Just for the record, I obtained an unofficial estimate from the Department of Commerce on the average rate of savings from 1920 to 1929. It was 4.5 percent. I must say, though, there was a fluctuation in that period from 1 percent to 7.5 percent. This indicates that we are being a little too presumptuous to assume the 1950–60 savings rate will remain in the future.

It is important to find out the basis on which these savings rates vary because it is such a large part of your basic assumptions. Is that a fair observation?

Mr. HELLER. I would say that anything that influences the saving rate is, of course, important in assessing the size of the multiplier. But the whole postwar experience since 1950 does support this basic proposition of a 6 to 8 percent saving rate and the postwar experience that reflects very substantial changes, as I was saying earlier, in the degree of stability in the economy.

Representative CURTIS. Yet the rate was about 3 percent during the 1930's and 4.5 percent in the 1920's. I don't know the rate during the 1910's. As a matter of fact, I understand we lack accurate figures before 1929.

Mr. HELLER. Beyond 1929 we don't have very accurate figures. Two comments should be made. One is, of course, if the saving rate should slide back down to such levels—which I would regard as very doubtful in the light of our present financial and economic structure—that, of course, would raise the multiplier, because it would mean that people would be spending a higher proportion of their income.

Secondly, I wouldn't want to take the 1930's as a guide to our activities in the 1960's.

Representative CURTIS. I wouldn't either. I am simply pointing out that there are different rates. My main point is that consumer purchasing power is not automatically translated into consumer demand. At least a lag is developing in this area. If the change in theory ever was accurate, and I certainly question that it was, it has become less accurate recently.

Let me relate my conclusion to a specific area—the field of agriculture. In this country, increased consumer purchasing power is not going to increase consumer demand in the field of agriculture. Yet here is a field where we have a very high incidence of unemployment. In fact, your presentation and report indicates a shift in agriculture.

We have rural unemployment. We have unused capacity. In fact, Government policy is to encourage a cutback in agricultural plant usage. Yet here is an area where increased productivity and technological advancement have been extremely rapid. I happen to think this is true economic growth.

For these reasons, our problems are not tired blood, but indicate rapid technological advancement. We even have a name for it. We call it automation. I can't understand how you can call a period like this one of economic sluggishness.

Mr. HELLER. May I address myself to your agricultural example, which I think is very much a case in point?

Representative CURTIS. Yes.

Mr. HELLER. We find in looking at the statistics for the movement of agricultural population into the cities that at the time of high activity in the economy as a whole, such labor transfers are effected very readily, and the number of workers moving into the urban community and transferring their productivity, so to speak, from the farm to the city is very high.

But it is only during sluggish periods that this movement slows. Indeed, one of the reasons for getting full employment, one of the reasons for getting high levels of demand, is to create the jobs that would ease this transition from those areas of our economy where high productivity is releasing workers.

Representative CURTIS. But, Doctor, you always beg the questions in your answers. You assume this is sluggish. Actually, during this same period, employment in service industries has been increasing. In your own charts you have shown certain areas where the unemployment rate is well below 4 percent. There is a strong demand.

We also know that the greatest problem in rural unemployment is the older person who will not move to the cities easily. I am not arguing that cyclical movement does not have an impact. Of course it does. In periods of downturn, your problem is greater than during an upturn. What is the real core of the problem?

It seems to me that in periods of rapid technological advancement you have a higher incidence of frictional unemployment. On page 15 of your statement, I was very pleased to see you list some of the dramatic shifts. In 1947, 17 percent of our civilian labor force was in agriculture; in 1962, only 7 percent. You also mentioned employment shifts in the services and women entering the labor force.

One thing you failed to mention was the impact of the draft law on the labor market. Another interesting figure which requires study, in line with the questioning of Mr. Proxmire, is the age at which people enter the labor force. We say our labor force begins at age 14. Yet I think statistics show that the average person enters the labor force at age 19. That age has been increasing as our young people have been staying in school longer. This is a rather dramatic change.

In spite of the listing of all these items which spell very rapid growth, you say, "As we point out in our report," and I know you do, on pages 23 and 24, "careful study does not suggest the current level of unemployment can be explained * * * by any unusual acceleration in the rate of worker displacement." Yet on page 15, you list some of the dramatic incidents of labor displacement. I don't see how the two statements jibe.

Mr. HELLER. The two jibe in the sense that we are looking at the period from 1946 to 1962, and in the four postwar recessions and four postwar recoveries we find a pattern of unemployment, any way they are analyzed which are essentially consistent one with the other. There is no indication that structural unemployment, which is a continuing problem, is really a significantly growing percentage of the total unemployment problem.

Representative CURTIS. But that is precisely what we all know about postwar recessions. Each time we reach a peak after a recession, we do not return to the previously low rate of unemployment. The rate has been rising which would indicate, quite clearly that it is more than cyclical.

I have suggested that a study of the component parts of unemployment would reveal it is frictional. If we do not treat this with training and retraining programs, this frictional unemployment would freeze it into structural.

Mr. HELLER. I agree with you entirely on the importance of training and retraining. Of course, the problem of the successively higher rates of unemployment is directly related, simply statistically, to the relative weakening of demand in these periods.

Representative CURTIS. That is your thesis. We are trying to examine whether or not that thesis is accurate. I don't think your thesis is correct. You beg my question each time.

Mr. HELLER. The rate of growth in demand, statistically, has slowed down in these periods.

Representative CURTIS. How do you measure that?

Mr. HELLER. The total demand of the private economy, of government, of exports, of investment, consumers.

Representative CURTIS. Aren't you really begging the question? You are using the gross national product, our production, and relating it to demand, are you not?

Mr. HELLER. But these are the sectors, the ones that I just listed, that generate the total demand for product. Their total demands have been diminished. I wouldn't, as I say, deny for a moment that we need to have this process of readaptation. I was trying to stress in our opening statement this morning that there really are three tracks of policy. One is to increase productivity, to modernize, mechanize, automate, and so forth. That releases labor. That is what has been going on in spectacular fashion in agriculture.

Representative CURTIS. But it creates more jobs than it releases in other areas.

Mr. HELLER. It also creates jobs. But as far as the full absorption of those people who are released, together with the new entrants in the labor force, you need the second track, which is the expansion of demand, and to build a bridge between these two you need the training and retraining.

Representative CURTIS. My argument would be that you have the demand, but you also have a necessary lag which will continue until you train others to assume new jobs created by technological advancement. Unfortunately, those displaced by technological advancement tend to be semiskilled and unskilled. This is the greatest impact. It is very difficult to train them in new skills. You must have an upgrading process in the entire labor ladder of skills.

Mr. HELLER. It is quite true that we need constantly to upgrade the skills and the mobility of the labor force. It is also true that the heaviest incidence of unemployment is among the unskilled and semiskilled workers, but this incidence has not significantly changed proportionately during the postwar period.

Representative CURTIS. I thought it had. I know my time is already up. I am sorry.

Senator SPARKMAN (presiding). It has been a very fine discussion.

Doctor, what is your answer to the proposition that Mr. Curtis made regarding the minimum age group of the labor force?

For instance, he said it is set at 14, but that as a practical matter it is 19. Is that right?

Mr. HELLER. If people between the ages of 14 and 19 remain in school and are not seeking jobs, they are not counted as part of the labor force.

Senator SPARKMAN. But if they are seeking jobs at that age, you do count them as part of the labor force?

Mr. HELLER. That is right.

Senator SPARKMAN. So it doesn't make a great deal of difference either way, does it?

Mr. HELLER. It really doesn't. Of course, it means that you have a somewhat greater total number of unemployed in your count, but, at the same time, your labor force, itself, is that much larger, and the impact on the unemployment rate is not very large.

As I say, the fundamental criterion is whether a person is actively seeking a job. If he is in school, presumably that is not the case.

Senator SPARKMAN. Doctor, while I have plenty of time, I want to echo the statement made by Senator Proxmire this morning, and commend you who worked up the tax bill in putting in the first formula for taxation of corporation earnings, 22 percent in lieu of the 30 percent, just reversing them, or 25 when it is lowered to 47. I am sure you are familiar with the fact that the Small Business Committee recommended that in its annual report several years ago and has continued to recommend it.

We have had bills in, and, as Senator Proxmire said, a good many of us have supported that program for some time. I think it will be a real benefit to small business. Of course, the benefit goes to all businesses, but it will be particularly beneficial to small businesses because so many of them have their earnings in that field.

I may say that not too long ago I sent a letter to President Kennedy recommending that this be done. Also, I went a step further and recommended that the minimum be raised from $25,000 to $50,000. You did not include that in the recommendation. How much difference would that make in the bill? Would you have offhand just a rough estimate?

Mr. HELLER. I do not know offhand. I know that the cost of the inversion that is putting in the 22 percent is $440 million. Extending that limit up to $50,000 would presumably not cost quite as much as that, but, nevertheless, not too far from it. That is just the worst kind of horseback estimate. I am sure Secretary Dillon will be in a better position to give you a firm figure on that.

Senator SPARKMAN. I will ask him about it when he testifies. Nevertheless, I do want to commend you for making that change in the rate. I think it will be a very real benefit.

Mr. HELLER. Senator, may I just say that that is really part and parcel of a basic approach in the tax program, which is to invigorate competition and to make the market system work. One of the best ways to accomplish this, of course, is to provide both more incentive and more wherewithal to the small corporations.

Senator SPARKMAN. There is one other item you mentioned. You said that housing could be expected to continue at about the same rate. I refer to home construction.

Mr. HELLER. Yes. We think that the high rates of the fourth quarter, which were about 1,520,000 private housing units, on the average, are likely to roughly continue in the residential field into 1963.

Senator SPARKMAN. I was not going to question that so much, but I was going to ask you this: Has your office given very much attention to the increase in foreclosures of FHA mortgages. There has been quite a series of articles concerning foreclosures in the Baltimore Sun which you may have noticed. I wondered if your office has been checking into that problem.

Mr. HELLER. We haven't studied the foreclosure problem as such. We have tried to look at the housing field and construction field as a whole, to see whether there are any signs of softness or weakness appearing. But I wouldn't say we have looked at the foreclosure problem, per se.

Senator SPARKMAN. I may say that the Subcommittee on Housing of the Senate has been giving some attention to it. In fact, we started inquiring into it late last summer. We are collecting a great many figures in order to determine the cause for the increase in the foreclosure rate. I thought you might have some information on it.

Mr. HELLER. As a matter of fact, this is a case, Senator, where we would be delighted to benefit from the information being gathered by your committee, because it would fit into our studies. I hope our staffs can get together on that.

Senator SPARKMAN. Mr. Patman this morning asked questions about the handling of the deficit that is going to result for the first couple of years. If the answer was given, I didn't understand it. This, I suppose, is not one of your problems, but I wonder how it is going to be handled so as to avoid inflation.

Mr. HELLER. May I ask Mr. Ackley to comment on that?

Senator SPARKMAN. Yes. I would like to know what our policy is going to be to avoid inflation.

Mr. ACKLEY. The association between deficits and inflation is far from a direct one to one relationship. We have had large deficits in the times of stable prices.

Senator SPARKMAN. I narrowed the question too much when I said with reference to inflation, because I think it bears upon the amount of savings, and whether or not consumer spending is going to be cut down, and those things, which we are counting on to bring prosperity. Therefore, I think it would be interesting to know just how it can be financed so as to give us the results that we want.

Mr. ACKLEY. It seems to me, Senator, that the most important thing to recognize is that inflation becomes a danger when resources are fully employed and when we are trying to put too much pressure on our resources, and trying to demand more than we are able to produce. So long as our problem is one of idle resources, and excess industrial capacity, additional demand is not likely to generate any serious inflationary problems. Perhaps I am not being fully responsive to your question.

Senator SPARKMAN. I understand the problem concerning inflation, but I still do not know how we are going to finance this added debt. Will it be by capital expansion, or by borrowing from the public, using the savings, or what?

Mr. ACKLEY. During a period of expansion, people add to their expenditures, but they also add to their savings. As our chart suggested, a small part of any increment of income is added to savings.

Senator SPARKMAN. Six percent I believe you estimated, didn't you?

Mr. ACKLEY. To personal saving. This, of course, is only one of the forms of saving in our society. There is saving through business, business saving, as well. So quite naturally in a period of expansion there is a demand for additions to people's financial assets, including assets in the form of Government bonds, or indirectly for Government bonds through various kinds of financial intermediaries.

So the problem is not one of a shortage of savings to finance the deficit. To the contrary, the problem is a shortage of markets. Only as we bring our operations up to capacity is the problem one of saving. Or, to put it another way, if we have full utilization of our resources, we can increase expenditure in one area only if we reduce it in another.

Then for the Government to attempt to spend more or reduce taxes would be inflationary because there would be no free resources to meet the additional demand. But so long as we are dealing with the kind of situation which we face, the problem is not one of shortage of savings.

Senator SPARKMAN. Thank you.

Mr. Kilburn?

Representative KILBURN. I didn't understand your last reply. I thought that when the confidence in the dollar went down, inflation occurs.

Mr. ACKLEY. Are you speaking of external confidence?

Representative KILBURN. Any confidence. If there is too big a national debt, people lose confidence in the dollar and inflation follows.

Mr. ACKLEY. We get inflation when people are trying to spend more than they are able to produce. It is certainly true that in periods of galloping inflation, people come to expect inflation and, therefore, don't wish to hold wealth in the form of cash. They try to get rid of it. This, of course, helps generate the inflation which is the cause of the trouble. So inflation tends to be self-generating under such circumstances. But these circumstances have occurred only very rarely. Certainly in the United States we have had no period in which that kind of problem has been serious.

Representative KILBURN. And we certainly don't want any.

Mr. ACKLEY. We certainly do not.

Representative KILBURN. I haven't been here, Mr. Chairman, so I will not take any more time except to say that I am very glad to greet my old friend, Walter Heller.

Mr. HELLER. Thank you, Mr. Kilburn. It is nice to be here.

Senator SPARKMAN. Senator Proxmire?

Senator PROXMIRE. I have found that the biggest objection to the President's proposal is not the tax cut, but the tax cut in relationship to the budget. We can see this in the change in the public attitude in the few days between the state of the Union message and the budget proposal after the President said this would mean a $98.8 billion spending program.

I think there is a feeling that since we start with a $8.8 billion deficit, since the President tells us we are going to spend between $4 and $5 billion more as a starter, on the basis of past experience we will probably increase spending above that, that a cut in taxes under these circumstances in a period of relative expansion really does go against that good old Puritan ethic you talked about, and in such a shocking and drastic way that it is very, very hard for us to accept.

My question is: Suppose the Congress adopts the policy that many of us have advocated of reducing spending below what the President has requested, and suppose we succeed in cutting back to the full extent of the tax cut, which, after all, wouldn't be a great deal this year, because I understand that the net effect of the tax cut will be about $2.7 billion for the calendar year 1963——

Mr. HELLER. On the budget deficit, that is right. The actual reduction in liabilities will be about double that.

Senator PROXMIRE. If we can cut spending by $2½ or $3 billion, trying more, but suppose we did that much, would your judgment be that the tax cut's economic effect would be washed out?

Mr. HELLER. Are you speaking of a $2.5 billion cut from the President's proposed $98.8 billion?

Senator PROXMIRE. Yes, without discussing any particular figure. Suppose the Congress succeeds in reducing spending by the same amount as it reduces taxes, reduces spending proposed in the budget. I am not saying we can get a balanced budget, but we will reduce the spending below the President's budget by about the same amount as in the tax cut.

Mr. HELLER. I would say that every dollar of expenditure cut that is made without a corresponding increase in the tax cut would be an offset to the stimulus that the tax cut offers to total demand. As I stated earlier in responding to a question from Senator Douglas, you would still have some effect on incentives by reducing the taxes in any event.

But as far as the overall impact on the demand for the products of industry and agriculture, and for services—as far as that demand is concerned—the pairing of tax cuts and expenditure cuts in effect simply wipes it out and makes it self-defeating.

Senator PROXMIRE. What you are asking for, then, is an increased deficit rather than a tax cut, and it makes very little difference if we spend more or reduce taxes, but on the other hand, increased Government spending would provide a greater multiplier effect and, therefore, that would tend to balance the increase in incentives you would have?

Mr. HELLER. I would restate it this way: It isn't the deficit we seek. What we seek is an increase in the total demand in the economy, a removal, as it were, of the fiscal drag on spending in the economy. The President has pointed out——

Senator PROXMIRE. I understand that, but in order to achieve that, you say no matter whether we do it through the tax route or the spending route, we will have to achieve a bigger deficit in order to promote greater demand, stimulate the economy.

Mr. HELLER. Under current circumstances, the net effect is going to be the achievement of a bigger deficit, as you either increase spending or cut taxes. The choice between the two is made on the basis of whether you want to do your primary stimulating in spending through the private economy or through the public economy. The President has opted in this $10 billion tax cut program, obviously, to do it through the private market economy.

Senator PROXMIRE. I think Congress certainly shares that opt, except that we also feel, or I feel, that this is such a drastic revision in governmental policy. We have never really done this. The Washington Post talks about an active deficit, about having a deficit at a time of expansion to promote still further expansion, a deficit which is constantly promoted, not something you stumble into because you fall into a recession.

Before we take this very significant and substantial step, I wonder if we shouldn't consider what we are doing in terms of perhaps going too far with the uncertain and uneven science of economics. This notion of just looking at the total picture, the impact of a tax cut, the impact of governmental spending, I think, has a lot of weaknesses. It seems to me it is the quality that is so very, very important.

I have here the "Budget in Brief," and I find that between 1957 and 1964, 7 short years, we increased our subsidy to aviation from $219 million, as shown on page 60, to $885 million. In other words, a fourfold increase in spending of subsidies to aviation. Water transportation was doubled, $365 million to $677 million. Advancement of business, $122 million in 1957 to $617 million.

You take these three forms of subsidies to business which have increased in 7 years from $800 million to $2,179 million. I am arguing that there is a lot of unjustified waste in this. You have pressure groups that are pushing for this kind of subsidy. I feel if you compare this kind of Government spending with spending for education, which is largely local, and should be, or State, and should be, I think that the effect in stimulating the economy, in providing for long-term growth, the difference, is very great.

I would think that we might possibly—and I think it is our responsibility as Members of Congress—be able to work out a program which would not result in a greater deficit, but which would result in higher quality of spending from the standpoint of the public interest, and either result in no tax cut or a tax cut which would be paralleled with a reduction in some of the spending which is in this reduction.

Mr. HELLER. I wouldn't for a moment suggest that the distribution of Government expenditures can't be improved. Obviously there are points where Government spending is less efficient than some other points. We always have to be on the lookout for reallocation. I might say that one way in which the President has managed to cut back the civilian side of the budget by a small amount, from the 1963 fiscal year to the 1964 fiscal year, has been through changing some of the priorities; giving somewhat less support to some of the older programs, and somewhat more support to newer programs.

This has to go on all the time as part of a sound budgetary process. Indeed, as far as the increases in expenditures are concerned, in the first 3 fiscal years of the Kennedy administration, compared, say, with the last 3 years of the Eisenhower administration, the rate of increase in the purely civilian expenditures outside of space, defense, and interest has been a good deal less. It has been about half of what that rate of increase was before.

I am trying to suggest that there is a degree of restraint on the expenditure side which is consistent with this general principle of tax reduction.

One other point: you mentioned that there was no precedent for this whatsoever. But the 1954 experience isn't entirely without relevance. President Eisenhower presided over a $7.5 billion tax cut in the teeth of a deficit.

Senator PROXMIRE. But there were great spending reductions.

Mr. HELLER. Expenditures were coming down from the Korean war, and, indeed, that is generally regarded as having set off the recession of 1953–54. If anything, the trouble is that the taxes were not cut sooner. But they were cut in the face of a deficit.

Senator PROXMIRE. They were cut at the same time that spending was cut.

I only have a minute more, so I would like to just ask you briefly about one more item. I get the feeling, in view of what the President has said, or more specifically from what you have said this morning, that if we cannot stimulate the economy adequately with the tax cut the President has proposed, and I have great reservations about it—I don't think we are going to get the reduction in unemployment you seek with this kind of a tax proposal—you would come back with another request for a tax cut.

I say that because you say that perhaps in 1957 the answer should have been a tax cut that year, a further tax cut. I am wondering how far we can go with this kind of thing. The theory is that if you cut taxes you are going to increase revenues, but obviously there is a point where this isn't going to work out. You gave the impression to me this morning, and I undoubtedly misunderstood you, that we have the highest tax rates of any industrial country.

Mr. HELLER. Income tax rates.

Senator PROXMIRE. The total tax burden, which is the important burden, is considerably less. Department of Commerce statistics show that West Germany has 34 percent of their GNP, France 33, Austria 33, Finland 32, Norway 31, Luxembourg 30, Sweden 29, Italy 29, Netherlands 29, Britain 28, and the United States 26.

There is no substantial industrial country, except maybe Canada, which has less than we have now. It would seem to me that these countries are thriving with higher taxes than we have and moving ahead, growing faster, the ones that I have listed, in general. How can we buy this theory that if we create a bigger deficit and cut taxes that eventually we are going to get our answer this way?

Mr. HELLER. I think in comparing our situation with theirs we have to also make a comparison between our situation today and our situation in the first postwar decade.

At that time—let's say the first 7 or 8 years after the war, including the Korean war—we had tax increases. With demand at very high levels, and, indeed, with a good bit of inflation, the high levels of taxation did not retard economic activity below those levels that the available manpower and available capacity could accommodate.

Once your economy falls below—demand falls below, and incentives fall below—that limit, the tax reductions become relevant and become necessary.

Another factor is that in these countries, of course, they do have very high levels of government spending, much higher than ours. That is what generates the high levels of taxation. They have been, by and large, spending all of their revenues. Those that we have made comparable studies of, like Germany, France, the United Kingdom, have even been spending beyond their tax revenues, or have been running deficits, if we translate their budgets into our basis.

So you have to take into account, as to your earlier question, the net drag, the net relationship between taxes and expenditures. In terms of our demands in the private economy, I think the evidence is pretty clear that that drag is now too heavy, that it is preventing us from getting to the full employment level that these countries are enjoying.

Senator PROXMIRE. My time is up, Mr. Chairman.

Chairman DOUGLAS. Mrs. Griffiths.

Representative GRIFFITHS. I would like to ask you: Has anyone ever done any study on the amount, the percentage, of money that is spent with the Defense Department now in comparison to what was spent during World War II and preceding World War II, and the number of man-hours it purchases today in comparison to what it did then?

Mr. HELLER. I am not sure I have this at my fingertips. I know that today the Defense Department is purchasing 10 percent of the goods and services of this country; that roughly, during the war, we were using 40 percent of the total gross national product in the war effort. Those are two percentages that don't answer your question, but are at least a first approximation.

Representative GRIFFITHS. The dollar value and man-hours would, I would say, today be much more. You are paying a much higher rate for the man-hour that you are getting than you were during the war, because the things you are buying are literally handmade, as compared to production-line items.

So you have built into that 10 percent, as opposed to 50, a lot of unemployment.

Mr. HELLER. Essentially it is a dual problem, is it not? One is that productivity has risen so that the number of man-hours required to produce most products in the economy is lower than it was at that time.

The other part of it, though, to the extent that you are not on an assembly-line basis, is somewhat offsetting. Insofar as you do have these handcrafted items in the defense equipment, more man-hours will be required for the end product. The thrust isn't all one way.

Representative GRIFFITHS. Before we close this book on lowering taxes for incentive, I do think it should be made clear that we are not entirely discounting the fact that we levy taxes to pay the bills.

Mr. HELLER. I can't do anything but agree with you on that.

Representative GRIFFITHS. Thank you very much.

Chairman DOUGLAS. Dr. Heller, I wonder if I might come back to the multiplier and its effects again.

Assuming that an $8 billion tax cut goes into effect, and assuming a multiplier of three, this would mean a $24 billion increase in the gross national product.

How much of an increase would this mean in tax revenue at the lower tax rates?

Mr. HELLER. May I ask Mr. Ackley to deal with that?

Mr. ACKLEY. If an $8 billion tax reduction increased gross national product by $24 billion, and if we are at least roughly correct that 30 cents of each additional dollar of gross national product increases the net receipts of the Federal Government——

Chairman DOUGLAS. Which I think is high.

Mr. ACKLEY. Possibly high.

Chairman DOUGLAS. Three-tenths or 30 percent of $24 billion would be $7.2 billion. In that case the tax reduction would come close, would it not, to paying for itself in the sense of additional revenues?

Assuming that Government net receipts increased by 20 cents for each $1 increase in the gross national product, there would be an increase in tax revenues of $4.8 billion, and a net loss from the tax cut of $3.2 billion. In other words, an initial loss in tax revenues of about $8 billion, offset by an increase in tax revenues of $4 billion to $5 billion, would bring an increase in the gross national product of $24 billion if the multiplier is 3.

How much of an increase in employment would you get? There were 67 million people gainfully employed, on the average, last year. The average gross national product was $554 billion. That would mean, very roughly, every employed person on the average produced $8.300 of gross national product. So you would get an increase, would you not, of somewhere between 2 million and 3 million in the numbers of the employed. Do you have a more precise estimate?

Mr. HELLER. We have made some studies, both of the average GNP per job as of 1962, which is $7,800, and of the marginal GNP that develops as you increase gross national product. The marginal increase is much greater, of course, than the average.

We carried this back over a number of periods, Senator Douglas, to see what the increment had been in GNP associated with a given increment in jobs.

Chairman DOUGLAS. What do you get?

Mr. HELLER. The figure that we are now using for this is $15,500 on the basis of figures like this: From the first quarter of 1958 to the second quarter of 1960, a recovery period, the added GNP per added job was $23,000. From the first quarter of 1961 to the fourth quarter of 1962, it was $33,600. In the second year of recovery, however, that dropped, out of that 2-year period, to $13,200 of added GNP per added job. Going back to 1954, from the second quarter of 1954 to the third quarter of 1957, the increase of GNP per added job was $21,000. We derived the $15,500 by taking into account the fact that in the early part of a recovery from a recession you get a much larger marginal increment because productivity rises faster.

Chairman DOUGLAS. Your figures on reemployment would be somewhere between 1 and 2 million?

Mr. HELLER. The reemployment——

Chairman DOUGLAS. Added employment, I meant.

Mr. HELLER. The added employment on the way from here to, say, 4 percent unemployment, would be about 2 million, or a little over 2 million. That includes the 1.1 million unemployed, between 4 and 5.6 percent, plus the people you draw into the labor force as you provide more job opportunities, which is about another 800,000 to 1 million.

Chairman DOUGLAS. You are assuming a 2 million increase in employment?

Mr. HELLER. Two million or slightly more.

Chairman DOUGLAS. I think you have to do a lot of work popularizing the multiplier and the accelerator, Dr. Heller. I happen to believe in both of these, but I think you have to do a lot of work to popularize it.

Mr. HELLER. We certainly do.

Chairman DOUGLAS. Mr. Curtis.

Representative CURTIS. Thank you, Mr. Chairman.

Returning to the ratio of savings to income, I want to emphasize again that much of your thesis assumes a lag in consumer demand, which is related to consumer purchasing power.

In our hearings last August, on the State of the Economy and Policies for Full Employment, Secretary Dillon inserted into the record two major studies of this very issue. The first study was prepared by the Federal Reserve Board-Michigan Survey Research Center, the second by the Bureau of Labor Statistics-Wharton School, the University of Pennsylvania. They are on page 673.

I am mentioning these for the record, Dr. Heller.

Table 1 estimates savings income ratios by income class for 1950. The income groups, after taxes, are divided by brackets of $1,000 and indicate a very wide divergence in the ratio of savings to income. Certainly since 1950 both administrations have prided themselves on the increase in the family income levels.

I am convinced that this ratio does change, just as this table indicates. Therefore, I think it becomes all the more important to study carefully the 7 percent savings rate that you assumed. Even more important, perhaps, is any understanding we could gain about the change in savings rate as incomes increase today.

Does this increase go automatically into consumer demand? What is the increased demand for? What role does idle or obsolete capacity play in this picture?

The steel industry, for example, has been operating at below 60 percent of capacity; is that not right?

Mr. HELLER. Yes. It has been in that order of magnitude.

Representative CURTIS. How accurate is this measure of capacity? Only this year the steel industry spent over $1 billion increasing its capacity to produce a thin sheet of steel that would enable it to compete with plastics and other materials.

There are too many similar examples. I suggest that we examine the nature of this idle capacity, in the same way we need to look into the components of unemployment.

I doubt if this idle capacity would respond to increased consumer purchasing power. Likewise, your own model projects an unemployment rate that varies little after the first year.

Am I not correct?

Mr. HELLER. The unemployment rate this year opened at 5.8 percent and dropped to 5.6 percent, I believe, in March, or 5.5 percent, and has varied around that level since March.

Representative CURTIS. You mentioned 5.3 percent. The rate went down to 5.3 percent in July, and then rose to 5.8 percent in November It dropped to 5.6 percent in December.

Mr. HELLER. That is right.

Representative CURTIS. We must go behind these assumptions to understand them.

In the 1962 Economic Report, you made reference to the full employment budget. In this you predicted that if 4 percent unemployment was attained by the end of fiscal 1963, the national income and product account budget would show a $4.4 billion surplus.

As far as I can determine, this full employment surplus estimate was not included in your 1963 Economic Report. Would you tell us why you failed to include it and give us the best estimate of what the full employment budget would look like at the end of fiscal 1964 if we assumed this 4 percent unemployment rate?

Mr. HELLER. I would like to comment on that and then ask Mr. Ackley to comment on your earlier observations concerning the savings rates in different income groups.

By the way, we inserted into the record last summer the same table that Secretary Dillon did.

Representative CURTIS. As a matter of fact, Mr. Chairman, it should be clear that I welcome leaving the record open at any point for you to supply additional data.

Mr. HELLER. With respect to the full employment surplus, we indicated last year that the full employment surplus would run something like $8 billion in the calendar year 1962. That was reduced somewhat by some of the actions taken by Congress and by the administration, both on the expenditure side and by the tax investment credit, and depreciation guidelines which reduced taxes somewhat.

Under this program that is now proposed, the surplus, the full employment surplus, would be cut to a very low level under the program at the end of 1964.

Representative CURTIS. Would you have a balanced budget on this assumption, if you projected it?

Mr. HELLER. As far as the specific question is concerned with respect to the year 1964, the President's program would still leave the full employment budget, that is, the budget on a national income accounts basis, in surplus, not a very large one, but a surplus of perhaps a billion dollars or so.

Representative CURTIS. I thought it was not in surplus.

Mr. HELLER. It would be in surplus under this program, at 4 percent unemployment.

Representative CURTIS. Assuming your full employment budget, would you have full employment, if applied here?

Let me remark that I am very pleased that my colleagues have gone into some depth in asking how you are going to finance the deficit. This was the line of questions I used in August, both on Ways and Means and the Joint Economic Committees, when the quickie tax cut was proposed.

I must say, however, that after listening to your replies to Senator Proxmire, in spite of the fact that you say you are not, you are advocating a deficit. It is merely a question of whether the deficit will result from the expenditure increase or a tax cut. The net result you are seeking is an imbalance between receipts from the public and payments to the public. This we call a deficit. You are arguing that if that deficit is reduced, it will not have the necessary economic impact.

Mr. HELLER. Mr. Curtis, what I am saying is this: Suppose we were today running a surplus of $6 or $7 billion at the present levels of unemployment. Then the object of the tax cut would not be to create a deficit, but to cut down, just as it is today, the drag on the economy.

But the residual effect would be to reduce the size of the surplus from, say $7 billion to $1 billion, rather than to increase the size of the deficit.

The point I am trying to make is that the stimulus, the thrust, comes from either the tax side or the expenditure side and the deficit is a residual that creates certain problems, problems of financing, problems of additions to the debt and so forth. But it is not the purpose of the tax cut or the expenditure increase for economic stimulus. The deficit does not supply the thrust.

It is the tax cut, or the expenditure increase, that supplies the thrust.

Representative CURTIS. As I understand it, increasing consumer purchasing power supplies the thrust.

Mr. HELLER. That is correct; plus increased incentives.

Representative CURTIS. In this instance, you are creating it through a tax cut. But, you argue, we should not cut back on the Government expenditure, which is a payment to the public, because you do not get the necessary flow. So you are really after that increase. You use a deficit to get it. That is the only place it comes from.

Mr. HELLER. The deficit is the net result. But we should distinguish between the type of deficits which have been occurring by sliding into recession or sliding into slack in which the deficit results from lower tax payments because income is lowered rather than lower tax payments out of a given income.

Lower tax payments that result from lower GNP and lower income do not provide any thrust to the economy. They provide a cushion. But lower tax payments that result from taking less out of corporate income and business income and leaving more in the hands of the private economy out of any given income provide a positive thrust and a positive contribution to expanding the national product and to expanding the growth rate.

Representative CURTIS. I see my time has expired. I want to close with one reference: I don't quite understand what you are saying here, but I do understand what the President says on XIV of his Economic Report. He refers to the frivolous borrower versus the prudent borrower. He is pointing out that there are two kinds of deficit.

If an individual spends frivolously beyond his means today and borrows beyond his prospects for earning tomorrow, it is a sign of weakness. But if he borrows prudently to invest in a machine that boosts his production or to pay for education and training that boosts his earning power, this can be a source of strength. The latter is a deficit through which he builds a better place for himself and his family, a deficit justified by his increased potential.

I can understand that, but I want to debate Government expenditure policy. So far, the administration does not want to talk about expenditures. Apparently we are to assume that none of these expenditures have been frivolous; they have all been prudent.

The administration needs to prove its case. Frivolous expenditure that creates large deficits is not good.

Mr. HELLER. It is unjustified. I agree entirely.

Representative CURTIS. Then we agree that Congress should examine expenditure policy.

Mr. HELLER. And tomorrow morning with Kermit Gordon, you will have that opportunity.

Representative CURTIS. That is right. Thank you.

Chairman DOUGLAS. Senator Proxmire.

Senator PROXMIRE. Dr. Heller, in the last 6 years, or 5 years, we have had a very, very disturbing failure on the part of our Treasury Department and other experts to gage what is going to happen to the gross national product or the deficit or anything of the kind. It is most disturbing to us because this committee meets as the Joint Economic Committee of the Congress and we are interested in economic policy, in advising our fellow Congressmen on what policies to follow.

Of course, our advice is no better than our information on what the future is going to be. In 1959, the previous administration anticipated a $466 million surplus, and we ended up with a fantastic $12 billion deficit.

In 1960 we anticipated a $4 billion surplus, and ended up with a $3.8 billion deficit. In 1962, we anticipated $1½ billion surplus and ended up with a $6 billion deficit. Last year a $463 million surplus and ended with an $8.8 million deficit.

What good is an estimate? We are told, if we adopt the President's proposals, that we will end up with about a $12 billion deficit. But it could be a surplus on the basis of past experience. This certainly would not seem to be beyond imagination. Or it could be a far greater deficit.

Mr. HELLER. The errors have not run in that direction.

Senator PROXMIRE. They did at one point run in that direction.

Mr. HELLER. Earlier in the game, yes, but not in this period of slack.

Senator PROXMIRE. I notice you have a $578 billion GNP you are estimating.

Mr. HELLER. Yes.

Senator PROXMIRE. That would be a relatively modest increase, compared to the one we had last year and the year before.

Mr. HELLER. That is true.

Senator PROXMIRE. If the tax cut and anticipation of further tax cuts are effective, you could end up with a greatly reduced deficit or perhaps a surplus.

Mr. HELLER. I think that there is an important difference between the projections for next year and the projections for previous years. What has happened in the past 5 years is that time and again the forecasters, the projectors, whether in a Republican administration or Democratic administration, have felt that we were going to thrust off the impact of this slack or sluggishness or gap that opened up in 1957. Instead, time and again, we have fallen short of our expectations about the degree of recovery. As a result, forecasts that were sincerely and genuinely made have fallen short of the mark on what revenues would be. They have also, if you will look at the components, underestimated a number of times what Congress would appropriate. But I grant you that much of the greater part of the miss had been on the revenue side, overestimating revenues on the basis of expectations that the economy would again hit its earlier postwar stride.

Senator PROXMIRE. You see, this is such devastating powerful advice, this economic statement. Putting myself in the position of the President, he was faced this year, it seems to me, from a political standpoint, with a very difficult decision. If he is told that he might get an increase of $24 billion in the GNP without a tax cut and I realize your assumptions are that he has a tax cut, then he is faced with these choices. He can, on this basis, come to the Congress with an estimated deficit of $9.2 billion. Now that's pretty hard to defend. People say, "Why don't you increase taxes or reduce spending under these circumstances?" Or what he can do is be optimistic and estimate we will have a $620 billion GNP and a balanced budget. Then he's all right this year; but next year, look out. Or he can cut spending, which he feels is impossible in view of our national commitments and our national goals. And seek something closer to a balance. On the other hand, what he has done, I think, is about the best thing he could do politically with it. He has made a virtue, an advantage of this tough political burden. He has said, "What we are going to do," as the Washington Post has said, "is that we will have an active deficit, a deficit that will put people to work." Then in June 1964, when this comes before the country, instead of having a deficit which the administration has to apologize for, defend, be ashamed of, this is something we planned, we worked for, and is going to put people to work.

Mr. HELLER. And the proof of the pudding would be in a diminishing unemployment rate and an increasing rate of increase in gross national product.

Senator PROXMIRE. Maybe you would get that without the tax cut. After all, this tax cut probably isn't going to have much effect the first year, or at least its real effect, its real punch and impact will be later.

Mr. HELLER. A good part of its impact would develop within the second and third 6 months, shall we say, after it went into effect. So a good part of its impact would begin to be felt in 1964, though the full impact wouldn't work itself out until 1965 and 1966.

Senator PROXMIRE. My point is not the economic calculations. My point is that the Nation's tax policy and spending policy is based on this economic advice. I have the greatest respect for you. I think you are as fine an economist as there is, and very sensitive to the limitations of economics. Nevertheless, somehow we find ourselves basing so much of the public policy on statements and estimates which have proven to be so faulty in the past and are likely to continue to be faulty in the future.

Mr. HELLER. This record of forecasts of revenues has grown out of a situation that has now been fully recognized in the analysis of both the outlook for 1963 and the policy that is adequate to meet that problem suggested by the outlook, namely, the persistent underutilization of resources, persistent unemployment. Actually, this is a problem which has been slow in gaining full recognition. I think it has full recognition now. I think there is very little doubt, on the basis of repeated experiences, that we do have a very large problem of reemploying these resources that have continually been unemployed or underemployed.

Senator PROXMIRE. You are not saying that your prognosis—your prognostications from now on are likely to be accurate, though?

Mr. HELLER. No, but I am saying——

Senator PROXMIRE. Take this very difficult area of personal saving, on which we have spent so much time today. As George Shea pointed out in the Wall Street Journal this morning, the fact is that if you have an increase in personal savings within the limitations you yourself have defined, between 6 and 8 percent, if that increases just 2 percent you lose the whole effect of your tax cut. In other words, if people save, of their personal income, not 6 percent but 8 percent, which is within experience and perfectly possible, and something you might expect, perhaps, in view of the fact that they are going to get this tax cut we have been talking about, if they do that, that 2 percent of the personal income adds up to almost precisely the total effect of the tax cut during the coming fiscal year.

Mr. HELLER. I wonder if I might ask Mr. Ackley to comment on that in terms of this analysis?

Mr. ACKLEY. One can't quarrel with the arithmetic that 2 percent of personal disposable income is approximately of that magnitude. Clearly, the personal saving rate has fluctuated within this range in the past dozen years, and there is room for a continued fluctuation. I think there is very little reason to suppose that it necessarily will happen in this way. It could move, of course, in the other direction. One has to base his judgments on the best information he has and put a certain range of uncertainty about it. What we do know is that these fluctuations, when they occur, seem to reverse themselves. If we look not only at annual data but also at quarterly data, for example, we find that the fluctuation is wider than that. If we take the saving rate by quarters, we will find that it fluctuates considerably, from one quarter to the next. But after a few quarters in which it is low, it tends to come back up again. What these data suggest is that there is a lag of variable length between receipts of additional income and the expenditure of that additional income, and at some points, for a while, additional income may tend to be more largely saved. But as it accumulates, it seems gradually to satisfy whatever needs people have had to build up temporarily their saving, and then they begin to respond again at a more normal rate.

As indicated in our annual report (table 8, p. 46), the saving rate showed no tendency to rise in the periods following the tax cuts of 1948 and 1954. There is certainly no evidence to suggest that the tax cut would cause the saving rate to rise in the manner you have indicated. Of course, it is conceivable that a rise in the saving rate due to some other cause might happen by accident to occur at about the same time as the tax cut. In this case, however, the shift would not weaken the case for tax reduction—indeed, if anything it would strengthen the case, since in the absence of tax reduction, the rise in the saving rate would have caused a decline in income.

We certainly don't propose to exaggerate the accuracy with which we can forecast the precise numbers. The figures used in these charts are obviously for illustrative purposes. But there certainly is no reason to suppose that the effect of tax reduction might be permanently offset by a full reduction in the saving rate. In any case, that reduction would be a one-shot proposition. Once the saving rate stabilized at the new lower level, unless it continued to fall, then the continuing increment of income from the tax cut would have its effect. The worst that could happen then would be to delay it for the period in which the decline in the saving rate was occurring.

Senator PROXMIRE. Once the saving stabilized at 2 percent less, it would continue to take that much more out of the spending stream, wouldn't it? It would continue to absorb that?

Mr. ACKLEY. Yes.

Senator PROXMIRE. So the effect of the tax cut would continue to be nullified, until you go back to what you had before? In other words, if you increase your saving by 2 percent, 2 percent of your total income, and you go on that way, then your tax cut is constantly put in the sock. If Mr. Martin follows his policy, I think that is what is going to happen.

Chairman DOUGLAS. Unless there is a pressing desire to ask more questions——

Senator PROXMIRE. I would like to ask one more question.

I am very much concerned, as are several other members of the committee, Senator Douglas, Mr. Patman, and others, about the great possibility, in my judgment, that the effect of the tax cut is going to be nullified by restrictive monetary policy. I call your attention to a very fine article by Dr. Buchanan, chairman of economics at the University of Virginia, which he wrote as a Fulbright professor, pointing out that we are moving into a racheting effect in our monetary system, because of the political advantage of tax cuts, to stimulate the economy and the potent political and financial push to stop inflation by raising interest rates. I think unless we fully realize that and prepare for it, and are willing to fight hard against it—this kind of restrictive monetary policy—we are going to dig a terrifically deep debt.

As Congressman Patman said, this morning, we are going to have a burden of servicing the national debt with a bigger debt and higher interest rates which is going to be most difficult and very unjustifiable.

Mr. HELLER. I am sure you know, Senator, that we are very much alert to this problem, and I don't think it is a bad augury that our long-term interest rates declined in 1962, and that today our long-term interest rates are below what they were at the beginning of the recovery. It does suggest that there has been a good deal of coordination and cooperation in the management of monetary policy, side by side with fiscal policy. I have every hope that this coordination will continue to avoid the result that you fear and that indeed I would fear, too, if it were a real possibility.

Senator PROXMIRE. Thank you.

Chairman DOUGLAS. Thank you very much, Dr. Heller, and Mr. Ackley. We appreciate your being here today very much.

The hearing is recessed until tomorrow at 10 o'clock, when Mr. Gordon, Director of the Bureau of the Budget, will testify, and 2 o'clock in the afternoon, when Secretary Freeman will testify.

Thank you again.

(Whereupon, at 4:08 p.m., the joint committee recessed, to reconvene at 10 a.m. on the following day, Tuesday, January 29, 1963.)

JANUARY 1963 ECONOMIC REPORT OF THE PRESIDENT

TUESDAY, JANUARY 29, 1963

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

The committee met at 10 a.m., pursuant to recess, in room AE-1, the Capitol, Senator Paul H. Douglas (chairman of the joint committee) presiding.

Present: Senators Douglas, Sparkman, Proxmire, and Javits; Representatives Reuss, Griffiths, Curtis, Kilburn, and Widnall.

Also present: William Summers Johnson, executive director; John R. Stark, clerk; James W. Knowles, senior economist; and Roy E. Moor and Donald A. Webster, economists.

Chairman DOUGLAS. The committee will come to order.

Mr. Gordon, we appreciate your being here this morning. We are very glad to welcome you to the very important and onerous task which you have assumed, Director of the Bureau of the Budget.

We appreciate your statement.

STATEMENT OF KERMIT GORDON, DIRECTOR OF THE BUREAU OF THE BUDGET; ACCOMPANIED BY ELMER B. STAATS, DEPUTY DIRECTOR; CHARLES L. SCHULTZE, ASSISTANT DIRECTOR; AND SAMUEL M. COHN, DEPUTY FOR FISCAL ANALYSIS, OFFICE OF BUDGET REVIEW

Mr. GORDON. Thank you, Mr. Chairman.

Having been Director of the Budget Bureau for just 31 days, I thought it wise to equip myself with a few of my colleagues in the Bureau of the Budget, and I would like to introduce them.

At my right is Mr. Staats, who is Deputy Director of the Bureau of the Budget.

Chairman DOUGLAS. An old friend.

Mr. GORDON. On my left is Mr. Schultze, Assistant Director of the Bureau of the Budget, and also Mr. Cohn, Deputy for Fiscal Analysis.

Mr. Chairman, I have a reasonably short statement and a collection of charts, which I think have been furnished to members of the committee.

At several points in the course of my statement, I will refer to charts which relate to points made in the statement.

Mr. Chairman and members of the committee, I welcome the opportunity to appear before this committee today to discuss the budget recently transmitted by the President for the fiscal year 1964.

Economic basis for the budget: Budget estimates must be based in part upon assumptions concerning the future behavior of the national economy. It is best that these assumptions be made explicit, so that those who appraise the economic outlook differently may judge the budget estimates in the light of their own views.

The economic assumptions underlying the 1964 budget take into account the fact that we have had seven quarters of economic expansion since the recession trough, during which the gross national product has risen by $61 billion, personal income by $43 billion, and corporate profits by more than $11 billion.

They also are influenced by the fact that the rate of expansion was substantially slower in 1962 than in 1961, and by the widespread expectation that the pace of expansion in 1963 is not likely to better the 1962 performance in the absence of new fiscal stimulus.

Chairman DOUGLAS. Mr. Gordon, I wonder if you would clarify that statement. Do you mean that unless we have new fiscal stimuli, 1963 in absolute terms will be no better than 1962, or that the additions to gross national product in 1963 will be no greater than they were?

Mr. GORDON. The latter, Mr. Chairman.

Chairman DOUGLAS. Well, assuming that they are no greater, rather assume that they are the same amount, what would the gross national product for 1963 be? What was the increment in 1962 over 1961?

Mr. GORDON. Well, the increment, actually, for 1962 over 1961 was about $35 billion. But this, I think, overlooks the fact that a large part of the expansion which is reflected in this increment occurred in the second half of 1961.

The rate of expansion within the calendar year 1962 was closer to about $6 billion per quarter. That is the rate——

Chairman DOUGLAS. $24 billion a year?

Mr. GORDON. About $24 billion a year.

Chairman DOUGLAS. Now, the average for 1962 was what, 554?

Mr. GORDON. 554, correct.

Chairman DOUGLAS. And for the last quarter, how much, 566?

Mr. GORDON. 562 for the last quarter.

Chairman DOUGLAS. That would mean, then, that it would be—are you speaking of fiscal or calendar year?

Mr. GORDON. I am talking of calendar years now, Mr. Chairman.

Chairman DOUGLAS. Well, the average, then, for calendar year 1963 at $6 billion in a quarter would be $578 billion.

Senator PROXMIRE. 578.

Mr. GORDON. At $6 billion a quarter, I think that is correct.

Chairman DOUGLAS. Yes; and yet you say that you expect to go up to 578 with a fiscal stimulus, so that the fiscal stimulus will add only $4 billion to the gross national product for calendar 1963?

Mr. GORDON. I think that the 574–578 comparison is within the range of possibilities, but I think it probably somewhat overstates the former figure in this sense: If you look at the pace of economic expansion in 1962, you find a slower pace in the second half than in the first half. The rate of expansion for the year as a whole was about $6 billion a quarter, but for the second half of the year, about $5 billion a quarter.

Chairman DOUGLAS. Now, you are looking for the big stimulus to occur in 1964 rather than 1963?

Mr. GORDON. That is correct. We would expect that the stimulus would begin to take hold toward the end of calendar 1963. But since it would affect only part of the year, it would not have a very great effect upon the total figure for the year as a whole.

Chairman DOUGLAS. This is to assume the tax cut is passed so that it will go into effect retroactively and it will be had by the end of this fiscal year, by July?

Mr. GORDON. Not necessarily precisely, Mr. Chairman, but I think it does assume that the tax bill will be enacted in time to have an effect on the economy some time around the middle of the year.

However, with early enactment of the President's new tax proposals, we would expect that the economic expansion of the last 12 months will begin to accelerate in the coming year.

Specifically, the budget is based on the expectation that the gross national product which reached $554 billion in calendar 1962 will rise to around $578 billion in calendar 1963.

Personal incomes in calendar 1963 are expected to advance to $459 billion, nearly $20 billion higher than last year, and corporate profits to $53 billion, up about $2 billion from a year earlier.

Since economic projection, however, is an imprecise art, I should add that such expectations encompass a range of possible levels of gross national product for 1963 extending to perhaps $5 billion on either side.

Looking at the trend of the economy more closely, we note that the current recovery has carried the gross national product to a new high of $562 billion, annual rate, in the fourth quarter of calendar 1962. This is $10 billion above the rate in the second quarter of the same year.

The budget estimates are based on a continuation of economic recovery at about this same rate of advance through the middle of the calendar year 1963. Thereafter, assuming early enactment of the proposed tax program, the rate of growth in economic activity would be expected to pick up as we approach the end of the year.

As this committee has often observed, there is a mutual relationship between budget policy and the economy. An economy operating substantially below its full potential not only irrevocably loses private production and income and Federal revenues, but also generates Federal expenditures which could, under happier circumstances, be avoided.

The Federal budget thus depends on the state of the economy and, at the same time, significantly influences the level of economic activity.

Expenditure outlook: Under the President's recommendations, Federal payments to the public in the fiscal year 1964 are estimated to total $122.5 billion, an increase of $5.7 billion over 1963. On an administrative budget basis, total expenditures are estimated at $98.8 billion, $4.5 billion above the present fiscal year.

TABLE 1.—*Payments to the public*

[Fiscal years. In billions]

	1962 actual	1963 estimate	1964 estimate
Administrative budget expenditures:			
National defense	$51.1	$53.0	$55.4
Space research and technology	1.3	2.4	4.2
Interest	9.2	9.8	10.1
Subtotal	61.6	65.2	69.7
All other functions:			
International affairs and finance	2.8	2.9	2.7
Agriculture and agricultural resources	5.9	6.7	5.7
Natural resources	2.1	2.4	2.5
Commerce and transportation	2.8	3.3	3.4
Housing and community development	.3	.5	.3
Health, labor, and welfare	4.5	4.9	5.6
Education	1.1	1.4	1.5
Veterans' benefits and services	5.4	5.5	5.5
General Government	1.9	2.0	2.2
Subtotal, all other functions	26.9	29.7	29.4
Allowances:			
Comparability pay adjustment			.2
Contingencies		.1	.2
Interfund transactions (deduct)	.6	.6	.7
Total, administrative budget expenditures	87.8	94.3	98.8
Trust fund expenditures:			
Health, labor, and welfare	20.4	21.8	22.8
Commerce and transportation	2.7	2.9	3.2
Housing and community development	1.5	.5	1.0
Veterans' benefits and services	.7	.9	.6
All other	.4	1.7	1.2
Interfund transactions (deduct)	.5	.5	.5
Total, trust fund expenditures	25.2	27.3	28.4
Intragovernmental transactions and other adjustments (deduct)	5.3	4.8	4.7
Total payments to the public	107.7	116.8	122.5

Table 1 provides a summary of these figures. It breaks down under administrative budget expenditures those expenditures related to national defense, space research and technology and interest.

It shows an increase in this category from $61.6 billion in 1962 to $69.7 billion in 1964.

All other administrative budget functions are summarized in the next subtotal. The figure here is $26.9 billion in 1962, $29.7 billion in 1963, and $29.4 billion in 1964.

This gives the total of administrative budget expenditures, which are $98.8 billion, estimated for 1964.

Adding in the trust funds which are shown in the next subtotal, we get total payments to the public of the figure I mentioned a moment ago, $122.5 billion, as compared with the indicated figures for 1962 and 1963.

Mrs. GRIFFITHS. Mr. Chairman, may I ask a question?

Senator PROXMIRE (presiding). Yes.

Mrs. GRIFFITHS. What is going to bring down agriculture in all the figures in 1964?

Mr. GORDON. There are a number of ups and downs within the agriculture budget, Mrs. Griffiths, but the principal cause of this change relates to the present cotton situation. At the present time, for reasons which I will elaborate in a minute, the Commodity Credit Corporation is taking in very large quantities of cotton. We expect that there will be substantial sales of cotton out of CCC inventories in 1964. The reason for this situation is that an expectation of a decline in the price of cotton has caused private holders of cotton inventories to reduce their inventories to the minimum necessary to conduct their affairs. This means that what would normally be private inventories are in fact going into CCC stocks this year, and that a large proportion of them will come out of CCC stocks into private inventories next year.

There are a number of other factors, but this is the major one.

The figures given in this table are summarized in the first chart in this collection of charts which I believe members of the committee have, breaking down total Federal payments by the three categories which I have just indicated, and showing not only the 1964 figures but showing the behavior of these three categories back to 1942.

Increased outlays for national defense, space, and interest are about equal to the increase in total administrative budget expenditures. For all other programs, combined, administrative budget expenditures in 1964 are about the same as—actually slightly below—1963. Although this large segment of expenditures is approximately unchanged in total, it contains a number of increases and offsetting decreases. I shall cover these changes in more detail later.

At this point, however, I want to emphasize the fact that a large part of the civilian expenditures recommended by the President represent an investment in the future progress of the Nation—facilitating the long-run growth of our economy. They include new programs and expansions in existing Federal activities in such areas as education, health, manpower retraining, area development, youth employment opportunities, conservation and development of natural resources, scientific research, and transportation.

Of the total Federal cash payments to the public estimated for 1964, about $17.6 billion, or almost one-seventh, are for Federal civil public works, for highways, hospitals, and other State-local assets, for small business, rural electrification, and other loans and additions to civilian Federal assets, and for such developmental activities as education, health, and nondefense scientific research and development.

Taken as a proportion of nondefense payments, rather than of the total of all payments, the ratio becomes more than one-fourth instead of one-seventh.

Of this $17.6 billion nondefense category, $10.8 billion is for additions to civil assets and $6.8 billion is for education, training, health, and nondefense research and development.

The second chart illustrates not total expenditures of a growth-inducing character, but just those which relate to additions to nondefense assets.

It breaks down this $10.8 billion figure which I have just given into the major components of additions to nondefense assets and shows the relationship of these payments to total Federal payments in 1964.

Since the war, as the President pointed out in the budget message, the pressure of a growing population, rising wages and prices, and demands for improved public services have resulted in sharp increases in expenditures at all levels of government. Since 1948, State and local government expenditures have more than trebled. Federal outlays for nondefense purposes have more than doubled, and these outlays include an expanding amount of aid to State and local governments.

The third chart illustrates the growth in State and local government expenditures and Federal nondefense expenditures, tracing them back to 1950. It shows the relationship in the rate of growth of these two types of civilian expenditures, indicating also the proportion of Federal aid payments.

This is the cross-hatched area which constitutes Federal aid to State and local governments. As you see, this has been a growing sum throughout this period of nearly 15 years.

In the 1964 budget, payments for aiding State and local governments are estimated to total $10.4 billion, compared with $9.4 billion in 1963 and $8.2 billion in 1962.

Highway and public assistance grants, together, comprise over three-fifths of such aid. Excluding trust funds, administrative budget expenditures for Federal aid to State and local governments are expected to be $6.6 billion in 1964, compared with $6.1 billion in 1963, and $5 billion in 1962.

This is illustrated in the fourth chart, which, like the chart we saw a moment ago, indicates the portion of total Federal payments which constitutes aid to State and local governments and breaks down in the pie chart the major components of payments to State and local governments in relation to total Federal payments.

The following table summarizes the various categories of anticipated increases and decreases in the sector of the 1964 administrative budget embracing all programs except defense, space, and interest.

TABLE 2.—*Changes in 1964 administrative budget expenditures for programs other than defense, space, and interest*

Description	*Billions*
1963 program expenditures (other than defense, space, and interest), as in table 1	$29.7
Expenditure increases in 1964:	
Pay reform already enacted	.3
Program commitments already made (urban renewal grants, public assistance grants, etc.)	1.5
Proposed increases in present programs (public health, manpower training, scientific research, etc.)	1.0
Legislative proposals for new programs (education, youth employment opportunities, etc)	.3
Total	+3.1
Expenditure decreases in 1964:	
Effect of new postal rates	—.5
Farm price supports	—.9
Other built-in decreases (U.N. loan, veterans readjustment benefits, etc.)	—.8
Substitution of private for public credit	—1.0
Other decreases	—.3
Total	—3.4
1964 program expenditures, as in table 1	29.4

It might be useful to look at this table in connection with the fifth chart, which in effect shows graphically the same figures as are shown in table 2.

In this category, 1963 program expenditures constituted $29.7 billion. We have here indicated the principal categories of expenditure increases in 1964 as compared with 1963 and the principal categories of expenditure decreases. Under the first heading, "Expenditure increases," we show $300 million for the pay reform, the civil service pay reform which was enacted by the Congress last year, and which will have the effect in fiscal 1964 of raising expenditures in this category by about $300 million.

The next heading shows "Program commitments already made"—that is, such things as contracts already entered into or payments under formulas established by acts of Congress, which will cause an increase in payments to be made in 1964 as compared to 1963. That sum is $1.5 billion.

The third heading represents proposed increases in present programs—that is, of a sort which do not arise from program commitments already made, including such things as public health, manpower training, scientific research, and so forth. This amounts to an increase of $1 billion. Then there are the new legislative proposals which are incorporated in the 1964 budget—education, youth employment opportunities, and so forth, which would expect to increase, giving you a total of $3.1 billion of increases.

The reductions are summarized under the next heading. The full year effect of the new postal rates constitutes a reduction in expenditures of about $500 million.

The matter of farm price supports, part of which I explained a moment ago, would constitute a reduction of $900 million.

Other built-in decreases—this would be the decrease counterpart of the item above called program commitments already made, built-in decreases, automatic decreases coming about for a variety of reasons, and some of the examples are given here—would achieve a reduction of $800 million in expenses. The substitution of private for public credit, which will be done in 1964, in several credit programs—this has in general the characteristic of arranging for private credit to be available for functions now served by direct public lending—would constitute a reduction of about $1 billion in expenditures, and all other decreases, about $300 million.

In the chart, as you see, the decreases in present programs, $1.1 billion, is the sum of built-in decreases and other decreases, giving total decreases of $3.4 billion.

This works out to 1964 program expenditures of $29.4 billion.

These changes, within an approximately stable total, reflect the President's determination both to minimize the impact of his tax proposals on the size of the deficit and, at the same time, to expand, modestly and selectively, those activities which contribute most essentially to the growth and progress of our Nation.

In the fiscal year 1964, as in other recent years, the Federal Government, through taxation and borrowing, will have receipts equal to some 20 to 21 percent of total gross national income or product.

This is illustrated in the fifth chart, which shows Federal payments as a percent of gross national product, and indicates that total Federal payments, measured in this way, have been quite close to 20 percent of gross national product for about the last 12 years.

However, only about three-fifths of that percentage of 20 to 21 percent—that is, 11 to 12 percent of the gross national product—will represent a use of national output by the Federal Government.

In other words, 88 to 89 percent of the Nation's output of goods and services will be purchased by business firms, consumers, and State and local governments, and only 11 to 12 percent by the Federal Government.

Moreover, of the Federal Government's 11 to 12 percent use of total output, 9 to 10 percent will be used in the defense and space programs and 2 percent in all other programs.

The remainder of Federal payments—about two-fifths of the total—will be made to individual consumers, business firms, and State and local governments in the form of social security benefits, veterans' pensions, loans, grants, subsidies, interest, and similar outlays which do not involve Federal Government use of goods and services.

Chairman Douglas. Mr. Gordon, do your totals include social security payments?

Mr. Gordon. Yes; this relates to total cash payments and social security payments would be a type of outlay which does not represent use by the Federal Government of any part of current output. It is, in technical terms, as you know, Mr. Chairman, a transfer payment.

Chairman Douglas. But it is included in your 20 percent of total gross national product?

Mr. Gordon. Yes; that includes all Federal payments, trust fund plus administrative budget.

Fiscal policy: The most important aspect of fiscal policy in this year's budget is, of course, the President's program for tax reduction and reform. The details of that program were spelled out in the tax message, and its economic impact has been analyzed both in the Economic Report and in Chairman Heller's testimony yesterday. I should like, today, to look briefly at the tax program in relation to the budget as a whole, as it affects both fiscal year 1964 and later years.

Table 3 gives the total receipts and expenditures on each of the three budgetary bases upon which these calculations are made. As you will see, it indicates a projected deficit in the administrative budget of $11.9 billion in 1964, in the consolidated cash budget of $10.3 billion and in the Federal sector of national income accounts, a deficit of $7.6 billion.

Table 3.—*Budget totals*

[Fiscal years, in billions]

	1962 actual	1963 estimate	1964 estimate
Administrative budget:			
Receipts	$81.4	$85.5	$86.9
Expenditures	87.8	94.3	98.8
Deficit	−6.4	−8.8	−11.9
Consolidated cash budget:			
Receipts	101.9	108.4	112.2
Expenditures	107.7	116.8	122.5
Deficit	−5.8	−8.3	−10.3
National income basis:			
Receipts	104.0	108.8	111.4
Expenditures	(105.7)	(113.2)	(119.0)
Purchases of goods and services	59.8	64.4	68.2
Other	45.9	48.8	50.8
Deficit	−1.7	−4.3	−7.6

Given the prospective level of gross national product, the tax and expenditures policies reflected in the fiscal 1964 budget will yield a large deficit on the basis of each of the three budgetary concepts. The 1964 deficit is a result, but not the means or the purpose, of fiscal policy. The means is the economic stimulus provided by a carefully phased program of tax reduction and reform. The purpose is the achievement of full prosperity and more rapid growth in the American economy—the attainment of an economic climate within which the chronic deficits of recent years will disappear.

As economic activity responds to the successive steps of tax reduction and reform, the advance in output and incomes toward full employment levels will be accompanied by a more than proportional increase in Federal revenues.

It is characteristic of our economy that corporate profits are more volatile than other forms of income. As a consequence, the advance toward full employment should see a particularly large rise in profits and in the Federal revenues derived from the corporate income tax. Within a few years after enactment, total revenues under the new tax system should be larger than those which would have been yielded by the existing tax structure.

The fact that under certain conditions a decrease in tax rates can lead to an increase in tax revenues should not be surprising. It is analogous to the situation which often confronts a business firm. A firm's revenues depend both on the price of its product and the volume of its sales. It has been typical of many of our industries that a reduction in prices can often so stimulate the volume of sales that total revenues are eventually increased. Since the response of volume to price reduction often takes time to work itself out, it may sometimes be necessary to accept a temporary reduction in receipts—to incur a deficit if you will—until the full effects of the price reduction are felt.

Eliminating the slack in our economy, returning to full employment, and speeding up the rate of economic growth are vital objectives in and of themselves, both for what they imply for the well-being of our citizens and for their effect on our position of world leadership. Fiscal policy, as reflected in the 1964 budget, lays the foundation not only for a more prosperous economy but also for an improved budgetary position.

As the tax reduction becomes fully effective and as the economy moves back toward full employment, a substantial part of the accompanying rise in revenues will be available and will be used to reduce the transitional deficit.

Many have wondered why the administration did not reduce expenditures in order to make room for a tax cut within a balanced budget. The answer to this is twofold:

First, the expenditures contemplated in the 1964 budget are, in the judgment of the administration, the minimum necessary to safeguard our national security and to fulfill our pressing domestic responsibilities. As I indicated earlier, expenditures for programs other than defense, space, and debt service have been held slightly below last year's level. To have gone even further in expenditure restraint would have been a disservice to the national security and the national welfare.

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Second, a reduction in the proposed level of Federal expenditures, not matched by a larger tax reduction, would be self-defeating under current conditions. Reduced Federal purchases of goods and services in fiscal 1964 would, of course, reduce private production, employment, profits, and wages. This, in turn, would lead to lower Federal revenue collections and a deficit would remain. In the end, the problem of Federal deficits can be solved only in a prosperous and growing economy. It is to this goal that the administration has directed its tax and expenditure policies.

I have a few comments, Mr. Chairman, on the matter of budget presentation which I might run through quickly.

Budget presentation: The members of the commitee may be interested in a brief summary of some of the changes we have made in the budget presentation this year, a number of which should be helpful to those interested in economic and fiscal analysis of the Government's activities.

The most obvious fact about the 1964 budget is, I suppose, that we have retained the smaller size, compact budget initiated last year. This innovation was well received and I believe it greatly increases the convenience of handling the budget material. I hope it will also continue to expand the use of the document and promote informed discussion of Federal budgetary issues.

The 1964 budget gives increased emphasis to the consolidated cash budget as compared to the administrative budget, although figures on the latter basis are clearly identified throughout the document.

The move to a more comprehensive coverage of the Government's program—including the approximately $30 billion of estimated trust fund receipts and expenditures—has been recommended at various times by such groups as the chamber of commerce, the Committee for Economic Development, and the National Planning Association.

Members of this committee have also shown an interest in the consolidated cash figures, and we believe the presentation in the 1964 budget is a useful step forward in providing a more complete picture of governmental activities and revenues.

Accordingly, in the tables and text throughout the budget document, where appropriate, information on trust fund transactions is provided in addition to information on the administrative budget basis. To help improve understanding of all three major measures of Federal finances currently in use—the administrative budget, the consolidated cash statement, and the Federal sector of the national income accounts—we have included in the budget a special analysis briefly explaining all these concepts and reconciling the figures on the three bases. (Special analysis A, p. 324 of the budget.)

Another innovation in the 1964 budget is the inclusion of a separate section of historical tables permitting ready comparisons of trends in Federal financial data over time in terms of all three measures.

Further, the President's budget message this year includes a new table (on p. 28) showing the total estimated new obligational authority, with the amounts requiring current action by the Congress shown separately from those becoming available under permanent authorization without current congressional action.

In the part of the document containing summary tables, we are continuing to include tables initiated last year summarizing obligations incurred, Federal civilian employment, and Federal expenditures of an investment nature. The table on the public debt in this section has been expanded to distinguish between the part of the debt held by the public and that part held by Government agencies and trust funds.

Finally, the nine special analyses, in part 6 of the budget, provide valuable additional information. In a number of instances they have been improved and expanded.

We hope to continue to improve the budget document to make it more useful for the many purposes it serves.

(The charts referred to are as follows:)

CHART I

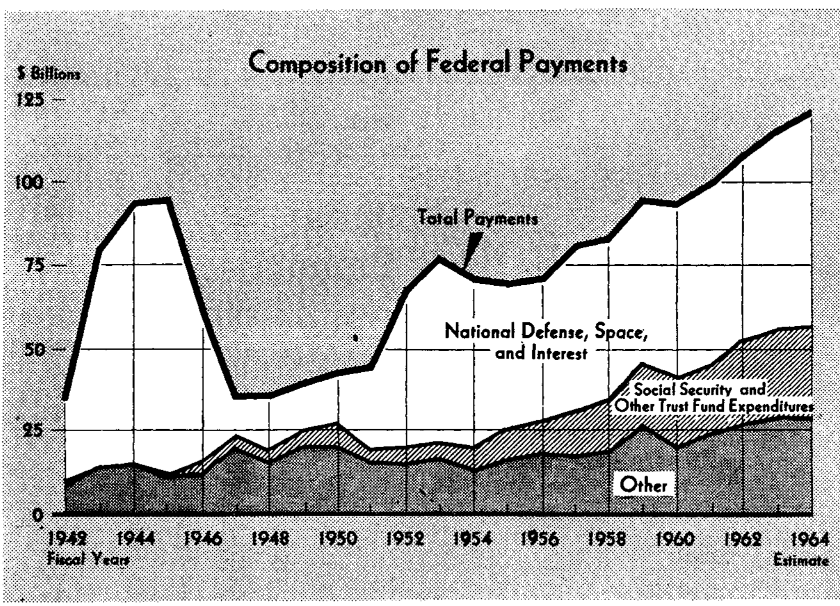

CHART II

Additions to Non-defense Assets

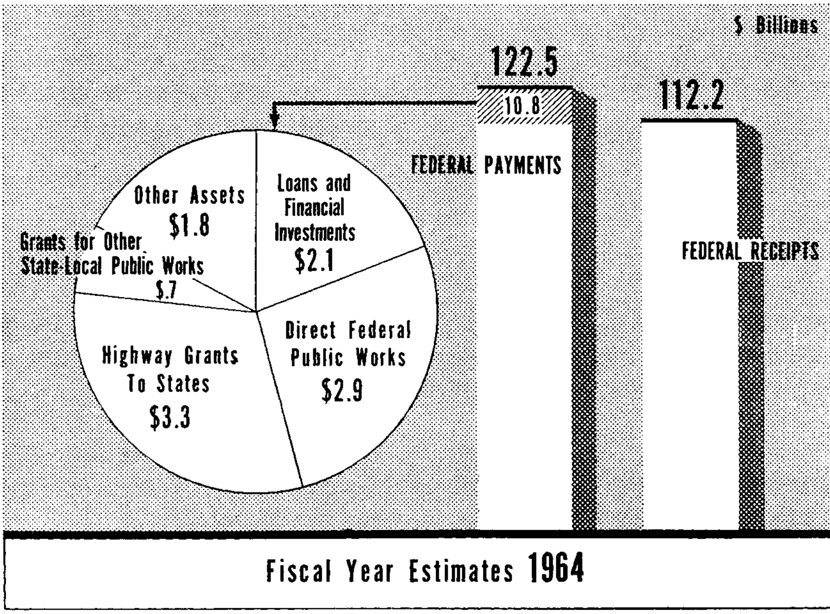

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CHART III

Federal Non-defense Expenditures and State and Local Expenditures

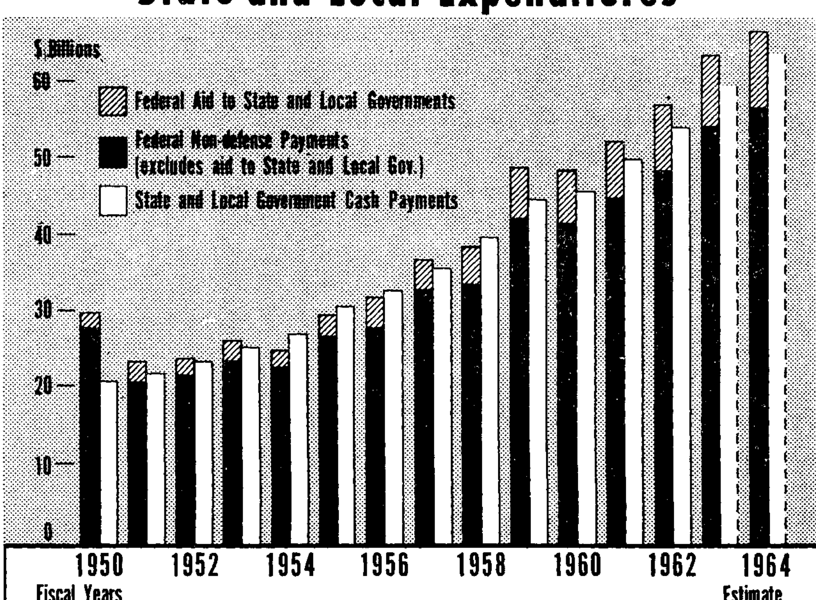

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CHART IV

Federal Aid to State and Local Governments

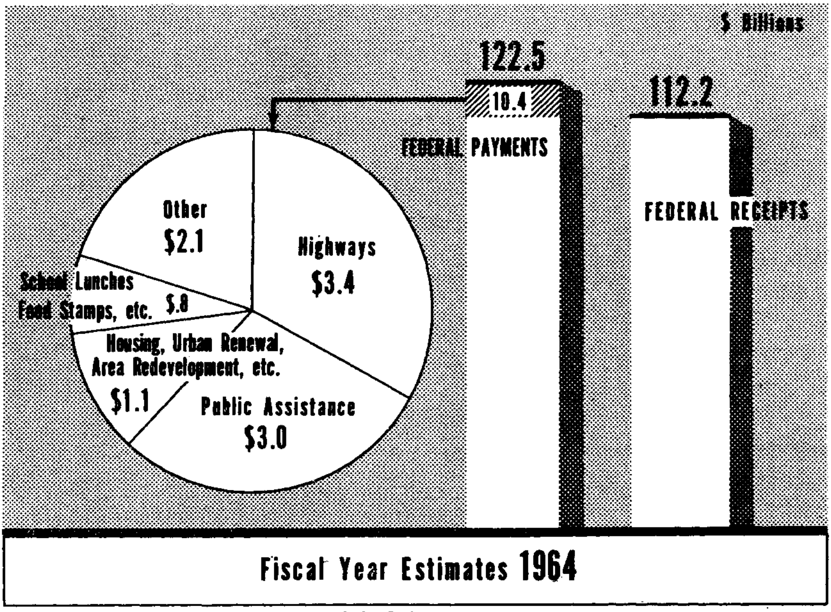

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CHART V

1963-64 Changes in Administrative Budget Expenditures (Other Than Defense, Space, Interest)

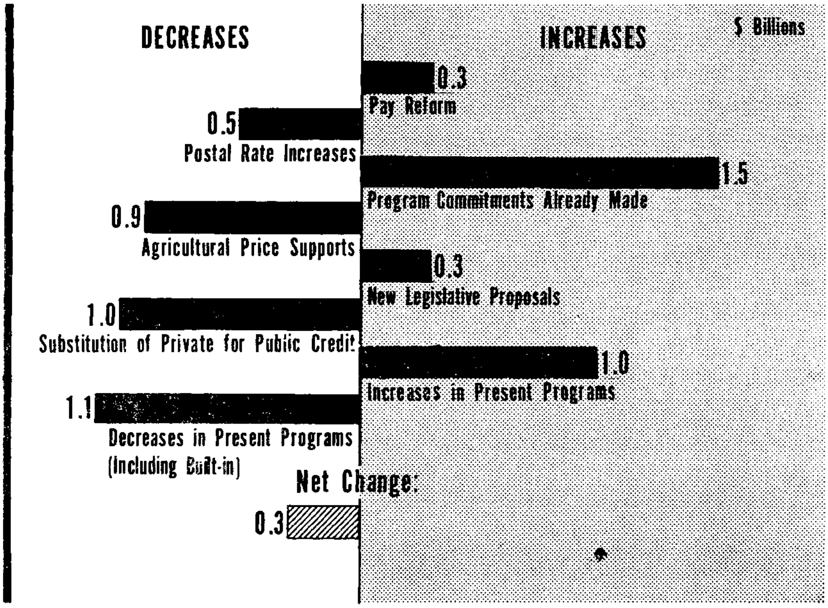

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CHART VI

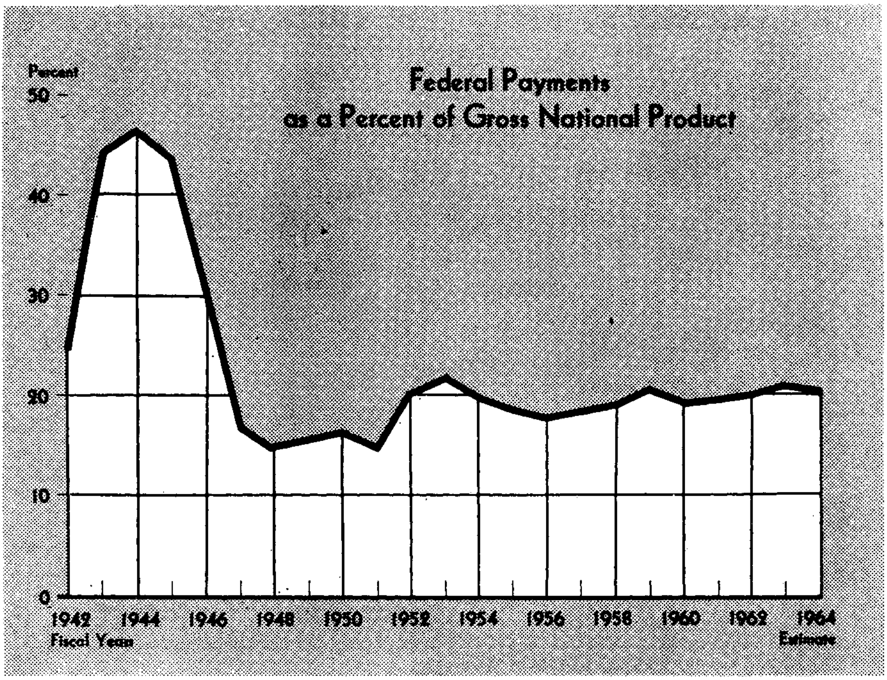

CHART VII

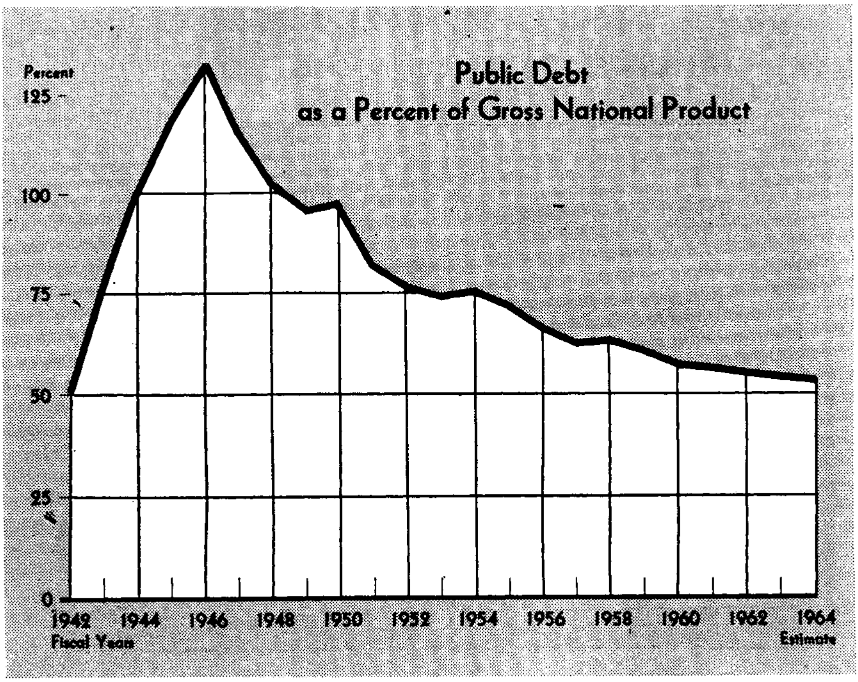

CHART VIII

Gross Public and Private Debt

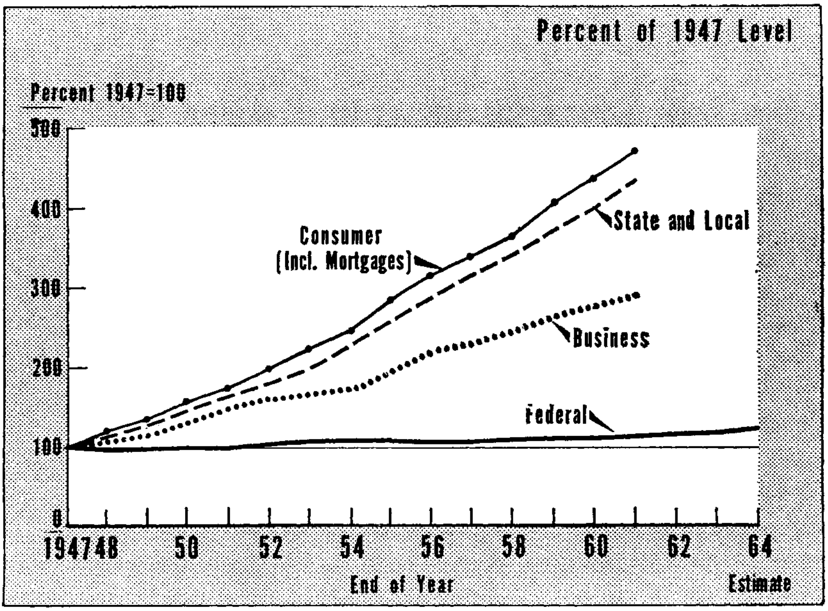

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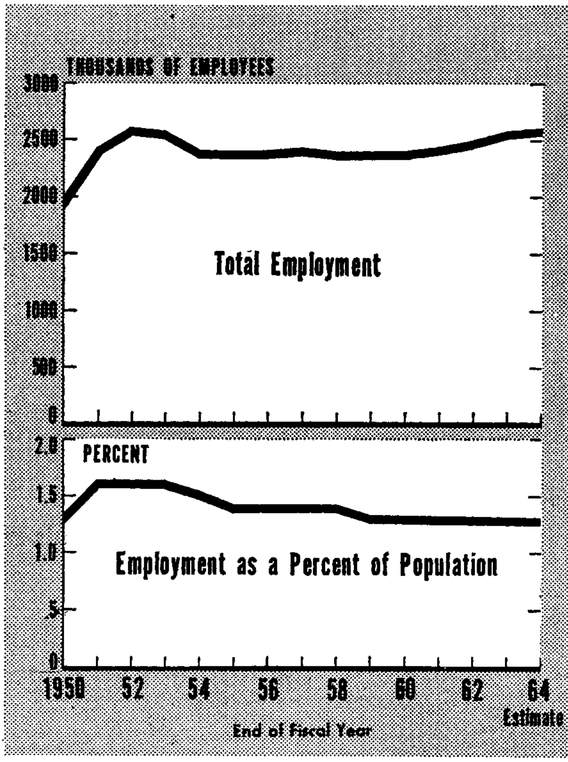
CHART IX

Executive Branch Civilian Employment



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Chairman DOUGLAS. Thank you very much, Mr. Gordon.

I want to commend you for putting increasing emphasis on the consolidated cash budget. It is a very graphic thing to do, because if the consolidated cash figures are compared with the previous administrative budget, it shows, of course, a very large increase.

Now, I am well aware of the fact that many cosmic-minded economists tend to concentrate their emphasis on totals and perhaps not to give importance to individual items.

I hope you will forgive me, but as an earthbound person, I tend to deal with some of these individual items and not with the general theory of the budget with which, on the whole, I agree.

I would like to start off with this chart which shows the changes in the administrative budget expenditures. I notice that you estimate that you are going to have a deficit of half a billion dollars less this coming year than the previous year.

Mr. GORDON. In this category, if I follow you, Mr. Chairman, it shows a net change of about $300 million—a net reduction of about $300 million, I am sorry; I misunderstood you. You were talking about the postal deficit. That is correct.

Chairman DOUGLAS. Do you believe that the increase in postal rates will exceed the increase in pay rates by this much?

Mr. GORDON. I have estimates, Mr. Chairman, as to the basis for computing the Post Office deficit. Perhaps this will provide the relevant information.

The increase in revenues arising from the recent postal rate increase is, for 1964, projected at about $580 million. In addition, a proposed administrative parcel post increase of $127 million should be added to that, providing a total of a little over $700 million in increased revenues arising from increased rates.

The postal pay increase—I do have this shown separately—is currently projected at $344 million for fiscal 1964.

Consequently, the projected increase in revenues arising from the rate increase is substantially greater—about twice as great, actually—more than twice as great as the projected impact of the pay increase.

Chairman DOUGLAS. But if the increase in parcel post rates does not go through, this would, of course, diminish.

Mr. GORDON. If it doesn't go through, you would reduce this figure by about $127 million.

Chairman DOUGLAS. Will there be a further increase in postal pay during the fiscal year 1964–65, or will the full effects be taken in 1963–64?

Mr. GORDON. Mr. Staats, would you like to answer that?

Mr. STAATS. Surely.

Mr. Chairman, as you will recall, the formula contemplated an annual review based on Bureau of Labor Statistics survey data on professional, technical, administrative employees—the report we have from BLS would indicate a 3 percent overall average increase. It would be slightly less than 3 percent for the postal service.

Chairman DOUGLAS. Three percent would be about $100 million?

Mr. STAATS. That is right.

Chairman DOUGLAS. Is that included in the estimate?

Mr. STAATS. That is not included in the post office. It is included in the overall totals, but not the post office.

Chairman DOUGLAS. Then you may find your revenues $120 million less than you expect and your expenses $100 million more, so the economy may be a quarter of a billion dollars instead of half a billion.

Mr. GORDON. The increase in expenses is included in the total budget.

Chairman DOUGLAS. Under postal?

Mr. STAATS. No; under new legislation.

Chairman DOUGLAS. In the Agriculture budget, where you expect to have a decreased expense of $900 million, is that based on the idea of selling an increased quantity of cotton abroad?

Mr. GORDON. I am afraid I can't answer precisely, Mr. Chairman, on the projected foreign sales. It is mainly based on a change in the relative inventories of holders of cotton. There may be a slight element which is related to changes in the rate of cotton exports.

Chairman DOUGLAS. But it is based on an assumption that a considerable portion of the cotton reserve will be sold?

Mr. GORDON. That is correct, sir. It seems to me this is a particularly good assumption—as assumptions go in the field of agriculture, where projections are very difficult to make—because the anticipated 1963 increase in CCC holdings of cotton is already occurring.

There have been, as of now, substantial shifts, in effect, of stocks from private holders to the Commodity Credit Corporation.

Chairman DOUGLAS. I am not objecting to this, I am just trying to make it clear.

Now, a similar decrease of $1 billion is estimated for the substitution of private for public credit. Does this mean that some of the housing expenditures by FNMA will be sold off to private investors?

Mr. GORDON. A part of this—not a very large part, but a part of this—represents a net sale of mortgages from the FNMA special assistance portfolio to private investors. That is not a very large component, however.

Chairman DOUGLAS. Well, having criticized the previous administration for counting the sale of capital assets, in its budget, particularly in the field of housing, in all consistency I am compelled to say that this looks like a very similar practice and subject to the same criticism that I made a few years ago.

Mr. GORDON. May I defend it, Mr. Chairman?

Chairman DOUGLAS. Certainly.

Mr. GORDON. It would seem to me that if it is an appropriate budgetary practice and procedure to count new loans when they are made as budgetary expenditures, it then follows, I think, as a matter of logic that repayments of loans or sales of loans should be counted as receipts.

Now perhaps neither should be counted. I would argue that there should be consistency in the treatment.

Chairman DOUGLAS. That is very well done, but doesn't this strengthen the case for a capital budget so you can segregate the items of current expenditure from the items of investment?

Mr. GORDON. It certainly seems to me, Mr. Chairman, that it argues for special attention to this part of the administrative budget—for recognizing that you are dealing with a quite different animal here than you are on expenditures which relate to the purchase of goods and services. And as you know, the Federal sector of the national income accounts does do this. It excludes transactions in financial assets, both sales and purchases.

Chairman DOUGLAS. I regret that I haven't had time to go over the budget in detail. Last year I thought it was a very commendable innovation for you to make an approach to a capital budget as an alternative method. Have you done that this year?

Mr. GORDON. There is a special analysis distinguishing investment from operating and other expenditures in considerable detail.

Chairman DOUGLAS. If that is done, how much would the deficit be for 1964?

Mr. GORDON. I am afraid that is a very hard one to answer, Mr. Chairman, because there are so many capital budget concepts. One figure that we can use as a beginning is this chart on additions to nondefense assets. We have been very careful to eliminate the acquisition of physical assets of a defense character, even though some of those may have a civilian use, and have restricted ourselves closely to additions to nondefense assets. This shows total additions of about $10.8 billion in fiscal 1964, which is somewhat in excess of the projected deficit in the cash budget.

Chairman DOUGLAS. So that if you had a capital budget of this type for fiscal 1964, the cash budget would be balanced?

Mr. GORDON. Here again, Mr. Chairman, I would have to say that this would depend upon the kind of capital budget concept you used.

Chairman DOUGLAS. If you include the items shown here?

Mr. GORDON. If this is the way it was done, it would show a small surplus in the capital budget. Almost any capital budget concept you used would have the effect of substantially reducing or eliminating the deficit.

Chairman DOUGLAS. Is it not true that if the European countries were to keep their budget in the same way we have kept ours in the past, including capital outlays along with current expenses, that virtually every country would have shown a deficit in almost every year?

Mr. GORDON. That, I think, is a correct statement, Mr. Chairman. All the European countries maintain a special budget. In some cases they are called capital budgets and in others extraordinary budgets. But the effect of this is to segregate transactions which are considered appropriate for debt financing. When a European talks about a balanced budget, he is talking about the operating budget, not the budget we are talking about.

Chairman DOUGLAS. Last year I asked the Bureau to collect material on European budgets and they did and we published a brief summary of this.

Have you developed this in more detail?

Mr. STAATS. There has been no further work done on that report.

Chairman DOUGLAS. I wonder if you would insert the material that you have in the record at this point?

I will ask unanimous consent that that be done.

(The Bureau of the Budget subsequently furnished the following information for the record:)

A study which was prepared by Mr. Andrew H. Gantt for Harvard University compares the central government budget results of England, France, and Western Germany with the United States. Adjusted to a basis comparable to the U.S. consolidated cash statement (Federal receipts from and payments to the public), the study shows that England ran deficits in 9 of the last 11 calendar years (1950 through 1960); France in every one of the last 10 calendar years (1951 through 1960); and Germany in 4 of the last 6 calendar years (1955 through 1960). In the 11 calendar years 1950 through 1960, inclusive, the United States ran surpluses in 5 years and deficits in 6. Research on this project was made possible by the support of the National Committee on Government Finance of the Brookings Institution.

Central government surpluses and/or deficits for recent years for 4 countries

Calendar year	England (millions of current £)	France (billions of current new francs)	Germany (millions of current DM)	United States (billions of current dollars)
1950	611	(1)	(1)	0.5
1951	−55	−2.40	(1)	1.2
1952	−464	−6.27	(1)	−.6
1953	−628	−7.94	(1)	−7.2
1954	−74	−7.56	(1)	−1.1
1955	−42	−8.32	2,221	−.7
1956	150	−11.72	1,331	5.5
1957	−175	−12.21	−2,926	1.2
1958	−101	−9.36	−1,755	−7.3
1959	−292	−5.48	−3,881	−8.0
1960	−453	−3.24	−641	3.5

[1] Figures not available at this time on the same basis.

NOTE.—The figures in this table differ from the usual "budget" deficit or surplus figures printed by these countries, which usually do not express adequately the surpluses or deficits for which their central governments are responsible. For instance, in the United States, the trust funds and other items are excluded from the budget figures. The figures in the table are on a basis analogous to the "cash receipts from and payments to the public" of the United States, which encompass the entire operations of the central governments of these countries, including trust funds, government owned and sponsored enterprises, etc. It should be noted, however, that no attempt has been made to include exactly the same operations in each country. If the central government of the United Kingdom operates her radio stations and they run a deficit, this deficit is included above, even though the U.S. Government has nothing to do in an operational way with the radio stations here.

Chairman DOUGLAS. I now ask the Bureau of the Budget to do the reverse. Suppose we kept our budgets in the same way that the Europeans do, what would be the situation?

Would it not show surpluses in virtually every year?

Mr. GORDON. We do, as a matter of fact, Mr. Chairman, have some work going on in studying the capital items in the Federal budget. Here again, you can easily develop a technical argument over the precise budgetary concepts that ought to be used.

But I think it is a fair statement that the effect of introducing the capital budget concept would either greatly reduce or eliminate the deficit in the ordinary budget.

Chairman DOUGLAS. My time is up.

Congressman Curtis?

Representative CURTIS. Mr. Director, what is the carryover of the obligational authority as of, say, June 30, 1963, the beginning of fiscal 1964?

Mr. GORDON. I will try to get that figure for you, Mr. Curtis.

As of the end of fiscal 1963, Mr. Curtis, in the administrative budget, the total carryover is $46.2 billion obligated and $40.9 billion unobligated, for a total of about $87 billion.

Representative CURTIS. Incidentally, what is your definition of "obligated"? Do letters of intent comprise obligation?

Mr. GORDON. I am informed that letters of intent do not comprise obligations.

Representative CURTIS. How much deobligation and then reobligation went on last fiscal year? Do you have any idea?

Mr. GORDON. I am afraid we don't.

Mr. STAATS. We can supply that figure.

Representative CURTIS. Could you? I know it would probably be difficult to get, but I am trying to find out if we are talking in terms of billions of dollars, or hundreds of millions, or what.

In reply to Mr. Curtis' request, the following material was subsequently received for insertion into the record:

For fiscal year 1962, Government agencies reported recoveries (deobligations) of prior year obligations in the 1964 budget schedules as follows:

	In millions
Foreign assistance—economic	$120
Department of Defense—military functions	341
Housing and Home Finance Agency	304
All other agencies	233
Total	998

The instructions covering the above reports call for the agencies to report those recoveries (deobligations) which are material in no-year or multiple-year accounts. Therefore, the above figures exclude recoveries in annual accounts (which are not available for reobligation), and exclude small downward adjustments in other accounts.

The figures are not applicable to deobligations of amounts previously obligated within the same fiscal year. Such deobligations and reobligations are often only technical in nature; for example, they often involve only the substitution of one supplier for another with no change in program or requirements.

It is not possible to determine in any one fiscal year amounts of recoveries which have been reobligated in the same fiscal year since, normally, such deobligated amounts become a part of the amounts available for obligation, along with other sources of money, and thus lose their identity.

Mr. STAATS. This is a very difficult thing, as you know, Congressman Curtis, because of the change-order problem in handling of defense contracts, particularly.

Representative CURTIS. This is one area, I might say, where Congress loses complete control over expenditures.

Mr. STAATS. This is one reason why we do not consider it a contract until——

Representative CURTIS. In other words, letters of intent are excluded.

The request for new obligational authority is roughly $108 billion; right?

Mr. STAATS. Right.

Representative CURTIS. So we will have $197 billion for obligational authority in the hands of the Executive for fiscal 1964.

Now, the first part of the budget message to the Congress sets up in charts, at any rate, the summary of Federal receipts from the public and payments to the public; correct?

Mr. GORDON. That is correct, sir.

Representative CURTIS. This is an area over which the Congress has no authority.

Once it has appropriated the money to the Executive, the spending rate is in the control of the Executive.

Mr. GORDON. That is essentially correct; but subject to provision of substantive law and other factors.

Representative CURTIS. So, the real item as far as the request to the Congress is concerned, begins on page 40 of the budget document; the request for new obligational authority.

Mr. GORDON. It is summarized, Mr. Curtis, in the budget message on page 28.

Representative CURTIS. It begins on 28, and the details are on 40.

Now, I notice, just to point up an item, in the payments to the public, the general impression might be given that we are cutting back in the field of agriculture, because the 1963 estimates are $6.7 billion and the 1964 estimates are $5.7 billion, a difference of a billion dollars; correct?

Mr. GORDON. That is correct, sir.

Representative CURTIS. Before I go on, let me ask, why wasn't there a double entry made of $2.5 billion additional receipts from the public, which, I understand, is what you are estimating for the Commodity Credit Corporation, and an increase of $1.5 billion in the expenditures, because your net is $1 billion. Actually, if you are net $1 billion, or minus the net here, to reduce it a billion, it has been increased or will be increasing $1.5 billion.

The only reason you get a minus is because you have had a $2.5 billion increase; right?

Mr. GORDON. I believe the answer, Mr. Curtis, is that like other public enterprise funds, the Commodity Credit Corporation is shown on a net basis.

I think this is generally true of public enterprise funds throughout the budget.

Representative CURTIS. But actually, it would have increased the expenditures by $1.5 billion. I am curious as to where those expenditures are.

Mr. GORDON. In the special analysis, relating to public enterprise and trust funds, which is what we are talking about here, gross expenditures——

Senator PROXMIRE. What page is that?

Mr. GORDON. Page 333 of the budget; the table at the top of page 333 shows a decline in gross expenditures for the Commodity Credit Corporation—I think that was the concept you were using—from $10.6 to $9.5 billion. That is 1963 to 1964. That is a gross reduction.

Representative CURTIS. Yes; but that is what I am getting at. Actually, the increase is $1.5 billion, because the net reduction of $1 billion comes from the sale of $2.5 billion. Otherwise, it would be a $2.5 billion reduction. That is what I am pointing out.

But let me go on to the next point. I simply wanted to stress that item.

The real indication of what we are doing in the field of agriculture, as far as the Congress is concerned with its control over expenditures, actually shows an increase, because the 1963 estimate, and I am now reading from the table on page 40, for agriculture, is a $6.7 billion new obligational authority, and a request for $8.144 billion for 1964, or actually an increase of $1.4 billion additional authority for the President to spend. He could spend this as far as the Congress is concerned; right?

Mr. GORDON. That is correct, sir. Once it is appropriated.

Representative CURTIS. If we vote it, he can spend it.

The front part of this budget, payments to the public, and receipts from the public, is purely within the discretion of the Executive. That is what I am showing.

Mr. GORDON. That is essentially correct, sir; but within the limits of tax and other laws.

Representative CURTIS. Also, if we go through these items of nondefense expenditures, we find that there is considerable increase in the budget requests. HEW shows an increase from $5.3 billion in 1963 to $7.1 billion, an increase of $1.7 billion, almost $1.8 billion in 1964. This is quite a different picture, I might say, from that given the public by the impression that the administration is holding to 1963 levels as far as budgetary authority to spend is concerned.

The President has simply said that he is going to spend at the rate of $98 billion.

Mr. GORDON. Mr. Curtis, I ——

Representative CURTIS. As far as the Congress is concerned, the the President is asking to increase these programs by considerable amounts.

Now, let me ask another question.

Mr. GORDON. May I make a comment on that, Mr. Curtis?

Representative CURTIS. Certainly.

Mr. GORDON. I think it is quite appropriate to pay close attention not only to projected expenditures but to the new obligational authority, as you were doing.

Representative CURTIS. And call the public's attention to it, too.

Mr. GORDON. Correct. And I would call your attention to the fact that the 1963 estimate of new obligational authority for all functions in the administrative budget other than defense, space, and interest, is $35.1 billion. In 1964, $35 billion, a reduction of $100 million.

Representative CURTIS. I am glad you mentioned that, because I now want to ask you about this item of $2 billion, a fiscal 1963 nonrecurring item for the Export-Import Bank. Of course, since it was nonrecurring, it is not included in this request.

That certainly should not be used as a matter to balance off, and hide, I might say, these increases in nondefense expenditures.

Now, is that not a fair observation?

Mr. GORDON. I certainly do not think that there is any intention to hide it, since it is clearly stated in the budget, Mr. Curtis.

Representative CURTIS. Is that not a nonrecurring item?

Mr. GORDON. This is, and of course there are other nonrecurring items.

Representative CURTIS. I am talking about a $2 billion item which is a one-shot proposition. That is the reason you have a $2 billion leeway which permits you to increase other areas, with recurring items. I was going to get to this point of mingling nonrecurring items in your budget with recurring items. It seems to me, that the way you have held this budget down is by taking nonrecurring items, minuses, and imposing recurring items to take their place. This is going to hit us in the ensuing year. I certainly think in a forthright presentation, there should be this distinctions made between recurring and nonrecurring items.

Mr. GORDON. May I comment on that statement, Mr. Curtis?

Representative CURTIS. Certainly.

Mr. GORDON. I question very seriously the presumption that a total figure for a new obligational authority in 1 year gives a clear indication of what expenditures are likely to be in the next year, as you have just indicated.

If you look at the various components of new obligational authority, I do not think it would support this conclusion. You have a variety of types, Mr. Curtis, of new obligational authority.

In the case of new obligated authority for the Commodity Credit Corporation, NOA tends to be related not to future expenditures but to past expenditures.

NOA is appropriated to the Commodity Credit Corporation to reimburse them for past losses. So it relates to past expenses, not future expenditures.

Representative CURTIS. I am talking right now about the Export-Import Bank, the $2 billion item. You have done the same thing with the Commodity Credit Corporation. I would suggest this is what you are doing in this several billion dollar shift from the public to private sector.

Actually, even in FNMA, what you are going to do is pay out these bonds, but you have simply accelerated the payment.

Let me say further, you have employed the same techniques in regard to balance of payments. After accelerating the payments of foreign debts of Germany and others, which are nonrecurring items, you then boast that you have cut the balance of payments from roughly a $3 billion rate down to about a $2 billion rate.

Yet you have nearly $700 million a year, which is from nonrecurring items. It is not so much that we who are used to dealing with figures cannot dig all this out, because it is here. But the administration has presented this in narrative form to the public and has been hammering home something that gives the public and the Congress, I might say, a very erroneous impression of what is going on.

You actually are increasing the rate of expenditure in recurring items in nondefense areas at a very handsome clip. And that is the point the Congress and the pubilc are concerned about.

Mr. GORDON. Mr. Curtis, I tried to satisfy myself on one of the points you made. The question of the extent to which one can rely on this year's NOA figures as a forecaster of next year's expenditures—I think this is implicit in what you have been saying. What I find is that NOA figures in one year are a very unreliable guide to expenditures in the next year. I would like, if I may, to give some examples.

Representative CURTIS. Might I point out that I am saying that when Congress gives the obligational authority it then loses control. So as far as the Congress is concerned, and we are the people's representatives, we lose the authority. I grant you that when the authority is turned over to the Executive, there are good legislative reasons why you cut back on your original estimates of expenditures, but sometimes the Executive freezes funds—sometimes he slows a program down.

I agree with you, there are many reasons for that. And incidentally, because the authority does exist, I am going to try to see to it, when you request, as you are going to request, us to continue the debt ceiling at $308 billion, that we cut your request so that the President will exercise some discipline in this area of expenditure rate. He can cut his expenditure rate from a $98 billion to a $96 or a $93 or $92 billion rate, if he would put his mind to it.

Mr. GORDON. I might say, Mr. Curtis, this year's budget is abundant evidence that the President has in fact exercised some discipline. You will recall that in looking at the 1963 NOA figures, many persons were predicting that 1964 administrative budget expenditures would substantially exceed $100 billion. This, of course, has not been borne out. This reflects, I think, the kind of restraint in expenditures to which you are referring.

Representative CURTIS. My time has run out and my colleagues have been very generous, because it went over 5 minutes. I will come back.

Mr. STAATS. Could I add, Mr. Chairman, just a brief point on the matter of carryover funds on unobligated authority? The figure on that is $87.2 billion. You are quite correct in pointing out that you add that to the $107.9 billion, which is new obligational authority requested.

However, I would like to point out that we anticipate that the carryover out of 1964 into 1965 and further years will also increase.

So it is not quite accurate to compare these figures by themselves. That figure will be, instead of $87.2 billion, it will go up to $95 billion.

Representative CURTIS. The point I am trying to make is that the Executive has this leeway, or authority, and we must view it in the total. Now, I would agree that, in many areas, the Executive doesn't really have much leeway, because these are fixed sums and obligations. But there is a considerable area of leeway.

Chairman DOUGLAS. Senator Sparkman?

Senator SPARKMAN. Thank you, Mr. Chairman.

Mr. Gordon, I shall ask you a very few questions.

I have read your statement since coming in. I appreciate your presentation.

I notice from the chart, and I have noticed from the budget presentation, one item about which I would like some clarification, that is, "Substitution of Private for Public Credit."

Now, it sounds very good, but I wonder if we are really going to realize the $1 billion that you hope to save by reason of that.

Now, there is one item that I have had some experience with that is in here, and I want to use this as an example. That is farm housing loans. I believe that the President's program calls for $400 million for the farm home loan program, but provides that only $50 million of that shall be in the form of direct loans. The other $350 million is to be shifted to insured loans. That is correct, isn't it?

Mr. GORDON. I will check the figure, Senator.

The basic point is correct.

Senator SPARKMAN. I think the figures are correct. Now, we have had insured loans for farm housing for a good many years.

I think it was put into effect back about 1953–54. I am under the impression that it has been almost wholly unsuccessful, and I wonder how we are going to make it work here.

The direct loan program has been highly successful. It was discontinued for a considerable period of time. There were several years in which there was no activity. Finally, a couple of years ago, we picked it up again and made available $450 million for direct loans, in varying amounts, as was required.

It has been a highly successful program. Losses have been practically nil.

I am just wondering what assurance we have that an insurance program now can be made to work when it actually did not work in past years?

I think it is still on the statute books and has not worked, and I believe the record will show that to be true.

Mr. GORDON. Well, Senator, I certainly agree that you can never be certain about the likely success of a new program, and although I am not intimately familiar with the details, I do have a general familiarity with them. I think perhaps the answer to your question is that there will be some new characteristics in this program, which may not have been the case in the past.

Insured farm housing loans in the past have been good investments, but for the most part, I would think highly illiquid investments.

What is proposed in the new budget is to make these insured housing loans eligible for purchase in the FNMA secondary market.

I believe this has not previously been the case. This makes the asset a much more attractive asset from the point of view of the lender, because he is readily able to convert it into cash through a highly organized secondary market if he has access to FNMA.

I think perhaps this is one of the principal differences in the proposed situation, as compared with the present one.

Senator SPARKMAN. Well, I hope you are right. I hope there will be careful attention to that so as to make it work. I have no objection to the change. I would be in favor of that. Actually, I would like to see the private credit resources used rather than direct loans from the Federal Government. But I do believe that it is a program that will bear watching.

Mr. GORDON. In many cases, Senator, as I understand it, the housing loans will be made by the Farmers Home Administration and sold to private investors with FNMA eligibility and Farmers Home will service the loan.

So that from the point of view of the lender, it becomes a particularly attractive asset, with servicing through the FHA instrumentality.

Senator SPARKMAN. Now that you have brought FNMA into the picture, let me ask you about some of the operations in that field. I was talking yesterday to an official of the Veterans' Administration and I was told that there is a rather vigorous sale of mortgages out of the VA portfolio to private investors. I wonder if there is much activity with FNMA's portfolio?

Mr. STAATS. The budget contemplates increased sales in 1964 of $150 million—to a total of under $200 million—out of the FNMA portfolio.

Senator SPARKMAN. What is the total holding, do you know offhand?

Mr. SCHULTZE. Senator, I believe it is about $3 billion. But this is a guess.

Senator SPARKMAN. I wanted to highlight that figure, because it seems to me $150 million is not a very large disposal out of $3 billion worth of holdings, particularly at a time when I understand conditions are pretty good for selling these mortgages.

Mr. GORDON. I think perhaps, Senator, part of the difficulty, one of the problems at least in FNMA disposal of its holdings out of the special assistance portfolio is that many of these mortgages bear face interest rates considerably below present market levels, which would mean if they were sold publicly, they would have to be sold at a discount.

I understand there are rather strong views held on that question in the Congress.

Senator SPARKMAN. Well, we have had rather strong views, but they have not been very well regarded so far as granting discounts when the taking of mortgages was concerned, so I think we might waive our strong views if FNMA could find a favorable market for getting rid of some of these, even if discounts have to be given for the low interest rate mortgages, provided the thing is going to happen that I anticipate—that is, that rates will increase in the future.

I am not an expert in this area, but I have been wondering why we did not take advantage of the present market situation to unload a great part.

Mr. GORDON. I am very glad to hear you say that, Senator, because I have been puzzled for a long time as to the basis for the objection to the sale of mortgages bearing low face interest rates at prices below par in a situation in which prevailing market rates are substantially above the face rate. It seems to me that sale of a 4-percent mortgage in a 5¼-percent market at a price which would make it as attractive to the buyer as a 5¼-percent mortgage is a favorable sale, even though it may reflect a sale below the face value of the mortgage.

Senator SPARKMAN. Certainly that would seem to be true if rates are going to rise, as has been indicated is likely to be the case.

That is all, Mr. Chairman. Thank you.

Chairman DOUGLAS. Senator Javits?

Senator JAVITS. Mr. Gordon, I did not have the benefit of hearing all of your testimony. I have been downstairs fighting about the filibuster.

But I did want to ask you just one or two questions which interest me greatly.

What effect do you gentlemen assume there will be on the public debt by the economic or by the policy, the fiscal policy, which is encompassed in your statement which anticipates a calculated deficit? What will be the effect on the public debt?

Mr. GORDON. It is anticipated the public debt will rise at the end of fiscal 1964 to $315.6 billion.

Senator JAVITS. What will that add to the carrying charges; do you estimate, on the public debt?

Mr. GORDON. About $300 million in 1964.

Senator JAVITS. When you say it will rise to $316 billion, from a figure of what?

Mr. GORDON. $303½ billion at the end of the current fiscal year.

Senator JAVITS. So that you will add about $13 billion to the public debt——

Mr. GORDON. About $12 billion, sir.

Senator JAVITS. At an interest cost, you figure, of $300 million; a quick calculation being what—3 percent?

Mr. GORDON. I am not sure how the average rate would work out, Senator. I think this takes account of the likely change in total interest payments on the entire debt.

Senator JAVITS. Well, now, does it assume any change in interest rates?

Mr. GORDON. The method by which these estimates are made assumes that the general level of interest rates prevailing currently will persist throughout fiscal 1964.

Senator JAVITS. Do you think the fact that we are embarking upon an adventurous program, trying to accelerate an economy which is advancing, but not rapidly enough, do you think that that ought to increase or reduce interest rates, or leave them where they are? With that fundamental policy, which we will assume?

Mr. GORDON. This depends, of course, Senator, on the policies pursued by the Treasury and the Federal Reserve System and the requirements of our balance-of-payments situation. It certainly seems to me that on the way up to full employment with substantial slack and unemployment remaining in the economy, there is no inherent reason why the general level of interest rates should rise.

And I would hope, consistent with the necessities of our balance-of-payments situation, that they will not.

Senator JAVITS. Now, in the consideration of running this calculated risk to which I am sure the Bureau of the Budget was a party, was there any consideration of other measures which had to be asked from us, as having a major impact on the economy?

For example, we have not been asked for all substantial purposes to do anything about national emergency strikes, yet that could have a very significant impact on the economy. In short, in the one package approach of a tax reduction, was there also any consideration of adding other legislative aspects to it in the Bureau of the Budget?

Mr. GORDON. I would point out, Senator, that the proposed tax program comes on top of a legislative program, some of it enacted, and some not enacted, which has implications for the general problem of prosperity and growth.

For example, the very substantial things that have been done in the readaptation field, in the field of manpower training and development, in the field of area redevelopment, in the provisions for facilitating adaptation of capital and labor under the Trade Expansion Act, and under the proposed youth employment opportunity legislation. These are all measures either on the books or proposed which have a very close bearing on the problem of expansion in the productivity of our economy, in an efficient and noninflationary manner.

Senator JAVITS. Is it therefore the position of the Bureau of the Budget that what the President said doesn't stand alone? The President said—he asked the Congress, as the principal means for accelerating the pace of the economy, to make this tax cut. Now is it the position of the Bureau of the Budget that other, these other, measures are also essential to accelerate the economy, or do you hold with the President that if we pass the tax cut we have done it?

Mr. GORDON. I would certainly maintain the position, Senator, that the principal means, the most important means for solving our broadest economic problem is a policy designed to help in the expansion of aggregate demand. And this is essentially what the tax program is designed to do. But the expansion of aggregate demand, although it seems to me a prerequisite for the achievement of our economic objectives, obviously doesn't solve every problem, as I am sure Mr. Curtis would testify. There are structural problems in the economy of a very important sort which we think are being attacked in a very promising fashion by some of the other programs that I have mentioned.

I would maintain, however, that the kind of economic climate which would be created by an expansion in total demand would be the kind of climate in which it would be much easier to solve many of these structural problems we are talking about.

Senator JAVITS. Now, let's approach this a little differently. Did you make assumptions in these estimates, and, if so, what did you assume as to strikes and man-days lost because of strikes?

Mr. GORDON. Although we have to make a startling number of assumptions in putting together a budget, I am not aware, Senator, that this is an explicit assumption which underlies the budget.

Senator JAVITS. What did you assume, with respect to our foreign trade?

Mr. GORDON. Here again, Senator, I think the effect of foreign trade developments, although extremely important for our balance-of-payments position, would not have a major impact on the calculations of the budget. Foreign trade would have, for example, some effect on customs revenues, but, in general, I would not think these would be a major impact.

Senator JAVITS. What did you assume with respect to those who might be displaced because of automation, which would be encouraged by all the policies we have just adopted, lower depreciation, the 7-percent credit for equipment, and so on?

Mr. GORDON. Well, I think here the answer would have to run in terms of the necessity for achieving a considerably higher and rising level of total economic activity so that the demand for goods and services would require the services of virtually the whole of our labor force. The automation problem is a problem of location, of skill, of age, and so forth. All of these are matters which are being attacked through the various sectoral measures I have mentioned.

Senator JAVITS. But you cannot give us any assumption which you have made as to those who would be displaced by automation?

Mr. GORDON. As to numbers?

Senator JAVITS. As to any quantum, as to its effect on your estimate.

Mr. GORDON. As to its effect on our assumptions with respect to the number of workers who will have their skills improved and upgraded through the manpower development and training program and other such programs?

Senator JAVITS. But not—but you can't give us any test you applied as to what automation would do to your work force and its earnings.

Mr. GORDON. I would think the answer, Senator, must be that the quantitative question is unanswerable.

Senator JAVITS. And finally—excuse me, I didn't mean to interrupt.

Mr. GORDON. What happens to persons displaced by automation depends largely on the state of employment opportunities generally in the economy. He may either be displaced into employment or he may be displaced into a new trade or new skill or new area in a climate of rising economic opportunity.

Senator JAVITS. Was any assumption made as to the impact of antitrust policy on the willingness or unwillingness of business to invest in new equipment or new expansion or the like?

Mr. GORDON. I am not aware of any explicit assumption on that point, Senator.

Senator JAVITS. Thank you, Mr. Chairman.

Chairman DOUGLAS. Senator Proxmire?

Senator PROXMIRE. This is a remarkably clear exposition of the most complicated and difficult document which our Government has each year. I think it is also amazingly short and concise. I think it is a fine presentation.

These charts are very helpful, too, in understanding it.

Mr. GORDON. Thank you, sir.

Senator PROXMIRE. I was happy, Dr. Gordon, that you were appointed Director of the Bureau of the Budget because I felt as I am sure other members of this committee felt, it is good that an economist with the particular and peculiar experience that you have had as a member of the Council of Economic Advisers should be in charge of the budget. And I note in your third paragraph you talk right off the bat of economic assumptions underlying the 1964 budget.

However, I would like to pursue just for a minute the question that was so much emphasized by Senator Javits. After all, if we are going to attack our economic problems primarily on the basis of tax reduction, shouldn't we on the spending side, on the budget side, simply proceed to meet those necessary costs which we have to meet as economically, as efficiently as we possibly can, and rely on tax adjustments to stimulate the economy?

I take it from your emphasis here, and from what you have told us, that maybe there is more consideration on economic stimulation, on the spending side than I thought we had before your presentation this morning.

Mr. GORDON. I don't think so, Senator. I would agree with your original statement, that at all times, but particularly at this very juncture, it is imperative that Government expenditures be held to the minimum level consistent with the protection of the national security, and the discharge of the Federal Government's responsibilities with respect to the economy.

Senator PROXMIRE. And yet, you say here, the economic assumptions underlying the budget take into account the fact we have seven quarters of economic expansion since the recession trough, and then you go on in the next sentence to say you are also influenced by the fact of the rate of expansion being slower.

Now, I am just questioning whether or not this is sensible under these circumstances to give weight to the economic picture to this degree in building your budget?

Mr. GORDON. I wish that it were not, Senator. The problem of projecting economic activity 18 months ahead, which is involved in every budget preparation, is one of the most taxing and difficult and perplexing of the problems of the budget. But it doesn't seem to me that you can ignore it. There have to be economic assumptions in a budget mainly, of course, to provide a basis for the estimate of revenues, but even to some extent to provide a basis for the estimate of particular items, of expenditures, and ever since we have been preparing budgets there have been economic estimates or projections underlying them.

Senator PROXMIRE. That is excellent. In other words, you have to know the economic estimates to determine how much money is coming in, and to cope with such economic problems as automation, developing new skills, providing additional education and manpower training. This is another consideration based on the economic considerations but any further than that I wonder if we should go.

Mr. GORDON. Well, now on the revenue side——

Senator PROXMIRE. I am asking you if we should in your judgment.

Mr. GORDON. Well, let me repeat, that there have been economic assumptions in every budget and in every budget message the United States has had. For most of this period these assumptions were implicit; they were not stated. But they had to be there because, if they are not there, there is no way of guessing or estimating what the revenues will be.

What we have tried to do, I think, is to come clean and say explicitly what our assumptions are. They are there whether we say it or not. They have to be there, and it seems to us a lot more useful to make clear our assumptions so that those who don't agree with our assumptions will be able to come to different conclusions.

Senator PROXMIRE. In your statement you say something that would seem to me the President has assumed also. You say:

> As I indicated earlier, expenditures for programs other than defense, space, and debt service, have been held slightly below last year's level.

There is no discussion of or justification of the increased spending for defense, space, and interest, and I would question spending increases in all three areas.

It seems to me they have all become sacred cows. They could all be reduced and I think we could make a stronger case in defense than in any other area and also make a very strong case in space.

Let me ask this specific question: Last year I was told that the Budget Bureau or NASA informed the House Appropriation Committee, that the NASA budget was not touched by the Budget Bureau; that it came to the Congress exactly as it was proposed by NASA, there were no cuts in it and no reductions in it.

Mr. GORDON. May I refer this historical question to Mr. Staats? That was before I was in the Budget Bureau.

Senator PROXMIRE. Yes.

Mr. STAATS. I don't recall the particular information that you referred to. I would like to say this, though, that technically this is correct. The defense budget was not formally revised, because it was a matter of working out a budget jointly with our respective staffs and coming to an agreement. We did not have a formal submission which we formally reviewed and reduced by a specific amount of money. This has not been the case this year, however, with respect to the space budget. It is still true with respect to the defense budget this year.

Secretary McNamara's formal request to the Budget Bureau really was a product of a long series of meetings and common staff work, and conferences with the President, where the decision was finally reached. Thus, when we get into the question of what is formally recommended as against what is formally submitted, we have to take these things into account.

This year, however, the budget that was submitted to the Congress in the space area was reduced by the President from the levels requested by the space agency. I will say, though, just so we are not unclear about it, that there were three levels proposed by the space agency this year in terms of its new obligational authority.

The figure that you see here represents a program which is designed to keep the original schedule of the manned lunar landing, but which does represent a considerable reduction in the other space programs.

Senator PROXMIRE. Are you telling me that the manned lunar landing program is $4.2 billion roughly, something like that?

Mr. STAATS. The total expenditures for fiscal year 1964 are $4.2 billion for the space agency. As for the manned lunar landing part of it I would have to check the figure on it.

[Expenditures estimated in 1964 for manned space flight are $2.7 billion of the $4.2 billion total.]

Senator PROXMIRE. Then you say the manned lunar landing part of it was accepted with the recommendations of NASA. There was not a paring or reduction.

Mr. STAATS. That is right. Because it was designed to proceed on schedule.

Senator PROXMIRE. Isn't the function of the Budget Bureau to exercise an independent viewpoint and to make their recommendations in view of the total overall ability of the Government to pay, and fitting the priorities into the President's overall program? Shouldn't there be, in other words, an independent determination in space and defense?

Mr. STAATS. Not independent of the President, if that is your question.

Senator PROXMIRE. No, I mean independent of the agency. You said you sat down with the Space people and with the Defense people, and came to an agreement. On the other hand, when we are dealing with education programs and you are dealing with other programs, it was a more objective, if I could use that word, independent, kind of an approach.

Mr. STAATS. No, I wouldn't draw this distinction at all. I think it goes purely to the question of how the staff work is conducted. In the case of the space agency this year, our staff has been working jointly with the staff of the Administrator for the past 4 months. So that when his recommendation was made with respect to the needs for the manned lunar landing program, it was very largely a product of trying to achieve its schedule at the least possible cost.

Hence, what I meant to say a while ago was that we did not change the schedule established by the agency and approved by the Congress last year with respect to the manned lunar landing program.

Senator PROXMIRE. And you have the same kind of collaboration, close work together, in Defense?

Mr. STAATS. Yes. And I want to say here for the public record that the Secretary of Defense has really been extremely cooperative with the Bureau.

Senator PROXMIRE. I think he is doing a marvelous job. I think we have never had a better Secretary of Defense or one more conscious of the necessity to keep costs down but, at the same time, this is such an enormous agency, the spending is so great, examples of waste are bound to come to our attention and here once again it seems to me that an indepednent appraisal, an objective appraisal would be very helpful to Congress, rather than this kind of——

Mr. STAATS. Well, it does represent an independent appraisal I must assure you, because we had many differences of views with Secretary McNamara and many of those had to go to the President for his resolution.

Senator PROXMIRE. Now, I just want to ask one more thing in this turn.

We have been told by the President this is a tight budget and we have been assured by Dr. Heller that in his judgment it was a tight budget with regard to the other elements of spending.

I notice, however, that looking on page 59 of the Budget in brief, 59 and 60, it seemed to have been possible, at least in 1 year in the last 7 years, to reduce spending and to cut it sharply and cut it in almost every category despite the increases in population, the increased demand on our Nation, in defense and in other areas.

I am talking about the year 1960, when there was a reduction in spending from $80 billion down to $77 billion. This in spite of the fact we had a big increase in research and development of nearly $2 billion, we had an increase in educational appropriations and yet it was possible that year to cut defense, to cut greatly in international affairs and finance, to cut agriculture, to reduce natural resources, and so forth. These are actual expenditures also, not estimated.

Why is it so difficult now or so almost impossible in the view of experts who come before us, to reduce spending when it was in fact accomplished in 1960, a year when we also had great demands.

Mr. GORDON. To answer that in detail, Senator I would want to look much more closely at the 1960 figure. It certainly seems to me as an approach to the answer that it is not unrelated to the very sharp increase of expenditures which occurred in the prior year.

Now, fiscal years are quite arbitrary things. The total administrative budget expenditures rose from $71.4 billion in 1958 to $80.3 billion in 1959. That was a very substantial increase, and the decline in 1960 still left 1960 a good $5 billion above 1958. I think if you look at the trend there, the behavior in 1960 would have to be related to the very sharp increase that occurred in the prior year. It may be that expenditures were pushed forward and made in the year 1959 and had the effect of reducing expenditures under ongoing programs in 1960. I can only speculate about the details but I suspect this is the basic approach to the answer.

Senator PROXMIRE. Well, let me just—I don't want to impose on my colleagues. I do want to ask you, however, on page 48 you show something that I think is pretty irrefutable as far as increasing obligations of the taxpayer. We have this administrative budget which has complexities and unfortunate complications that make it hard to understand, the national income accounts budget, the cash budget, all have defects, capital budget, too.

But on page 48 it shows that virtually every single department of Government is going to have an increase in personnel, in employment, in employees in 1964 as compared to 1963 except Defense and some of those increases are very great. The Department of Labor is 14 percent, General Services Administration 9 percent increase in 1 year, and I am wondering if this isn't perhaps one of the best indications of the fact that we are increasing our Federal obligations and our Federal spending.

Mr. GORDON. Could I call your attention, Senator, to the last chart in this collection of charts that I think you have before you?

Senator PROXMIRE. Yes.

Mr. GORDON. It shows for a 14-year period the change in executive branch civilian employment. It shows a sharp rise, of course, during the Korean conflict, a decline at the end of that period, a leveling off period and then a rise that started in 1959 or 1960. It seems to me very revealing, however, to take account of the fact that this is a rapidly growing country with a rapidly rising population, and to relate the size of civilian Federal employment to the population. The bottom line is a measure of that relationship. It shows that since the Korean conflict the percentage of the population employed by the Federal Government has diminished, and it has been essentially stable since 1959.

Actually, although it does not show up here, between fiscal 1963 and 1964, there is a slight decline. The population, if I remember correctly, will rise about 1.7 percent; Federal employment about 1.4 percent. It does seem to me important to relate the growth in Federal employment to the growth in the size of the country and in the size of the population.

If I may, I would like to take a minute to point out some of the effects of the expansion in the population and in the demands on the Federal Government as background for appraising this rise of 35,000 in Federal employment from 1962 to 1963. I have a number of examples which seem to me very persuasive.

In the Department of Defense, for example, the average number of retired military personnel will increase by 30 percent between 1962 and 1964, necessitating an expenditure increase of $250 million. This is a built-in increase in retirements.

The number of veterans or survivors receiving payments will rise by 10 percent between 1962 and 1964, adding $160 million to outlays, and will have some effect on Federal employment.

Between 1962 and 1964 school enrollment will increase by 7 percent, increasing the expenditures of the school lunch and milk programs by $22 million. The number of passports issued increased by 25 percent from 1959 to 1962, and is expected to increase another 25 percent by the end of 1964. The number of patents issued will increase from 50,000 to 60,000 over this 1962–64 period. Between 1961 and 1964 visitors to the national parks will increase by almost 20 percent. I could go on. I have a very long list.

But I think it is this kind of thing which gives you a sense of what the expansion in the size of the country means to the provision of Federal services and the growth in Federal employment. And it seems to me very impressive that there has been this decline in the ratio of total Federal employment to the population over the last decade.

Senator PROXMIRE. My time is up, Mr. Chairman.

Chairman DOUGLAS. Congressman Reuss.

Representative REUSS. Mr. Chairman, Director Gordon, I would like to join my colleagues in welcoming you here today. You did a remarkable job on the Council and I know you will, too, on the Budget Bureau.

My questions will concern regional economics, which is also a problem confronting the Joint Economic Committee. It may be that you will want to refer this to one of your associates.

Particularly, I am concerned with the lag in industrial growth in recent years in the Midwest, that great area of our country between Detroit and St. Louis, and Ohio, and going up through Chicago and Milwaukee to Minnesota. Not only has the growth rate of this general area of our country tended to lag behind that of most other areas, but when you look at the policy of the Federal Government you will find that civilian payrolls, military payrolls, the giving of research grants, have likewise tended to neglect the industrial interest of the Midwest.

This, let me hasten to add, is due to a complex of factors and certainly willed action by the Federal Government is not the only factor. But just within this last year we have had recognition by the Defense Department, for which I praise it, that there tends to be a distorting concentration of national research and development energies in such areas as the Boston area, the Washington area, and California. We of the Midwest notice this particularly because we produce most of the scientific Ph. D.'s in the country, yet we tend to lose them to other areas of the country, notably these three.

I notice in this year's budget that at least two enormous new installations are contemplated, one the Environmental Health Center set up by the Department of HEW, which is to be plunked right down in the suburban sprawl of the Washington area, on the ground that there are a lot of scientists in Washington already and we might as well put this center there. I think it is ultimately to cost $70 million.

And then along comes NASA and proposes to plunk down a multimillion dollar electronic center right in the heart of the Boston electronics complex. Again the ground given is that there are a lot of electronics people around there already.

Where will all this end? Does the Bureau of the Budget have a policy for the Federal Government with respect to some equalization of industrial growth in this country, and if so, what is that policy? This is where you may want to refer it to those who have been in the Bureau longer than you.

Mr. GORDON. I am very fortunate, Mr. Reuss, in having at my left a colleague who has spent a good part of his time in the heartland—at Indiana University—and I think perhaps he is prepared to say something about the special problems of this area in relation to the issues you raise. Mr. Schultze.

Mr. SCHULTZE. There are only parts of your question that I have any direct knowledge of, but I think one piece of research that we carried out at Indiana is relevant. It turns out for that State and I suspect also for Michigan, certainly Ohio, and probably Wisconsin, that the answer in large part may be traced to the industrial mix, the industrial composition of these States. If you look at recession after recession, you find that whenever economic activity falls below capacity, these States with very heavy durable goods manufacturing in them are affected more severely than others. If you then examine a growth trend from 1947 to 1957, you find these States doing rather well compared to the rest of the economy. But from 1957 on, given the gap we have had in our economic performance, the economic problems in these States reflect the slowdown in our rate of growth and are perhaps even more attributable to the growing gap between our Nation's capacity and our actual production.

I think this is the explanation to your question; by no means all of it, but a very good part of it.

In other words, an increase in aggregate demand back to levels of 4 percent unemployment would, I think, find in a lot of these States, a more than proportionate increase certainly in industrial employment. This is clearly the case in Indiana and I suggest might be true of the area in general.

Representative REUSS. Does the Bureau of the Budget in its function of riding herd on the executive branch, have a policy with respect to the industrial growth of various segments of the Nation?

Mr. STAATS. If you are referring here to the second part of your question a moment ago with respect to the location of Federal installations?

Representative REUSS. Yes, and let me broaden that a little bit, Mr. Staats, to include general policy in research grants, and whatever the Federal Government does.

Mr. STAATS. Right. Well now, I would like to make about three points here. One is with respect to new civil public works programs included in the 1964 budget this year. We tried to give preference, wherever projects were equally meritorious, to the projects going into the underdeveloped areas, the redevelopment areas, and the areas of labor surplus.

Now, this was applied rather carefully to all the public works programs, the Corps of Engineers, Bureau of Reclamation, General Services Administration, all through the whole budget.

Second, with respect to specific locations of the type that you mentioned a while ago, the Environmental Health Center and this new Electronics Research Center announced by NASA, I must say in these kinds of considerations, the technical capability of the agency to perform its function has tended to play a predominant role.

The environmental health center question as you know has received a good deal of discussion in both of the last two sessions of Congress. In this case the proposed center has been reviewed by two Secretaries now, in coming to the same conclusion, that it would be a mistake to locate it elsewhere.

It is therefore shown in the budget to be located in the Washington area, although this, I must say, still has to be reviewed by the Congress again. No action has been taken.

We have been very conscious of the need to locate Federal buildings outside of the Washington area and we do have a very carefully developed policy, thanks in part of the interest of you and others in the Congress, to locate outside the Washington area any building that can function equally well.

For example, in this budget we have a proposed new Patent Office. The present facilities are terribly cramped and it is reducing the employees' capability to a great extent. But we did find, working with the Commerce Department, and they, in turn, with the Patent Association, that they were able to agree to have the building located outside of the Washington area.

Similarly, we are currently studying a proposal from the Department of Interior on the Geological Survey building which faces a similar problem. There has been no decision taken on this one but it is offered as an example again of the kind of thing we are trying to do wherever we possibly can.

Representative REUSS. For which, incidentally, I have the greatest praise for you and the Budget Bureau. It seems to me in the last 2 years there has been real progress, at least with respect to whether you put something in the Nation's Capital in Washington or whether you put it elsewhere in the country.

I was raising, however, a somewhat broader question. The Department of Defense, which has been praised for some things by Senator Proxmire this morning, should also be praised, I think, for setting up a division which is quite conscientiously looking at our nationwide problem of industrial development in all its aspects, and making sure that whatever tendencies are encouraged by the Federal Government are tendencies that are in the national economic interest. I will ask you, Mr. Director, to include when you correct the record an answer to the following question: Will you review what the Department of Defense is doing with respect to the dispersion of industrial development, and comment on whether it may not be possible to generalize that, through the Budget Bureau, throughout the entire operation of the Federal Government?

I have the impression that while the Department of Defense is doing a good and thoughtful job in this, the people at HEW, at NASA, at Atomic Energy, just haven't heard of this, that it just doesn't occur to them that they should do anything but make the rich richer, so to speak. I am wondering if this isn't a proper function of the Bureau of the Budget.

Mr. GORDON. I would be very happy to look into this, Mr. Reuss, and submit a report.

(The material referred to follows:)

The Office of Economic Adjustment is the division in the Department of Defense to which reference was made. It was established in May of 1961 to minimize the economic impact on communities resulting from adjustments in defense programs. The early work of this office was almost exclusively devoted to working with the communities affected by base closures in seeking to find substitute economic activity to offset the losses to the community from the defense closure of a base or depot. Since that time, the work of the office has been expanded to include analyses of the economic effects of changes in procurement programs.

The basic approach taken by the office is to energize local leadership, be it community, region, or State, to analyze its resources and relate them to both short-term and long-term economic growth, whether in the fields of education, science-oriented industry, transportation, and so forth.

The office works with an interagency committee under the chairmanship of Secretary Hodges, which is advisory to the Secretary of Defense on problems of this type. The office works closely with selected agencies which can be of help, depending upon the particular problem involved. NASA and Atomic Energy are not at this time members of this committee and it may well be that extension of this committee or some similar arrangement may be helpful. We intend to pursue this question to determine what is most appropriate to secure the benefit of this type of activity.

Chairman DOUGLAS. Would the Congressman suggest an emendation in the case of space and atomic energy, make the desert blossom as the rose? [Laughter.]

Representative REUSS. I approve that not only substantively, but figuratively. My time is up.

Chairman DOUGLAS. Mrs. Griffiths.

Representative GRIFFITHS. Thank you, Mr. Chairman.

Mr. Director, if you will look at your statement where you say:

Second, a reduction in the proposed level of Federal expenditures, not matched by a larger tax reduction, would be self-defeating under present conditions.

Would you care to estimate what kind of a tax increase would be necessary to cover this year's budget so that there would be no deficit?

Mr. GORDON. What kind of a tax increase would be necessary to——

Representative GRIFFITHS. Increase.

Mr. GORDON. To cover this year's budget so there would be no deficit? Offhand, Mrs. Griffiths, I am afraid I cannot give you a quantitative reply to the question.

Clearly it would have to be very substantial because one would have to take into account the fact that an increase in tax rates would so depress private spending and investment as to cause the general level of activity of the economy to decline so that you would have to get a larger total tax take out of a smaller economy than you have now.

You would have these two effects working against you. It would have to be, I am afraid, an enormous sum.

Representative GRIFFITHS. Would it be, for instance, $300 per taxpayer?

Mr. GORDON. I think it could come to a great deal more than that.

Representative GRIFFITHS. It would?

Mr. GORDON. A great deal more than that.

Representative GRIFFITHS. If such a tax——

Mr. GORDON. Because, if I may say so, because one has to assume that you are collecting this higher level of taxes from a smaller number of people since the effect of the policy, of course, would be greatly to reduce employment and economic activity.

Representative GRIFFITHS. Well, that was going to be the second question of mine. How many people do you think would be unemployed, added to the unemployment rolls, by a tax increase sufficient to cover the deficit?

Mr. GORDON. May I hold a rump conference here on that question?

Well, you ask very hard questions, Mrs. Griffiths. I am reluctant, of course, to answer this because it involves a large number of variables which have to be very crudely estimated.

Let me say it would not surprise me if the consequence of this policy were a rate of unemployment approaching 10 percent of the labor force as compared with the present rate of about 5½ percent.

Representative GRIFFITHS. And an estimated tax rate of how much?

Mr. GORDON. Well, this might entail an increase in tax receipts at present levels of income—that is, an increase in tax liability at the present levels of income of, perhaps, something in the neighborhood of $20 to $25 billion a year.

I am afraid these get into quite astronomical figures, and I am very uneasy about making judgments of this kind off the top of my head.

But it does seem to me quite clear that to achieve this purpose by increasing taxes sufficient to balance the budget at present levels of expenditure would so depress production, employment, and purchasing power that it would not be an extravagant estimate to say the unemployment rate migth move up toward 10 percent.

Representative GRIFFITHS. Now, if you reduce by a shotgun approach the expenditures to meet the income, how much would you have to reduce it, that is, you could not just reduce it the present estimated amount, could you, to meet the income?

Mr. GORDON. You are talking, Mrs. Griffiths, about reducing total expenditures——

Representative GRIFFITHS. To meet your income.

Mr. GORDON (continuing). To meet the present estimated income?

Representative GRIFFITHS. No, to meet the income you are going to get if you reduce the expenditures.

Mr. GORDON. I am not sure that I follow the question. Will you state it again, please?

Representative GRIFFITHS. If you reduce by a percentage basis the expenditures, how much would you have to reduce it to meet the income you would get if you reduced the expenditures?

Senator PROXMIRE. How much would you have to reduce them to balance the budget?

Representative GRIFFITHS. Yes.

Mr. GORDON. The answer, Mrs. Griffiths, I think, would be symmetrical with the answer I have just given you or closely symmetrical, but not exactly. There are some technical differences to the answer I have just given you with respect to the increase in taxes.

This would, I think, tend to produce a sharp decline in gross national product which might even get as high as $50 or $60 billion a year, and might yield a rate of unemployment more or less in the same order of magnitude as the rate of unemployment I was just referring to in connection with the other strategy, the tax increase strategy.

Representative GRIFFITHS. I think you can tell from the questioning even of this committee that if you tried the second route you would have those people who would want to point out that the decline must be made here, you can cut here safely, some would say cut out all foreign expenditures; some would say reduce the prices that are paid on defense items. So that in this you would get into some questions once you begin that.

But the point I want to make is that we began this administration with a call for sacrifices, and when you offer a tax cut it sound like you are not asking for a sacrifice. But all you have to do is listen to us and know you are asking people to sacrifice long-held prejudices and beliefs on what taxes are for and what they do, and what expenditures are for and what they do.

Now, if you are going to switch the rules I think that the least you can do is to make more specific your statement and tell us with more exactness what will happen if you increase taxes to balance the budget or you decrease the expenditures to balance the budget.

Mr. GORDON. I think, Mrs. Griffiths, that with some thought and calculations, more precise answers could be given to this question than the one I gave off the top of my head today, but I would certainly agree that these are relevant questions.

Representative GRIFFITHS. Then, Mr. Chairman, may I ask that he supply the answers for the record?

Chairman DOUGLAS. I think that would be excellent. Without objection.

Representative GRIFFITHS. Thank you.

(The information referred to follows:)

The following estimates are the results of an aggregative analytical approach to the question of the economic effect of a tax increase or a cut in expenditures in the fiscal year 1964. They are not intended to be more than illustrative of the general orders of magnitude involved. Because of the presence of many unknown and unpredictable factors, the estimates can be no better than very rough approximations. In all cases, the changes in tax liabilities, GNP, and unemployment are measured from levels consistent with the President's 1964 budget; that is, from estimated levels which assume enactment of his tax proposals, reflecting a net revenue reduction of $2.7 billion in 1964.

Moreover, the estimates are addressed, not to the question of the desirability of achieving a balanced budget, but to the size of the tax rate increase or expenditure decrease which might be needed in present circumstances to balance the proposed 1964 budget. Indeed, one of the major objectives of the administration's tax proposals is to eliminate the deficit in a constructive way by generating the kind of increases in the level of production and income which would, in a few years, yield tax revenues sufficient to balance the budget.

To balance the fiscal year 1964 administrative budget, assuming currently estimated expenditure levels, it would be necessary to increase total tax collections by $11.9 billion over the amount estimated in the 1964 budget. Raising tax rates to achieve higher collections of this amount would, of course, reduce GNP, employment, and income. This decrease in the tax base would reduce the yield from both new and existing taxes, as compared with their yield at current income levels. Hence, the increase in tax liabilities—based on current levels of income—would have to be larger than $11.9 billion in order to achieve a net increase of that amount in actual tax collections.

Specifically, the estimates below assume (1) an increase in taxes which would have the bulk of its immediate effect on consumers' spendable income and consumption, (2) a total impact on GNP averaging during the first year 1.5 times the initial effect on consumer expenditures and rising to a higher level toward the end of the year, (3) an estimated marginal tax rate on GNP of 25 percent during the period of substantial tax increase and changing economic climate, and (4) a lag in tax collections behind the accrual of liabilities averaging 20 percent, or something less than one calendar quarter. On this basis, it is estimated that a tax increase to cut the presently estimated administrative budget deficit by $11.9 billion might involve—

An increase in tax rates in fiscal year 1964 sufficient to raise total tax liabilities, at unchanged levels of national income, by approximately $20 billion.

A decrease in GNP of some $25 billion for the year, and a decrease in the annual rate of GNP at the end of the fiscal year of roughly $40 billion.

An increase in unemployment averaging perhaps 1½ million workers for the year, with the increased unemployment reaching 2 to 2½ million by the end of the year. These numbers would be approximately equivalent to a rate of unemployment of 7½ to 8 percent of the civilian labor force for the year as a whole and to a rate of 8½ to 9½ percent by the end of the year.

Alternatively, if it were sought to reduce Government expenditures sufficiently to eliminate the estimated 1964 deficit—

The required cut in expenditures and the effect on GNP and unemployment would be about the same as for the tax increase if the expenditure reductions were all made in transfer payments such as veterans pensions and compensation) or grants to States for transfer payments (such as public assistance) to individuals.

If the required expenditure cut were all in Federal purchases of goods and services (which generate taxable income almost immediately), a larger reduction would be needed; this would reduce GNP and increase unemployment by more than the amounts previously estimated.

If either the tax increase or the expenditure reduction policy were adopted, the reduced level of GNP and employment would mean a lower tax base for fiscal 1965 and the prospect of a sizable deficit for that year.

Chairman DOUGLAS. I hope you will forgive me if I take a worm's-eye view of some of these issues.

On page 16 of the big budget, under the heading of "Expenditures under the direction of the Architect of the Capitol," I find a budget outlet of $7,530,000 for underground garages.

Now, this has been an old interest of mine, because the previous garages have been a terrific expense per car, and I dug up the previous report of the Assistant Architect of the Capitol contemplating the expenditure in 1957 prices of $42 million for approximately 1,900 cars at a cost of something over $22,000 a car.

Now, I am curious to see the garage-building game continuing, and I would like to ask if you have figures indicating the number of cars that would be sheltered and housed in this underground garage at a cost of $7,500,000.

Mr. GORDON. I am afraid, Mr. Chairman, that I cannot give you that information.

A few minutes ago the question was raised as to whether the Budget Bureau was exercising its proper review function with respect to the Defense Department and the Space Agency. We said we thought we were, but we plead innocent here with respect to estimates from the Congress and the Judiciary. The Budget Bureau does not exercise review functions.

Chairman DOUGLAS. So you merely pass on recommendations from the Architect?

Mr. GORDON. That is right.

Chairman DOUGLAS. Is my information correct that about 1,000 cars will be provided for in this garage, which would mean an average cost per car of about $8,000?

Now, I have collected statistics on underground garages all over the Nation and the cost is usually about $3,000 a car.

The average is, I think, somewhere around $2,400 a car. Somebody should ride herd on this.

You say you do not ride herd on the Architect of the Capitol, but I think this is the responsibility then for Congress, and I am glad to see that there is no mystic significance attached to the fact that you include this in the big budget. You merely reprinted something that the Architect of the Capitol requested; is that true?

Mr. GORDON. That is correct.

Mr. STAATS. That is correct.

Chairman DOUGLAS. If I may skip from a minuscule subject to overall subjects, I take it that the theory behind the tax cut is that what is called aggregate consumer demand is inadequate and is necessary to build up aggregate consumer demand.

Now, an inadequacy of consumer demand simply means to me that the sum total of price tags on goods now produced or which could be produced with idle labor and capital is in excess of the sum total of monetary purchasing power in the pockets of consumers. I think that is merely a more precise way of stating what is said to be inadequate consumer demand.

If you wish to produce equilibrium, there are two ways of dealing with this: One is to bring prices down to the level of consumer monetary purchasing power; the other is to raise consumer monetary purchasing power up to the level of prices.

Now, I am very frank to say that my own preferences would be in favor of the first method, which would call for a vigorous antitrust policy and the extension of the competitive system into various areas of life where it is not now prevalent. But I suppose you reached the conclusion this would take too long. There would be doubtful public support for it. The legal processes would be difficult, and so on. So the method which you have adopted is to pump monetary purchasing power into the economy, through the injection of additional bank credit, up to the level of prices; is that true?

Mr. GORDON. In a sense these are logical alternatives, Senator.

It does seem to me, however, that the position that the purpose can be achieved by a reduction in prices—and this, I think, is apart from the question of the merits of antitrust policy—but the question of whether this can be achieved through reduction of prices must, it seems to me, rest on what will be the effect on wage payments of price reductions.

You are assuming a compression of the margin between the two, so that the level of money income payments which are spent on consumption goods will not be unduly depressed by the policy. I would simply raise a question here as to whether experience leads us to believe that there is, in fact, much compressibility or expansibility in margins for the total economy as between wages and pieces.

I do not doubt there is some compressibility or expansibility here, but I would wonder whether there is a sufficient amount to do the job you have in mind.

Chairman DOUGLAS. What would you say to a reduction in excise taxes?

Mr. GORDON. I would think, Senator, that a reduction in excise taxes would have an economic effect not very different from the reduction in other kinds of taxes. There would be some differences.

It does seem to me, however, that given inherent limitations on the amount of tax reduction which is consistent with our present economic situation, that we are much wiser to attack this problem via the income taxes rather than the excise taxes.

Chairman DOUGLAS. With a reduction in excise taxes, of course assuming a competitive economic system which we may not have, the benefits would go immediately to consumers.

Mr. GORDON. With respect to those types of goods which are sold to consumers, that is correct.

Chairman DOUGLAS. That is right, and if the tax reduction were concentrated on durable goods, and local telephone service, for instance, that will be a direct return, and——

Mr. GORDON. I would think that this would have the effect of increasing the disposable income. I am not sure you could assume that the tax reduction would be spent on the particular service in question, but I think it would be a fair presumption that a large part of it would be spent on some goods and services.

Chairman DOUGLAS. And wouldn't it be concentrated primarily in the lower and middle income groups rather than in the upper?

Mr. GORDON. This would depend on the particular excise tax you are referring to, Senator. I can think of some excise taxes which would have very little effect on lower income groups.

Chairman DOUGLAS. Well, you could pick out those commodities which are primarily consumed by the great mass of families.

Mr. GORDON. Of course, some excise taxes, as you all know, are imposed for quite different reasons, for consumption control reasons.

Chairman DOUGLAS. I am not in favor of reducing the excise tax on spiritous liquors.

Mr. GORDON. Some people would make a similar argument on tobacco where the purpose is more complex than the raising of revenue.

Chairman DOUGLAS. No, not even that.

Mr. Curtis.

Representative CURTIS. I am very happy to have the Senator call attention to that because these are Korean excise taxes which we well might forgo extending by ignoring them.

I want to open up a new area for discussion, particularly now that the Federal income tax has taken the center stage as the villain. I want to discuss the entire picture of taxation.

We, at the Federal level, have a great tendency to think of the Federal Government as the prime mover, and forget the State and local governments. It is quite interesting that it is the Federal Government which is primarily dependent on its revenues for the profits tax, or from economic transactions that result in profits, for which are measured in profits.

The States largely rely on transaction taxes; the local governments have the best tax of all, in my judgment, which is the property tax based on economic value.

But it is the mix in our entire society that makes the difference.

I have been very interested in your presentation and the presentation of the President in his economic message, especially where you relate the percentage of State and local debt and, incidentally, private debt, to the public debt.

The thing that intrigues me—it does not intrigue me because I think I know the answer—is the use of the starting point of 1946 which, of course, was——

Mr. GORDON. 1947, Mr. Curtis.

Representative CURTIS. Well, 1947, but the President has used 1946. At any rate, it is the period right after the very heavy Federal deficit of World War II.

Mr. GORDON. That is correct.

Representative CURTIS. And, of course, we know that the Federal Government is primarily responsible since its primary responsibility is in defense.

What I think is more important, and certainly will give us the accurate picture, is to take a look at the relationship of private debt, of State and local debt, and Federal debt in years prior to that, the 1930's, the 1920's, the 1910's, and the 1900's. I might add that the same is true of expenditures, because expenditures and debt seem to run similarly. I have inserted a chart like that into the Congressional Record yesterday, on page 1102, showing that the total adjusted Government debt for 1960 was $301 billion. Of that total, $240 billion was Federal, $60 billion was State and local; 79.7 percent Federal, and 20.3 percent State and local.

Before World War II, similar to tax receipts the ratios were almost the reverse. In 1912 the total Government debt was $5.7 billion;

$1.2 billion was Federal; $4.5 billion, State and local; 21 percent Federal, and 79 percent State and local. You see, almost the reverse.

World War I reversed the percentages. In 1922 the Federal debt had gone down to 79 percent, and the State and local debts were raised to 31. By 1932 the ratio had shifted still further for State and local debt, 50 percent State and local, and 50 percent Federal. World War II brought that ratio to 94 percent Federal and only 6 percent State and local, and it is from this high point that we have been seeing this decline.

It strikes me that this is a normal and a very healthy decline. Certainly it should not be put in the context that we have had increases in local and State debt at higher expenditures. We should expect this.

This brings me back to a very key part of the budget—Federal aid to local governments. If the Federal income tax is to take more of this, and I happen to think it is because it gets right into the warp and woof of our economic system when it is a tax on profits, then we should not be relying as heavily upon it. We are making a very grave error in this Federal aid to local and State governments. This is an area where we ought to rely more heavily on the transaction tax and, certainly, the property tax.

Fortunately we are. The property tax, the unheralded hero since World War II, has not received the attention that it deserves to see how it has responded.

This is an area very few people have studied. Should we reform Federal income tax laws or examine this very question of expenditure policy of the Federal Government?

It seems to me that we ought to rely less heavily on the Federal income tax, and more heavily, as we are continuing to do, on bringing a balance back into these local areas.

This is a matter of expenditure policy, I think you will agree. You have pointed it out very nicely in the amounts of money that the Federal Government is actually spending for local matters, whether it is education, sanitation, community facilities such as courthouses, or public works.

So I think the question I should ask, and leave the record open so that you can comment at more depth on this, is what consideration has been given in the Bureau of the Budget to the use of State and local taxes in lieu of the Federal income tax to bear these costs?

Couldn't we reduce our expenditures very nicely in these areas so that we could rely more heavily upon local and State governments to provide these programs.

Mr. GORDON. Well, Mr. Curtis, this is a question that I think Secretary Dillon, who will be testifying later, will be better equipped to handle than I am.

Our side of the budget responsibility, of course, relates more heavily to the expenditure side than to the receipt side.

Representative CURTIS. That is what I am talking about. Let us take the expenditure side, these grants-in-aid programs. Traditionally these have been taken care of by property and transaction taxes.

Let me add another point. I hope this idea of putting a large portion of health costs on the back of the most regressive tax in our whole collection, the payroll tax or social security tax never takes effect. This is part of the concept of this budget.

So I think if we are going to talk in terms of the economic impact of tax systems, we must relate our expenditure policy—both present and future—to the methods of taxation. This is where I want to see more discussion.

I happen to feel, as you can tell from the way I have presented this, that our economy could be much healthier if it were based more heavily on what I would say is the economic value tax, the property tax.

Can we leave the record open because if you do have any comments to make on this, I would like to have them?

Then I want to call attention to something that to me has gone almost unnoticed.

We talk about the need to increase the amounts spent for education, and I could not agree more. The President in his campaign in 1960 said that we have to double the amount we are spending on education in the next decade. My reply was, Why does he want us to slow down? We almost tripled it in the previous decade.

I want to call your attention to the January 1963 Health, Education, and Welfare Indicators. On page 25 there is a chart of public educational construction, bond elections, bond sales, and contract awards. This is shown in total dollars, dollars of the bond issues passed, and the percentage of those that passed.

On page 27 the results of the previous bond issues, educational construction value put in place, are shown.

We had been running at a rate of over $1 billion worth of new bond issues passed, beginning in 1957, rising to the peak of $1.8 billion in 1960.

In 1961 the figure dropped by $1 billion to $854 million. This is where school construction for 1963 and 1964 is going to come. These are the bond issues passed.

The actual construction put in place is still holding up very nicely in 1961 at $3.6 billion.

It is this kind of breaking down into component parts, I think, that needs to be done to understand expenditure policy.

I might say also, looking forward to local and State expenditures, that here is an amount of $1 billion that must come from somewhere. This is a $1 billion drop in construction that is going to hit us, and I have heard no one even comment on it. Have you noticed that?

Mr. Gordon. That has not been called to my attention, Mr. Curtis, no. I didn't know that.

Representative Curtis. Well, I wanted to make this point, and if you care to comment on this area, the record will be open. This is one area I hope to fully develop in the Ways and Means discussion of tax reform.

In my judgment, this is why the Congress must examine expenditure policy. We must decide at which level to spend. Policy must not be made on the basis that one group is interested in people and the other is not. I think we all are.

The issue is not that we want more education and more health. It is a question of what tax system and what procedures we can best use to gain these ends.

Thank you.

Chairman Douglas. Senator Proxmire.

Senator PROXMIRE. I hate to get off the same trolley as Tom Curtis because I admire him. He is a wonderful fellow.

But the worst part of this budget, the worst part of this tax proposal, is that it does increase our reliance on the income tax and does it sharply and leaves the sales taxes as they are, and is going to impose a greater burden on our already overburdened State and local governments which, I think, is most unfortunate, because those State and local taxes are more regressive—there are few taxes more regressive than the property tax, and I think if we continue to cut income taxes, let other taxes remain at their same level or increase, and try to absorb these expenses, we are going to have a far more regressive system in the future than we have had in the past.

Mr. GORDON. Senator, I do not follow your statement that the enactment of this tax bill would increase the burden on State and local governments. I would have thought that the stimulus to economic expansion which enactment of the tax bill will bring, will substantially increase the tax revenue of the States, many of which are quite proportionately——

Senator PROXMIRE. I find myself often arguing against myself. But let me explain what I mean. If we hold down these aid to local government programs as Congressman Curtis so eloquently argued a minute ago, on the ground that we cannot afford it, or because we have to cut our Federal taxes, then I say that this burden has to be picked up by State and local governments that already are having a terrible time.

We can talk about tripling our educational expenditures, but these people are not voting for the school bond issues now, and if we are going to cut feeble aid programs to local governments, it means education is going to suffer and we are just closing our eyes to the grim facts of life if we adopt that policy.

Mr. GORDON. There is another extent, Senator——

Senator PROXMIRE. Also I wanted to indicate that the main thrust of my argument is that you're not lowering the taxes that Paul Douglas referred to, the excise taxes, which are sales taxes, and I think pretty regressive compared to the income tax—yet you're not touching them although, as Mr. Curtis acknowledged, these were emergency wartime taxes put on for the purposes of retarding demand, put on for the purpose of discouraging people from spending money. We are leaving them on, though, and reducing other taxes that are generally more progressive.

Mr. GORDON. Of course, some have been reduced or eliminated, the tax on transportation, for example.

Senator PROXMIRE. Only partly eliminated. It was not eliminated on airlines. It is 5 percent.

Mr. GORDON. Fifty-percent reduction in the case of airlines, but 100 percent in the case of trains and buses.

Senator PROXMIRE. Now, the telephone tax is 10 percent, the tax on watches, which is a necessity for many people, is still 10 percent.

Mr. GORDON. Correct.

Senator PROXMIRE. There is another part of this budget that I think is most unfortunate and discouraging. The whole philosophy is to rely on taxes to stimulate economy.

Senator Douglas said that it was his understanding that instead of reducing prices we were stimulating the economy by putting more purchasing power into the hands of the people through additional bank credit. I wish we could do it this way.

It seems to me this is exactly what we are not doing.

In fact, the provision you explained this morning would do exactly the reverse. What I am talking about is instead of emphasizing so much tax reduction you ought to emphasize reducing interest rates and providing an increase in the money supply.

You told us this morning that you are advocating selling capital assets, selling FNMA bonds, for example, to the public, which has exactly the same effect as the Federal Reserve Bank selling their Federal obligations, which will soak up money, which will raise interest rates, which will tend to retard the economy and have exactly the opposite effect of the tax cut which is promoted to stimulate the economy.

Mr. GORDON. May I comment on that, Senator?

Senator PROXMIRE. Yes, indeed.

Mr. GORDON. It is quite true that taking these sales of financial assets like mortgages alone, and looking at nothing else, it is quite true that the sale of a very substantial volume of mortgages would tend to tighten monetary conditions.

But I think one has to take into account that this is, in effect, substituting for the sale of an equal amount of Treasury debt.

Senator PROXMIRE. We hope so.

Mr. GORDON. If you did not sell these mortgages you would sell an equal amount of Treasury debt, so that the mortgage sales looked at in the whole spectrum of Federal financial activity would have no net effect.

Senator PROXMIRE. That is a mighty big assumption though, that depends on what Mr. Martin does, and his colleagues.

Mr. GORDON. That is correct.

Senator PROXMIRE. And Mr. Martin is notoriously independent.

Mr. GORDON. I think what I have said is true, Senator, without regard to what Mr. Martin does; basically and ultimately, of course, what happens to credit availability and interest rates is determined largely by the policies of the Federal Reserve system, in part by some of the auxiliary policies of the Treasury; and no matter what the monetary effects of particular Federal programs may be, they can be either accentuated or offset or unaffected, depending on what the general monetary climate is.

But I think if you are just looking at this one aspect of the budgetary program, the sale of a little over $1 billion in financial assets, they are simply substituting for the equal sale of Treasury bonds and, hence, taken alone they have no general monetary effect.

Now, it is quite true that the Federal Reserve policies going on at the same time might have a monetary effect upward or downward. But I think it is important to recognize that the sale of these assets in themselves would have no monetary effect.

Senator PROXMIRE. Well, if everything else is exactly the same as it would have been without this sale, it seems to me that they would have a monetary effect. You have to take compensating action, the Federal Reserve has to.

Mr. Gordon. Yes.

Senator Proxmire. On the basis of my brief experience with Mr. Martin, I do not believe they will.

Mr. Gordon. Even if the Federal Reserve made no change in this policy as a result of this action, it would still have the effect of reducing by an equal amount Treasury sales of bonds to finance the deficit.

Senator Proxmire. But the sale of these mortgages does tend to drive mortgage prices down and interest up.

Mr. Gordon. So that entirely apart from monetary policy, I think it can be said that this action is neutral.

Senator Proxmire. You see basically what I am concerned with is the philosophy that has been announced by many fine commentators and writers such as Sylvia Porter and others who are very eloquent and very bright in this area, but they enunciate a policy which seems to be the administration's, and which is most unfortunate if it is, and that is, we are going to stem inflation by raising interest rates.

If we suffer inflation because of this unbalanced budget, in other words, loose fiscal policy, and tight monetary policy; and what this means is that the tax cut is likely not to be as effective as it might otherwise be, No. 1, what it means; No. 2 is that the debtor class is hurt and hurt badly. I am talking about the farmers who get no benefit at all from the cut in income taxes as 85 percent of them pay no income taxes.

On the other hand, they are debtors, and they pay high interest rates. This is true of many other older people, retired people, and so forth. So that I think we ought to take a long, hard look at the equity implications of this program and of its apparent reliance on interest rates to stem inflation and, particularly, the alibi that is aways given—I think you might have given it this morning and that Dr. Heller gave yesterday—we ought to challenge it every time, and that is we have to do this because of the international balance of payments.

We have not had one single study before this committee that showed we have to raise interest rates because of the international balance of payments.

Every study made—Dr. Bell, for example, of Haverford, last year, and others showed that lower interest rates do not adversely affect our balance of payments; he documented it and documented it very carefully.

Furthermore, we have evidence to show that our interest rates are lower than they are in West Germany, the United Kingdom, and other areas on the short-term part of the market, which is crucial.

At any rate, although we have challenged Secretary Dillon and Mr. Martin to show us studies, they have yet to show us studies. The Roosa study showed a nonsignificant effort on balance of payments from lowering our interest rates.

Mr. Gordon. Did the Bell study to which you referred relate to both long-term and short-term rates?

Senator Proxmire. Yes, it did. It was a very comprehensive study, as I recall.

Mr. Gordon. I am sorry to say I am not familiar with it.

Senator Proxmire. Of course, its main thrust was in the short-term area which would be most pertinent. I put it in the record.

Mr. GORDON. I think it is important to point out, Senator, as you well know, the behavior of long-term interest rates in the last couple of years has been downward, if there has been any movement.

Senator PROXMIRE. Yes.

Now, Dr. Heller said that yesterday, it has been downward very slightly, an upturn right now, according to documentation that Congressman Reuss put in the record yesterday. And, furthermore, we have had a slack in our economy, and interest rates ought to be downward. We are not talking about a vigorous expanding economy. The economy has not been moving ahead.

We have unemployed facilities and unemployed people. Under these circumstances the interest rates should fall. It is still high compared to any period back to pre-World War II. It is exceedingly high.

Mr. GORDON. The area of interest rates with which I was most closely associated when I was on the Council and which, I think, are enormously important are, of course, mortgage rates. Here I think we have had a very reassuring record of a gentle but steady downward movement in lending rates on new mortgages for the last 2 years, a virtually uninterrupted decline, although a slow decline, and I think this has been stimulated and encouraged by policies that the Federal Government has pursued, designed to make credit easier for the financing of construction, particularly residential construction.

Senator PROXMIRE. It could be worse. I just wanted to indicate that I think the decline in interest (*a*) has been slight; (*b*) if you take a ratio of the money supply to the gross national product, the job money has to do, it is as tight now as it has been since the middle twenties.

It is true, even if you include time deposits, it still is not very encouraging.

Thank you, Mr. Chairman. My time is up.

Chairman DOUGLAS. Senator Javits.

Senator JAVITS. Thank you.

(The following was subsequently received for the record:)

EXECUTIVE OFFICE OF THE PRESIDENT,
BUREAU OF THE BUDGET,
Washington, D.C., January 17, 1963.

PRINCIPAL FEDERAL STATISTICAL PROGRAMS INCLUDED IN THE 1964 BUDGET

This statement describes in greater detail than was possible in Special Analysis I, "Principal Federal Statistical Programs," pages 417–420 of the 1964 budget of the U.S. Government, the subject matter content of the new projects included in the recommended programs.

The programs in the 1964 budget designed to collect statistical information for the use of the Government and the public are described in two categories: current and periodic. A summary description of the new projects included in the principal current statistical programs and the activities proposed under the periodic programs in 1964 follows.

RAYMOND T. BOWMAN,
Assistant Director for Statistical Standards.

EXECUTIVE OFFICE OF THE PRESIDENT,
BUREAU OF THE BUDGET,
Washington, D.C., January 17, 1963.

PRINCIPAL FEDERAL STATISTICAL PROGRAMS INCLUDED IN THE 1964 BUDGET

The 1964 budget recommends the expenditure of $109 million to produce statistics for the use of business, Government and the public at large, compared to an estimated expenditure of $87.7 million in the present fiscal year. Of the total amount recommended, $91.9 million is for the regular or current programs of Federal statistics, compared with an estimated $74.3 million outlay this year, a 24-percent increase. Provision for periodic statistical programs—the large-scale census type surveys usually taken once or twice a decade—amounts to $17.2 million in 1964, $3.8 million more than that available in 1963.

The objectives of the Federal statistical system are to provide accurate, comprehensive, and timely data needed for the operations of the Government, to achieve efficient utilization of Government statistical resources with minimum burden on respondents, and to furnish the public with information about the functioning of the economy and the welfare of the people.

In planning the Federal statistical program for 1964, the continuing need for prompt, reliable information was a primary consideration. In addition, greater emphasis than heretofore was placed on meeting the needs for data which cast light on the sources and character of economic expansion—growth studies—and on the problems of local areas, particularly metropolitan areas.

This emphasis in the 1964 statistical programs results not only in the maintenance of the present level of activity in growth studies as such, but also in increased support of activities which are essential to economic projections and the analysis of growth patterns: the strengthening of basic statistical data on manpower, production, distribution, capital outlays, and related activity.

The needs of metropolitan areas and other localities for more detailed statistics are recognized in recommendations to improve State and local estimates of employment and unemployment, and to initiate programs which will obtain a wide range of data for metropolitan and other local areas, including annual estimates of income by source, current estimates of population and migration, projections of future population, housing vacancy statistics, monthly retail sales estimates and data on the finances of local government units.

The statistical program for the coming fiscal year will also implement a number of the more important recommendations of the President's Committee to Appraise Employment and Unemployment Statistics, which issued its report in September 1962. Provision is made to extend and improve information not only on the levels of employment and unemployment in the Nation at large and on employment in States and local areas, but also on a wide variety of related information: employment estimates by occupation, job vacancy statistics, causes of labor force fluctuation, and more comprehensive data on hours of work. An increase of about $4.0 million is recommended for employment and unemployment statistics in fiscal 1964, about $2.6 million for the Bureau of Labor Statistics, about $1.0 million for the Bureau of Employment Security. Also included are the funds shown below, under demographic and social statistics, for the Census Bureau's methodological research which will support efforts to strengthen employment and unemployment statistics. Of the funds provided for the Labor Department, about $1.5 million will be transferred to the Census Bureau for collection and tabulation of household statistics.

The amounts recommended as obligations for current statistical programs in the coming year (compared to estimated outlays this year and actual outlays in fiscal 1962) are shown by broad subject matter areas in table 1. These amounts are shown by agency in table 2 which also shows obligations for the periodic programs, most of which are conducted by the Bureau of the Census in the Department of Commerce. The increases shown for 1964 over 1963 reflect higher costs of existing programs in 1964, resulting from pay increases, as well as the costs of the program additions or improvements. The figures do not include all current Federal statistical activity, since some cannot be separated from operating programs, but the coverage has been expanded over that of last year's special analysis to include statistical activities of the following agencies:

Bureau of Mines (Interior).
Bureau of Old-Age and Survivors Insurance (HEW).
Corps of Engineers (DOD).

Civil Aeronautics Board.
Interstate Commerce Commission.
Federal Home Loan Bank Board.
Housing and Home Finance Agency.
National Science Foundation.
Economic Research Service (Agriculture)—additional coverage of program.
Office of Education (HEW)—additional coverage of program.

A summary description of the new projects for 1964 included in the principal current statistical programs and the activities proposed under the periodic programs follows.

CURRENT PROGRAMS

LABOR STATISTICS

This area includes statistics on employment, hours, and earnings, by industry; number and characteristics of persons in the labor force, whether employed or unemployed, labor turnover, wage rates, industrial relations, industrial hazards, foreign labor conditions and productivity. Programs of the Bureau of Labor Statistics in these areas and statistical programs of the Bureau of Employment Security and the Bureau of Old-Age and Survivors Insurance are included, as well as the estimates of farm labor requirements and supply prepared by the Department of Agriculture and research on scientific manpower resources carried on by the National Science Foundation.

Manpower and employment data

A general expansion of statistical investigation in the field of manpower and employment statistics reflects in large part the impetus provided by the recommendations of the President's Committee to Appraise Employment and Unemployment Statistics. In 1964, emphasis will be placed on experimental work to sharpen labor force concepts, such as the criteria to be used in determining when a person is unemployed; studies of the factors affecting labor force participation; methods of strengthening State and area manpower estimates, improving estimates of hours and worker productivity; and planning for a new series on job vacancies.

This 1964 program to implement the Gordon Committee recommendations does not represent the full cost of the Committee's recommended program. Not all the projects have been included at full scale for the first year, less urgent projects have been postponed entirely until later years, and the methodology and cost of carrying out other recommendations can be determined only after some results have been obtained from the preliminary research and development work provided for in this budget.

Experimentation and research in concepts and methods will be carried on in part through setting up a panel of households in addition to that now used in the present current population survey. This new panel will be a representative sample of the population, capable of providing national statistics independently of the current monthly series of labor force estimates. Proposals for addition to the present labor force questionnaire will be tried out on the new panel ($1,320,000 BLS).

The coming fiscal year will also see the beginning of a long-range effort to test and improve the reliability of State and local estimates of employment and unemployment, now based only in part on current data. Data drawn from administrative records of unemployment insurance programs will be supplemented by an increasing amount of information drawn from special surveys of households and investigation of employer records. Experimental work will be conducted in at least two local labor market areas in the coming year ($700,000 BES).

The monthly estimates of employment and hours based on reports of employers to State employment security agencies and the Bureau of Labor Statistics will be strengthened over a period of 2 years. Samples of reporting employers will be enlarged for some industries, especially in the service trades, and increased emphasis will be placed on obtaining estimates of weekly hours. The employer reports on employment and hours, now available for States and more than 100 major metropolitan areas, will be extended to an additional 50 urban centers ($525,000 BLS; $230,000 BES).

Among other projects provided for in the 1964 budget are—

(*a*) Studies and analyses of reasons for persons entering or leaving the labor force ($190,000 BLS).

(*b*) Development of estimates of employment by occupation in major industries ($220,000 BLS; $30,000 BES).

(*c*) An annual survey of hours and earnings of supervisory, clerical, and other nonproduction workers in manufacturing ($175,000 BLS).

Planning for the initiation of job vacancy statistics will be undertaken. Analyses will be made of the reliability and uefulness of scattered data already available on job openings, and an investigation made to determine whether employer's records permit meaningful reporting of vacancies ($50,000 BLS; $100,000 BES).

Funds will also be provided both to the Census Bureau and the Bureau of Labor Statistics for major methodology research in different aspects of manpower statistics and in seasonal adjustment techniques.

An increase of about $400,000 for the National Science Foundation is included to permit expansion of the National Register of Scientific and Technical Personnel. In addition to providing for normal growth of the register, these funds will permit a wider coverage of engineers and social scientists, and provide current addresses for the registrants. This increase will also provide for additional scientific manpower studies, with particular emphasis on solving problems of estimating the demand for scientists of various types.

Measurement of productivity

To improve the information on productivity and on the impact of technological change on employment, it is proposed to expand the present program by (*a*) initiating studies for important industries not now covered, such as construction, trade, transportation equipment, chemicals, and machinery; (*b*) undertaking surveys of producers and users of new equipment to obtain information on the spread of new technology; and (*c*) conducting exploratory work on the relationship of average industry productivity to "best plant" productivity ($125,000 BLS).

Occupational outlook program

Research in occupational trends and outlook will be stepped up in fiscal 1964 to keep pace with the rapidly changing requirements of the economy. Since 1957 both the content of the occupational handbook and the number of inquiries about the outlook for particular occupations have increased without a corresponding increase in underlying research. The "Occupational Outlook Handbook" and related publications are depended on as the major sources of employment outlook information in schools ($85,000 BLS).

Wage statistics

Community wage surveys will be made in an additional seven urban areas and the sample coverage will be expanded in the 80 areas in which surveys are now made each year. These changes are necessitated by the increase in the number of metropolitan areas and by industrial growth and population changes. It is essential that these surveys be maintained on a sound technical basis in view of their wide use for private and governmental wage and salary adjustments, and particularly their use in the appraisal of Federal pay scales ($80,000 BLS).

Fringe benefits expenditures

Additional funds are provided for accelerating and expanding the present program for collecting data on employer expenditures for employee fringe benefits and on the composition of payroll hours—paid leave and hours at work. Fringe benefits are an increasingly important part of total compensation, and data on hours at work are needed for more refined productivity measures. Information will also be collected from private employers in connection with analyses of Federal fringe benefits ($330,000 BLS).

Technical assistance and services in labor disputes

This project involves establishment of a small staff to provide technical assistance and services to the Secretary of Labor, the Federal Mediation and Conciliation Service, public factfinding boards and special study commissions in connection with major labor disputes. These services would include the preparation of background material ($80,000 BLS).

Employee benefit plans

Analytical studies of the benefit, administrative, and financial aspects of health and insurance and pension plans will be started in the next fiscal year, utilizing particularly the file of such plans in the Office of Welfare and Pension Plans of the Department of Labor. Some studies will also be made of other types of employee benefit plans ($55,000 BLS).

DEMOGRAPHIC AND SOCIAL STATISTICS

An increase of about $3 million is recommended for demographic and social statistics, raising total obligations to $13 million for this program in fiscal 1964. Demographic statistics measure the population growth of the Nation and its political subdivisions and provide basic information on characteristics of individuals and families; included is the body of data generally referred to as "vital statistics," i.e., births, deaths, marriages, and divorces. Social statistics are concerned primarily with data on the well-being of people, their health, education, and welfare.

Principal statistical programs included here are those relating to the above activities in the Bureau of the Census, the National Center for Health Statistics, the Office of Education, the National Science Foundation, and the Bureau of Old Age and Survivors Insurance.

Much of the information in this category, particularly with respect to population statistics, comes from periodic census programs, covered later in this report.

Population statistics

Work on population statistics next year will proceed along a number of lines in the Census Bureau as follows:

(*a*) In recognition of the growing problems related to planning for cities and areas, an annual series of population estimates covering about 100 local areas in 1964 will be inaugurated by the Census Bureau, and assistance will be furnished to other localities desiring to make their own estimates. Field surveys will be used in a general effort to improve the methodology of the annual State estimates ($350,000).

(*b*) Work will go forward on projections of population growth through the year 2000 under various assumptions. These estimates are basic for economic and labor force projections and most forms of social and business planning ($105,000).

(*c*) Intensive work will be undertaken on population problems of urban areas. These will include detailed surveys and studies of causes of population movements in and among cities, patterns of family formation and growth, shifts in the characteristics of the population from day to night in central cities, etc. ($270,000).

(*d*) Methodological research dealing with methods of sampling and interviewing households, and other techniques for obtaining data will be greatly expanded, with primary emphasis on methods for improving demographic, housing, and labor force statistics ($530,000).

Health and vital statistics

An increase of approximately $500,000 is recommended for the National Center for Health Statistics, including about $200,000 for the national health survey, $200,000 for vital statistics programs, and $100,000 elsewhere, principally for electronic data processing.

The national health survey covers a wide range of health and health-related topics through interviews, physical examinations, and records of institutions providing hospital and other medical services. These data are compiled through three major activities: the health interview survey, the health examination survey, and the health records survey.

The recommended program provides for continued full-scale operation of the health interview survey including support for methodological and developmental studies.

The health examination survey program for 1964 will, for the first time, cover children aged 6 to 11. In addition, data resulting from the completed cycle of examinations for the population, aged 18 to 79, will be analyzed and published. The budget provides for development of plans and procedures for the next subsequent cycle of examinations looking toward a stabilized operation in which simultaneously there are carried out (1) analysis of data from one cycle; (2) collection of data in a second cycle; and (3) planning for a third cycle.

The health records survey in a series of new steps will provide information on the health of the institutionalized population, and especially for the aged population in places which provide nursing, personal, and residential care. Preliminary data will be assembled from records of hospital discharges.

The recommended increase for vital statistics provides for (1) support on evaluation and development of methodology and data to improve their quality, utility, and timeliness; (2) a continuation of census-related studies such as the construction of life and actuarial tables; (3) assistance to the States in improving methods of registration; (4) development of more adequate statistics on marriages and divorces; and (5) development and analysis of additional basic data relating to births and deaths utilizing followback techniques on probability samples.

The increase recommended for the other activities of the National Center includes provision for more effective operation of newly installed electronic data processing equipment and for analytical studies of trends in general and infant mortality.

Educational statistics

The Educational Statistics Division of the Office of Education is making progress in developing a more adequate system of reporting on current educational statistics. In 1964, more effective control of statistical operations will be established, the field staff working with State offices of education will be strengthened and pilot projects initiated for improving data on teachers in elementary and secondary schools, on school facilities, and on faculty in institutions of higher education. In 1964 more projections of data will be made ($300,000).

Statistics on physical and social sciences

Programs of the National Science Foundation, concerned primarily with statistics and their analysis in the social sciences and the relationship of the physical to the social sciences, would be increased by $500,000. These additional funds will permit the collection and analysis of data on the impact of scientific advances and improved technology on the national economy, studies of the effects on the economy of the dissemination of scientific information, and the development of statistical projections of selected economic sectors.

Social security statistics

A net reduction of about $300,000 in the social statistics program of the Bureau of Old-Age and Survivors Insurance for fiscal 1964 will result from the completion in 1963 of a large-scale nationwide study of the health status and social and economic characteristics of senior citizens. The decrease in this aspect of the Bureau's program offsets increases for actuarial studies and for activities included under labor statistics.

PRICES AND PRICE INDEXES

This program area includes the collection and processing of data for four major price index series. The Bureau of Labor Statistics prepares the Consumer Price Index and the Wholesale Price Index. The Statistical Reporting Service, Department of Agriculture, compiles the indexes of prices paid and of prices received by farmers. About $5.6 million is provided in the 1964 budget for current programs on the major indexes. (In addition, $1.3 million is provided under periodic programs to complete the revision of the Consumer Price Index.) Funds have also been provided to the Bureau of the Census for preparation of an index of the prices of new houses, for which data will be collected as an integral part of construction statistics program. Exploratory work will also be done by Census on indexes of costs of land for residential development.

Research being carried on by the Statistical Reporting Service on methodology and the study of data collection problems peculiar to the areas of prices paid and received by farmers is continued, as is also the price and index number research for which the Bureau of Labor Statistics received appropriations this year.

Work initiated this year on restructuring the Wholesale Price Index on an industry basis will continue. Additional funds ($112,000) are requested for the Bureau of Labor Statistics to prepare indexes of prices paid for Government-purchased goods, beginning with GSA procurement; to develop techniques for more accurately measuring changes in prices of commodities imported and exported; and to develop practical methods for obtaining more realistic wholesale prices of commodities for which the differences between quoted and actual transaction prices are significant.

PRODUCTION AND DISTRIBUTION STATISTICS

This broad area, the largest of the groups used in this classification of Federal statistics, includes the data gathering and analytical work of the Statistical Reporting Service and Economic Research Service in the Department of Agriculture on agricultural production, marketing, and distribution, and the statistical activities of the Bureau of the Census in the Department of Commerce on industrial production, distribution and service trades, foreign trade, transportation, and related topics. This presentation also includes for the first time the statistical activities pertaining to transportation in the Corps of Engineers in the Department of Defense, the Interstate Commerce Commission, and the Civil Aeronautics Board, and the mineral statistics in the Bureau of Mines in the Department of the Interior.

Statistical reporting for agriculture

Nineteen hundred and sixty-four is the fourth year in the long-range plan for improving crop and livestock estimates through the use of enumerative surveys and objective measurements of yields on a probability sample basis. Work in 11 Western States in which pilot operations are carried on in 1963 will be placed on a full scale and pilot work will be conducted in the remaining 13 States in the East. One more year will, thus, be required before the long-range plan will be in full-scale operation in all of the 48 contiguous States. An increase of $1,045,000 is included in the 1964 budget of the Statistical Reporting Service for this program.

A request for $106,000 is also included to provide for the development of new and improved systems of automatic data processing. This action is necessary to insure that the tabulations and calculations which are required for maximum utilization of the new survey data are made within the stringent time schedule which must be met for the official crop reporting board estimates and forecasts.

Agricultural economic research

Costs of expanded work in the three projects described below are partially offset by a reduction of some $200,000 in the funds used to support research and analysis in marketing economics.

Provision is made for expanding work underway in the Economic Research Service on analyzing land requirements and potential production nationally, and for selected land resource areas throughout the country. This additional research will lead to estimates of the acreage required to satisfy national requirements for various products in the future, the optimum regional distribution of particular products as related to consuming centers and productive capabilities of the land, and the acreages in each region which could be transferred to new uses. Approximately $200,000 for research is recommended for this work in order to provide a basis for more effective formulation and administration of development and conservation programs dealing with millions of acres of farmland which are surplus for crop production purposes.

The current outlook and situation reports of the Department of Agriculture, which provide appraisals of economic prospects, demand, and prices for farm products can be improved by strengthening the basic economic and statistical analysis of agricultural commodities. The commodity research which backs up these reports must take into account various alternative proposals for farm programs in terms of their impact on farm output, prices, and incomes. An additional $125,000 is allocated in the budget for expanded work in this area.

The budget also includes additional support ($185,000) for analysis of foreign agricultural production and consumption, country by country, and evaluation of the impact of foreign activities on agriculture in this country. In this research, particular emphasis will be placed on trade of the Common Market countries in farm products and the impact of changes in trading arrangements on U.S. agricultural exports.

Business statistics

This budget reflects the continuation of efforts to improve statistical information on trade, particularly at the retail level: $110,000 is requested to produce data on retail sales of all general merchandise, apparel, furniture, and appliance stores for 40 additional metropolitan areas. This represents an increase from the 20 largest areas for which such a program was initiated in the 1962 budget.

The weekly retail sales series, also initiated in 1962, on a small scale, requires improvement. This series, which provides national estimates of total retail sales with subtotals for sales of durable and nondurable goods stores, for general merchandise, apparel, and food stores and for several other major kind of business groups, is based on a fixed subsample of the larger sample included in the monthly retail trade survey. This subsample needs to be expanded in order to avoid the loss of accuracy which follows deterioration in coverage. About $85,000 is provided for this purpose.

Initiation of a new program to provide measures of the physical and dollar volume of retail inventories of large consumer durables is recommended. Initially the program aims at monthly measures of the physical volume and value of all large consumer durable items. Further development in subsequent years would be expected to show data for such separate classes of merchandise as furniture, various types of appliances, and automobiles; $105,000 is requested for this program in 1964.

Many important purposes served by retail trade data are not being met by the kind of business statistics now published because of the trend in recent years for retail establishments to sell many different and almost unrelated lines of merchandise. An amount of $50,000 is recommended to do the developmental and experimental work needed to determine how best to collect such data.

Manufacturing and industrial statistics

New work is planned in the compilation and analysis of data on industrial capacity and its utilization. Data on individual establishments available in the files of the Census Bureau can be tabulated and analyzed to provide measures of capacity or measures related to capacity, such as past peak output or physical volume indexes for individual industries or product classes. The feasibility of obtaining direct estimates of capacity from industry in conjunction with some of the regular industry surveys will also be explored; $230,000 is included in the 1964 budget for the Census Bureau to undertake this capacity statistics program. Of this amount, approximately $100,000 is needed to organize and analyze the historical data already available.

A series of monthly surveys of consumption and stocks of primary metals and other basic materials will be initiated. These data showing changes in manufacturer's inventories of basic materials will provide a sensitive measure of business conditions and a leading indicator of cyclical movements of business; $40,000 is requested for this project.

The program of the Bureau of Mines provides for a survey of water use in the mineral industries.

Foreign trade

The Bureau of the Census plans to adjust import statistics from f.o.b. (free on board) values to c.i.f. (cost, insurance, and freight) values. The resulting statistics will make our import figures comparable with those of most other countries of the world who already report their imports c.i.f. This undertaking is budgeted for $100,000.

Transportation

The Census Bureau proposes to compile a guide to sources of transportation data which will be useful to business and Government data users; $30,000 is requested for this undertaking.

A series of indexes of the volume of commodities transported by truck, water, oil pipelines, and air—transportation sectors not now covered—is to be initiated as part of the transportation statistics program of the Census Bureau; ultimately a composite index of all commodity movements reflecting the relative importance of and trends in all modes of transportation will be available. Much of the essential basic information is already collected—for example, rail carloadings are compiled by the American Association of Railroads. In the case of inland waterways, pipelines, and air transportation, data can be obtained during fiscal 1964 through arrangements with other Government agencies or carrier associations. Compilation of data for other segments of transportation such as intercity trucking not reported by the American Trucking Association will require study and exploration and $85,000 is included in the Census budget for this undertaking.

The budgets of the following agencies also provide for some strengthening of their statistical activities: Civil Aeronautics Board—a request of $85,000 to permit additional economic research and to develop and partially implement plans to improve the Board's origin and destination statistics program; Interstate Commerce Commission—a request for an additional $145,000 to enable its economic research staff to handle a greater workload and to provide an economic counsel staff to aid the Commission in its major merger and rate cases; Department of Defense, Army Corps of Engineers—a request for an increase of $65,000 to produce ton-mile statistics by type of carriage and to handle the added workload resulting from increased domestic waterborne commerce.

County business patterns

The "county business patterns" report, now compiled at intervals of 2 or 3 years, is to be prepared and published on a regular annual basis. The report provides county figures on the number of establishments in operation by kind of business, the quarterly payroll and employment during the week ending nearest the 15th of March. Regular annual publication will permit a more realistic and timely analysis of regional and local problems as they affect individual industries and overall economic activity. An additional $160,000 is provided for the Census Bureau to carry out this project.

CONSTRUCTION AND HOUSING STATISTICS

An increase of almost $3.7 million, which would more than double the size of this program, is recommended for 1964. Construction and housing statistics have not kept pace with other fields; the program proposed in this budget would permit significant gains in the improvement of existing series and in the development of new data, particularly with respect to reporting current trends in the housing market.

Provision is made for an increase of $1,400,000 in funds available to the Bureau of the Census to make essential improvements in the present housing starts and value of work-in-place series ($315,000); to initiate quarterly series on housing vacancies which will ultimately cover 35 standard metropolitan statistical areas, and to provide technical assistance to localities wishing to make their own estimates of vacancies ($675,000); to begin publication of construction price indexes for new homes and to explore the possibility of developing price indexes for residential land ($105,000).

An increase of $2,100,000 is recommended for the statistical and research activities of the Housing and Home Finance Agency. The major part of this increase, $1,400,000, is for basic and analytical data concerning housing markets and costs. It would permit extension of the current new sales housing survey to obtain data on new rental housing and on the characteristics of purchasers and renters; the initiation of a statistical program for existing housing similar to that for new housing; and the conduct of analytical studies of families in relation to housing demand and of the impact of new construction and turnover on the existing housing supply. Another $300,000 is provided to obtain data on the housing problems of special groups such as the aged and minorities. An allocation of $300,000 will permit inauguration of analytical studies in depth on urban development and community services, of which about a half would be devoted to the collection of data on the impact of relocation upon families. Finally, $100,000 of the increase is intended to be used for area economic studies including development of techniques for the establishment of metropolitan data centers and the preparation of economic base studies.

Full-year operation of the series on interest rates charged on conventional mortgages and further strengthening of the statistical program staff of the Federal Home Loan Bank Board are involved in the approximately $100,000 increase recommended for this agency.

NATIONAL INCOME AND BUSINESS FINANCIAL ACCOUNTS

About $9.5 million, an increase of $1.6 million over the amount appropriated for fiscal 1963, is recommended in 1964 for strengthening statistics relating to national income, business, and financial accounts. Increasing emphasis is being put on studies of factors affecting economic growth, on region detail, and on international trade.

This area of statistics embraces measurement and analysis of business fluctuations, estimates of national income and the gross national product, and the compilation of data on the financial structure of industry. Summary accounts of the economic activities of consumers, business, governmental units, and international transactions are prepared.

In addition to all of the activities of the Office of Business Economics, this area includes the work of the Internal Revenue Service in compiling statistics from personal and corporate income tax returns; estimates of farm income by

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the Economic Research Service in the Department of Agriculture; statistics on the financial and other operations of State and local governments compiled by the Bureau of the Census; the financial reports program conducted jointly by the Federal Trade Commission and the Securities and Exchange Commission; and other economic statistical series compiled by the Securities and Exchange Commission.

A number of the projects for which increases are being recommended in 1964 are part of a long-range program set forth in a comprehensive review of our national accounts by the National Accounts Review Committee (a committee organized by the National Bureau of Economic Research at the request of the Bureau of the Budget).

National income and business accounts

Estimates of changes in national income and output, of interindustry sales and purchases, and of U.S. balance of payments are prepared in the Office of Business Economics, Department of Commerce. This Office also provides detailed data on a monthly and quarterly basis on business trends.

The increase recommended for the work of this Office would bring up to an effective level three projects which had been initiated in fiscal 1963 and launch three additional projects in 1964. Three projects to be brought to an effective level this year are:

(*a*) Analysis of the impact of Government operations on business activity and development of a functional classification for Government spending; a study of the time lag between Federal obligations and outlays will also be made ($30,000).

(*b*) Improvements in data measuring international transactions permitting more accurate estimates of the balance of payments ($45,000).

(*c*) Development of an annual series of estimates of income for about 100 metropolitan areas, showing industrial sources of income ($40,000).

Three new projects scheduled to begin in fiscal 1964 are:

(*a*) Estimates of the distribution of personal income from the 1960 Population Census and other sources. This project is expected to provide more detail on income sources and recipients than the 1953 study based on the 1950 census ($65,000).

(*b*) A study of capital formation and use, involving (1) a study of how capital gains and losses influence business decisions and (2) estimates of the value of capital stock by types and industry and an analysis of the relation of investment to capacity and economic growth ($90,000).

(*c*) An assessment of factors influencing the demand for consumer goods and services ($90,000).

State and local government accounts

(*a*) The Census Bureau will strengthen its program of assistance to and cooperation with State and local governments with the objective of achieving better and more uniform Government statistics. The possibility of a cooperative inservice training in the Federal Government for statistical personnel of State and local governments will be explored ($86,000).

(*b*) Annual data will be collected by the Census Bureau for 122 of the largest metropolitan areas covering local government employment and finances for each area and its component counties. Thus far such data have been available only at 5-year intervals from the census of governments. Annual surveys will provide information needed for the study of government operations, and will make possible comparisons from year to year and from area to area ($165,000).

(*c*) An annual directory of the more than 90,000 local governments will be initiated. Information on local government units is now collected only once in 5 years as a part of the census of governments. The number of school districts has been declining by an average of 3,000 each year, while several hundred new municipalities and special districts have been established. A current directory will be of use to both business and government, and will facilitate taking the quinquennial census of governments ($65,000).

National inventory of wealth

An exploratory and testing program will be undertaken by the Bureau of the Census looking toward a census or national inventory of wealth. A census of wealth would provide, for the first time in our history, comprehensive benchmark data on the types, uses, and age distribution of structures and equipment, as well as characteristics of other tangible and intangible items of wealth. The amount of $60,000 is recommended to cover the first phase of planning.

Financial accounts

Increased funds for the statistical program of the Internal Revenue Service are being recommended to handle (*a*) an increasing load of tax returns, (*b*) changes in tax laws and regulations, (*c*) the need for better and more detailed income statistics, and (*d*) increased technical service furnished by the IRS statistics staff to other groups and agencies. The enlarged flow of data will not only assist the Secretary of the Treasury in the effective administration of the tax laws, but will make an important contribution to financial and income statistics ($480,000).

A study will be made by the Census Bureau of methods by which quarterly balance-sheet and income statistics can be developed for nonmanufacturing industries, particularly retail trade, wholesale trade, and the service industries. $60,000 is recommended for this study.

The Securities and Exchange Commission will initiate statistics on the financial position of broker-dealers and make other improvements in statistics on the securities markets ($38,000).

Economic growth studies

Interagency studies of economic growth initiated in 1963 will continue. A major objective of the studies is to provide projections of the national economy under alternative assumptions to determine the key variables in economic growth. Studies of consumer and investment demand and capital formation are included.

About $500,000 is included in the 1964 budget for growth statistics (the same as in fiscal 1963). Use of this amount will be as follows: approximately two-fifths for the Bureau of Labor Statistics, two-fifths for the Office of Business Economics, and one-fifth for other agencies.

Periodic Programs

The periodic statistical programs for 1964 include provision for the major censuses scheduled by law at 5- or 10-year intervals, and the revision of the Consumer Price Index. Funds are also included for preparatory work on the national housing inventory to be conducted the following year and for the second year of the 2-year program to modernize the automatic data processing equipment in the Census Bureau.

Census of governments, 1962

The sum of $0.4 million is requested to complete the tabulation and publication of data obtained from some 90,000 local governments. The census of governments covers four broad subjects: Governmental organization, public employment, taxable property values, and governmental finances (revenue, expenditures, debt, and financial assets). The total cost of this census, over a 4-year period, is estimated at $2.6 million. Emphasis is being given in the publication program to the presentation of more data on all subjects for metropolitan areas.

Economic censuses, 1963

These censuses cover business, manufactures and mineral industries, and transportation. Preparatory work for them was started in 1962. The total cost is estimated at $19.6 million, of which $8.6 million is provided for 1964.

For the census of business approximately 70 different report forms, tailored to the 412 different kinds of businesses, will be mailed to nearly 2½ million establishments engaged in the retail, wholesale, and service trades. Sample surveys will be designed to obtain supplementary information on capital expenditure, retail credit, value added, and other items not requiring reports from all establishments in the various trades. Completed reports will be received and the initial editing and electronic computer processing will begin. The main part of the work of tabulations and preparation of data for publication will be done in fiscal 1965.

The census of manufactures covers some 300,000 manufacturing plants in 430 separate manufacturing industries; the census of mineral industries involves obtaining reports from 35,000 establishments in 55 individual mineral industries. The work schedule for these censuses is similar to that in the business censuses, i.e., printing and mailing of report forms, followup of completed reports, editing, coding, and preparation for computer processing.

The census of transportation consists of four major segments: (*a*) A commodity transportation survey will provide data on the transportation and geographic distribution of products by manufacturers, showing the means of transport, origin, destination, type of commodity and weight of shipments; (*b*) a national travel survey will collect data on selected factors of passenger transportation of major significance in local or urban transportation, as well as information on the volume and nature of trips beyond the local area; (*c*) a survey to obtain data on the inventory and use of private and for-hire trucks; and (*d*) a bus and truck carrier survey will obtain data for those carriers not subject to the economic regulations of the Interstate Commerce Commission. The census of transportation, as required by the census law, is designed to provide information which is not compiled and published by regulatory agencies and will thus provide for the first time data not otherwise available.

Census of agriculture, 1964

This is the second year for which funds are budgeted for work in connection with the census of agriculture to be taken in the fall of 1964. In addition to the usual work on preparing forms, training materials, administrative controls, and pretesting plans call for a sample survey to be conducted in the fall of 1963 covering certain items of information not required for small area tabulations and not necessary or feasible to be included in the full-scale enumeration.

Nineteenth decennial census

Funds for 1964 in the amount of $700,000 are requested to do research and field testing of procedures intended to permit effective use of a list of household addresses in the conduct of the 1970 census of population. This project, to be carried on during the next 2 years, will test the feasibility of a plan to use a list of households, initially available from the 1960 census and maintained on a current basis, as a principal means of distributing questionnaires to be used in the 1970 census. If feasible, the use of mailing lists and related procedures will reduce the cost and improve the quality and timing of the 19th decennial census.

National housing inventory

The national housing inventory to be taken in fiscal 1965 will require preparatory work in 1964. This inventory will provide data on the number, size, quality, and characteristics of the Nation's housing, and of the housing in 25 standard metropolitan statistical areas. During fiscal 1964, planning activities, for which $210,000 is recommended, will be concentrated on the development and field testing of enumeration schedules and procedures, sample design, and development of processing methods.

Modernization of computing equipment

The sum of $4.6 million is provided to complete the 2-year program for which funds were initially appropriated in 1963 for the Bureau of the Census to modernize its electronic computing facilities. During 1964 an additional large-scale computer and necessary peripheral equipment will be installed and the training of personnel and the conversion of procedures necessary for the use of the new computers will be completed.

Revision of Consumer Price Index

This budget provides $1.3 million as the final installment on the 5-year program for the revision of the Consumer Price Index. Work on test indexes will be carried on until compilation and publication of the Index on the revised basis begins in January 1964.

In addition to providing the revised weights necessary for the CPI, the information collected in the survey of consumer expenditures will be tabulated and published so as to permit detailed analysis of the patterns of consumer spending in relation to incomes, occupations, sizes of families, and other family characteristics.

The funds requested for fiscal 1964 include $300,000 for conducting consumer expenditure surveys in 6 additional areas which, with the areas already surveyed, will provide the weights necessary to publish price indexes for all 22 standard metropolitan statistical areas with 1960 population over a million persons.

TABLE 1.—*Direct obligations for principal current statistical programs, by broad subject areas*

[In millions of dollars]

Program	1962 actual	1963 estimate	1964 estimate
Labor statistics (Departments of Agriculture, HEW, Interior, and Labor; National Science Foundation)	16.6	18.6	23.9
Demographic and social statistics (Departments of Agriculture, Commerce, and HEW; National Science Foundation)	8.1	9.9	13.0
Prices and price indexes (Departments of Agriculture and Labor)	4.4	5.2	5.6
Production and distribution statistics (Departments of Agriculture, Commerce, Defense, and Interior; Civil Aeronautics Board; Interstate Commerce Commission)	26.7	30.0	33.5
Construction and housing statistics (Department of Commerce; Federal Home Loan Bank Board; Housing and Home Finance Agency)	2.3	2.7	6.4
National income and business financial accounts (Departments of Agriculture, Commerce, and Treasury; Securities and Exchange Commission, Federal Trade Commission)	6.4	7.9	9.5
Total, principal current programs	64.4	74.3	91.9

NOTE.—Detail will not necessarily add to totals because of rounding.

TABLE 2.—*Direct obligations for principal statistical programs, by agency*

[In millions of dollars]

Agency	1962 actual	1963 estimate	1964 estimate
CURRENT PROGRAMS			
Department of Agriculture:			
Economic Research Service	9.1	9.5	10.4
Statistical Reporting Service	8.7	10.0	11.6
Department of Commerce:			
Bureau of the Census	10.7	12.8	17.3
Office of Business Economics	1.6	1.9	2.4
Department of Defense: Army Corps of Engineers: Waterborne commerce statistics	.9	.9	1.0
Department of Health, Education, and Welfare:			
Bureau of Old-Age and Survivors Insurance: Statistical activities	2.8	3.4	3.3
Office of Education: Educational statistics	1.1	1.3	1.8
Public Health Service: National health statistics	4.5	5.2	5.9
Department of the Interior: Bureau of Mines: Mineral statistics	2.0	2.2	2.3
Department of Labor:			
Bureau of Employment Security: Statistical activities	1.5	1.7	2.6
Bureau of Labor Statistics	12.7	14.6	18.7
Treasury Department: Internal Revenue Service: Statistical reporting	3.4	4.4	4.9
Civil Aeronautics Board: Statistics and research	.4	.5	.5
Federal Home Loan Bank Board: Statistical reporting	.4	.5	.7
Federal Trade Commission: Financial reports	.3	.3	.3
Housing and Home Finance Agency: Urban studies and housing research	.4	.4	2.5
Interstate Commerce Commission: Transport economics and statistics	1.3	1.4	1.5
National Science Foundation: Statistics and research	2.3	3.0	3.9
Securities and Exchange Commission: Operational and business statistics	.3	.3	.3
Total, current programs	64.4	74.3	91.9
PERIODIC PROGRAMS			
Department of Commerce: Bureau of the Census:			
1958 economic censuses	0.2		
18th Decennial Census	6.7	2.8	
1962 Census of Governments	.9	1.3	.4
1963 economic censuses	1.0	3.1	8.6
1964 Census of Agriculture		.7	1.3
Modernization of computing equipment		4.0	4.6
Preparation for 19th Decennial Census			.7
National housing inventory			.2
Department of Labor: Bureau of Labor Statistics: Revision of Consumer Price Index	2.1	1.5	1.3
Total, periodic programs	10.9	13.4	17.2
Total, principal statistical programs	75.3	87.7	109.1

Chairman DOUGLAS. Unless someone else has a question which they feel they must ask, we thank Mr. Gordon and his associates. We appreciate your coming. Your testimony was excellent and I enjoyed the questioning.

We will meet this afternoon at 2 o'clock when Secretary Freeman will be the witness.

(Whereupon, at 12:30 p.m., the committee adjourned to reconvene at 2 p.m. this same day.)

AFTERNOON SESSION

Chairman DOUGLAS. We are very happy to have you, Secretary Freeman. We appreciate your coming.

I see that you have a very brief statement, so will you start in, please?

STATEMENT OF HON. ORVILLE L. FREEMAN, SECRETARY, U.S. DEPARTMENT OF AGRICULTURE

Secretary FREEMAN. If I may, sir. Thank you, Mr. Chairman.

Mr. Chairman and members of the Joint Economic Committee, the situation in American agriculture—the progress we have made in the past 2 years as well as our need to consolidate and extend that advance—calls for full support of the principles and policies expressed in the Economic Report of the President.

I should like to summarize the significance of the President's report as it relates to agriculture under four headings.

I. The improvement of the past 2 years in farm income, and the effect of this rising farm income on nonfarm employment and sales.

II. The potential effect on farmers of the tax reduction proposed by the President.

III. The significance for agriculture of other measures proposed by the President to promote faster growth, especially measures for education and manpower development.

IV. The overall importance to agriculture of full employment and accelerated economic growth.

In addition, I should like to call to your attention the emphasis given by the Council of Economic Advisers, in its annual report to the President, of the importance of the role of agriculture in our international trade position.

Improved farm income: The past 2 years have seen a meaningful increase in farm income. Net farm income in 1962 was a billion dollars more than in 1960. Even of more personal interest to each farmer was the average increase in net income per farm of about $450.

This figure, incidentally, is a national average and would be subject to local differences which might be the product of special local conditions.

This is a significant average increase of nearly 15 percent, raising the average income of $3,075 per farm in 1960 to an average of $3,525 in 1962.

This trend is encouraging. The need for further improvement is highlighted by the fact that average per capita farm income is still under 60 percent of the average nonfarm income.

More prosperity on the farm very quickly is translated into greater prosperity in our towns and cities.

This fact is sometimes overlooked and I think can be and should be properly emphasized.

Between 1960 and 1962 gross farm income increased over $2½ billion. This has had a pervasive stimulating effect on the economy, and particularly in the smaller rural communities that are closely associated with agriculture. The increased flow of income to farmers in the 2-year period generated roughly 200,000 additional jobs, ranging from the rural trading centers to the large industrial centers such as those where much of the farm machinery industry is concentrated. USDA is now studying the effect on Main Street of increases in farm income. Some preliminary estimates of this study now underway are presented here.

Increased farm income brings more jobs in industry; for example, the increase in farm purchasing power was translated into increased sales of farm machinery. Between 1960 and 1961, the value of tractor shipments for domestic use rose 23 percent. The domestic shipments of other farm machines and equipment increased only slightly in 1961. But in the first 9 months of 1962, the value of shipments both of tractors and of other farm machinery ran some 8 percent above the same period in 1961.

This increased activity in farm machinery, flowing out of the enlarged farm purchasing power, showed up in increased employment and a sharp reduction in unemployment in the important farm machinery industrial centers.

In Peoria, Ill., the unemployment rate dropped from 5.6 percent in September 1960 to 3.4 percent in September 1962.

In Rockford, Ill., the rate dropped from 4.6 percent in September 1960 to 3.7 percent 2 years later.

In the Davenport-Rock Island-Moline area, the unemployment rate dropped from 4.6 to 2.9 percent.

In Racine, Wis., unemployment in September 1960 was 4.9 percent of the work force. In September 1962 it was down to 4.1 percent.

Chairman DOUGLAS. Mr. Secretary, I notice that you forecast very accurately which members of the committee would be here this afternoon.

Secretary FREEMAN. Thank you, Mr. Chairman. This is one of the main efforts of any Cabinet officer.

Representative GRIFFITHS. Mr. Chairman, may I say something?

Chairman DOUGLAS. Mrs. Griffiths.

Representative GRIFFITHS. I would like to point out that Rockford, Ill., is going to take some business away from Detroit. Under the circumstances he has presented here, I do not think it is necessary for them to get it.

Secretary FREEMAN. Mr. Chairman, may I please not get involved in that?

These recent rates of unemployment in farm machinery centers are significantly below the rate for the Nation as a whole and are generally at levels associated with full employment.

The events in the farm machinery industry are clear illustrations of the beneficial effects of the increase in farm income on employment opportunities in industrial centers substantially removed from the farm production line.

Increased farm income invigorates the small town: The attached table shows the increase in farmers' expenditures between 1960 and 1962 for some important categories of goods and services used in farm production and in farm family living.

According to a survey of farmers' expenditures made some years ago, most of farmer purchases of these items are made in small towns and cities. Based on that survey, it is estimated that more than $1.1 billion of the increased farm income between 1960 and 1962 was spent in towns with populations of less than 5,000 and more than $1.5 billion in places of less than 30,000 people. These figures are probably low since no information is available on the distribution of certain categories of expenditures.

It is evident that the increased expenditures by farmers for the wide variety of things they buy has been directly of benefit to the merchants of Main Street whether they deal in tractors, automobiles, feed, fertilizer, building materials, food, clothing, gas and oil, and so forth. This development has invigorated the small merchant and the rural community which were subjected to increasing economic pressures during the 1950's essentially as a result of declining farm income.

There is other evidence of an improved situation in rural communities stemming from the increase in farm income. In 618 selected agricultural counties, total deposits in insured commercial banks on December 31, 1961, rose $408 million, or 6 percent, from a year earlier.

In these selected agricultural counties, there was $7.2 billion on deposit December 31, 1961, in insured commercial banks.

Also, in trading centers under 15,000 in population, deposits in insured commercial banks on December 31, 1961, was $37.4 billion, $2.2 billion, or 6 percent higher than on December 31, 1960. Thus, local funds have been built up to provide the means for increasing investment and more rapid economic growth in rural areas.

I have some specific county illustrations, where the close relationship between farmers and Main Street is illustrated by the following developments which occurred in 1961 as compared with 1960 in selected farm-oriented counties in different types of farming areas distributed around the Nation.

I won't burden you to read those to you. Suffice it to say they are widely distributed and they show a repeating relationship between increased cash income on various kinds of farm enterprises and county retail sales.

Conversely, the relationship works the other way. Where there has been a decline in farm income, there has been a decline in trade. On top of page 6 there are some examples, where a decline in farm income for a number of reasons, primarily weather, drought, has resulted in fewer sales on Main Street.

This study, I hasten to add, is not completed, but it is one we are going to try to complete and keep up to date, because if I might repeat, I think the very significant relationship between agriculture and other employment and economic activity, with labor and people working in the shops, and with small merchants and the dollars that flow through their tills, is very often overlooked. Agriculture has a very strong and persuasive effect on the Nations economic well-being.

No. II, the effect of tax reduction on farmers: The most immediate impact of tax reduction on agriculture is the cut in tax payments. Farm people now pay about $1⅓ billion in Federal income taxes.

Most of this comes from taxpayers in the lower brackets. We estimate that the 3-year reduction in tax rates will reduce the tax liability of farm people by $250 to $300 million, or about 20 percent, with a corresponding increase in the amount of income, after taxes, that farmers have at their disposal.

Besides providing some relief from the continuing cost-price squeeze, this tax saving will enable farmers to increase their purchases of farm machinery, equipment, and other industrial products. It will also enable them to increase their purchase of consumer goods so as to enjoy a higher level of living.

Capital gains: Reduction of the rates on capital gains will be of significant benefit to farmers. Over the years, a large part of the total profit in farming has taken the form of capital appreciation in land.

A man who bought a farm in 1940, for example, and sold it in 1962, would realize a very substantial capital gain. Reports of the Internal Revenue Service indicate that roughly 100,000 returns filed in 1959 showed capital gain or loss from sale of farmland.

Tax benefits to the aged: Almost 10 percent of the rural farm population—about 1.3 million persons—are 65 years old or older. Another 1.3 million will reach that age within 10 years.

The proposed changes in the tax treatment of older people thus is of direct concern to these farm people.

Under existing law a taxpayer can take an additional $600 exemption. The proposed change would eliminate the additional $600 deduction and replace it with a $300 credit against taxes otherwise owing. Nearly all farm taxpayers over 65 will realize a tax saving from the substitution of a $300 tax credit for the $600 extra exemption. Many will be exempt altogether.

Averaging of income: Returns from farming in many areas of the country vary greatly from year to year, depending on the vagaries of the weather, changes in farm prices, and other factors. For example, a typical Winter wheat farmer in the Southern Plains had a net income in 1957 which was three times his net income in 1956.

Farmers in these areas must therefore depend on their earnings in good years to carry them through the bad years. Present revenue laws discriminate against individuals whose incomes fluctuate in this fashion. A proposal for averaging incomes over a period of years, which the President has indicated will be submitted, would relieve many farmers of this tax penalty.

Depreciation reforms: while not part of the President's 1963 tax proposals, the depreciation reforms put into effect last year have been of notable benefit to farm taxpayers. According to Treasury Department estimates, the annual tax saving to farmers from liberalized depreciation rules approximates $90 million.

Education and manpower development: interdependence in the American economy is such that all measures designed to promote faster growth in general will be reflected, in the long run, by advantages to agriculture. But two proposals in the President's Economic Report are of especial significance.

Improving educational opportunities by measures to insure a more adequate flow of resources into education are of particular concern to rural areas. In much of rural America there is great need for greater educational opportunity, for both children and adults.

The proportionate number of people needed in farming is steadily declining. Underemployment prevails in our depressed rural areas. Technical and vocational training is needed to provide nonfarm opportunities for many who cannot find opportunity in agriculture to earn an adequate living.

The President's recommendation of a Youth Employment Opportunities Act, to develop the potential of untrained and inexperienced youth and to provide useful work experience is one in which we are also especially concerned. Farm youth, as well as young people in the cities, will gain from increased opportunities to qualify for and to find constructive employment.

I might add, there is almost unlimited opportunity for constructive and sensible investment in the Nation's forests, of which 186 million acres are within the jurisdiction of the Department of Agriculture, and a lot of which we would like to get to work on.

Probably the most significant benefit to agriculture is that flowing from the general economic stimulation this tax reduction will produce. Each year a large number of farm people, many of them youths just entering the labor market, go into nonfarm occupations.

The nonfarm-economy benefits from this influx of trained and productive workers, agriculture benefits from reduction in underemployment and unemployment in that sector, and all workers, farm and nonfarm, benefit in being able to earn more satisfactory income.

A lagging economy, with large-scale unemployment, can make only limited use of the workers an increasingly efficient and productive agricultural sector is making available. By stimulating economic activity throughout the country, this tax reduction can open up jobs for farm youth, aid in the development and revitalization of the local economy of rural areas, and enlarge part-time employment opportunities off the farm.

Agriculture and international trade: I would like to call your attention to the recognition given to the role of agriculture in international trade by the Council of Economic Advisers, particularly in chapter 4 of its report. USDA's program to promote the export of agricultural products and commodities is noted. Support is given to the position this Nation has taken to try to keep open the market for our farm products in the EEC. Its importance is indicated by this paragraph from the CEA report.

How the community implements its common agricultural policy will determine, more than anything else, how the nations of the free world develop their agricultural policies—whether these policies are internationally or nationally oriented, whether they promote efficient production and competitive trade or lead to protected national and regional markets in which resources are used inefficiently. The community's agricultural policy will also affect the entire course of free world commercial policy. Industrial and agricultural trade are closely interrelated and it would be difficult and shortsighted to try to maintain highly protective barriers in one and free competition in the other.

(The unread portion of the statement of Secretary Freeman is as follows:)

SPECIFIC COUNTY ILLUSTRATIONS

The close relationship between farmers and Main Street is illustrated by the following developments which occurred in 1961 as compared with 1960 in selected farm-oriented counties in different types of farming areas distributed around the Nation.

Cash farm income on representative dairy farms in Sullivan County, N.Y., increased 2 percent in 1961 over 1960; retail sales in that county over the same period increased 1 percent.

On typical dairy and hog farms in Dodge County, Minn., cash income was up 6 percent; county retail sales up 3 percent.

Cash income on typical egg farms in Cumberland County, N.J., was up 1 percent from 1960 to 1961; county retail sales moved fractionally higher.

In Desha County, Ark., cash income on typical cotton farms rose 15 percent; retail sales were up 2 percent in the county.

Cash income on typical sheep and cattle ranches in Greenlee County, Ariz., was up 16 percent in 1961 over 1960; retail sales were 13 percent higher.

On representative cattle ranches in Johnson County, Wyo., cash income rose 38 percent; retail sales rose 2 percent in that county.

Cash income on representative hog fattening and beef raising farms in Linn County, Mo., was up 11 percent; retail sales in the county were up 2 percent.

On typical hog and dairy farms in Clayton County, Iowa, cash income rose 14 percent; county retail sales were about 2 percent higher.

Cash income on typical cash grain farms in Jasper County, Ill., rose 8 percent; retail sales were up 4 percent in that county.

On representative tobacco farms in Jones County, N.C., cash income increased 5 percent; retail sales went up 3 percent.

In Early County, Ga., on typical peanut and cotton farms, cash income went up 11 percent; retail sales in the area rose 3 percent.

But the relationship also works the other way. That is, a decline in farm income diminishes trade.

On typical wheat and small grain and livestock farms in Bottineau County, N. Dak., cash income dropped 49 percent due to drought conditions; retail sales in the county declined 4 percent from 1960 to 1961.

Cash income on typical wheat and corn and livestock farms in Dickey County, N. Dak., was down 5 percent; county retail sales were also down 5 percent.

In Lincoln County, Wash., on typical wheat and fallow farms, cash income was down 2 percent; retail sales in the county dropped about 5 percent.

In the Winter wheat area, cash income on typical farms in Rawlins County, Kans., dropped 3 percent; retail sales in the county were down 2 percent from 1960 to 1961.

How and where farmers spent their additional income in 1962 (increases of expenditures by farmers, by item and by size of place where purchases were made)

[In millions of dollars]

Expense item	Total increase 1960-62	Estimated expenditures in towns with population of—		
		Under 5,000	5,000-29,999	30,000 and over
Feed	438	337	88	13
Tractors	131	86	34	11
Automobiles	185	98	57	30
Fertilizer, lime, and pesticides	63	47	13	3
New construction	133	96	31	6
Repair and operation of buildings	152	109	35	8
Food	330	234	75	21
Clothing	160	67	56	37
Household furnishings	95	55	29	11
Subtotal	1,687	1,129	418	140
Other and savings	892			
Total	2,579			

Chairman DOUGLAS. Thank you, Mr. Freeman. I want to commend you for coming without a bevy of assistants and associates at your elbow and being willing to face this committee, simply equipped with your knowledge and information.

I am going to ask Congressman Reuss to begin the questioning.

Representative REUSS. Thank you, Mr. Chairman.

Mr. Secretary, I want to congratulate you on the forthright and aggressive job you have been doing in connection with the last point you mentioned, maintaining and trying to expand our agricultural exports.

You have said many times, in Brussels and other places, in the last year and a half, how vital this is, and I think your performance before various international bodies could well be a model for other representatives of the United States, even though so far, as who knows better than you, you have not——

Secretary FREEMAN. Moved mountains.

Representative REUSS. You have not been able to bring back the bacon.

I would like to ask you this: Under Secretary Murphy testified before a subcommittee of the Joint Economic Committee in December, last month, on just this question—the impact of the proposed Common Market variable levies on our U.S. exports. His testimony was to the effect that the ultimate imposition of those levies in their most exclusionary form, particularly if the Common Market were expanded, could have an almost catastrophic impact on our farm exports. A figure as large as half a billion dollars a year was mentioned as a possible loss in our present export level.

Is that substantially your estimate of the magnitude of the problem?

Secretary FREEMAN. If you combine the fees with the establishment of a high internal price structure, which would encourage additional production, it would have exactly that effect.

Representative REUSS. And much of the production, as the Economic Report points out, would be not only close to disastrous for this country's agricultural picture and balance-of-payments situation. In the long run, it would be bad for the very countries that were attempting it, because it would divert workers from doing that which they can do most productively to doing that which they do relatively inefficiently.

Isn't that an additional point?

Secretary FREEMAN. Yes, sir; I certainly think it is. In a number of the countries where the agriculture is based on small and generally inefficient units, and where they face at the same time a literal labor shortage and are actively recruiting labor from outside countries, it seems to be economically unsound to continue this kind of relationship and to exclude more efficient agricultural production which could come in at a lower cost.

Representative REUSS. Let me ask you this question. Fortunately, you are a lawyer, and since this question is——

Secretary FREEMAN. Did you say "fortunately"?

Representative REUSS. Since this question is somewhat legalistic, the Common Market was allowed to be set up under a section of the General Agreement on Tariffs and Trade which says that a customs union or free trade area is permissible when, and only when, its tariffs and other arrangements after the union has been set up are no more restrictive than was the situation beforehand.

Secretary FREEMAN. Right.

Representative REUSS. That is article 24 of GATT.

Now, in fact, if the Common Market starts reducing agricultural imports from the rest of the world, including the United States, in any way so as to disadvantage this country or any other signatory country in GATT, below the 1957 level when the Common Market was set up, this constitutes a violation of the GATT agreement itself, does it not?

Secretary FREEMAN. I think it does; yes.

Representative REUSS. I am glad to hear you say that, because that is the way I read the agreement, too.

So far, you have not actually tried to press that point.

You have sort of thrown yourself on the mercy of the Common Market members.

Secretary FREEMAN. That is not, Congressman, completely accurate. As a matter of fact, one of the reasons why the President insisted, before the 24–6 agreements were signed, that there should be a standby agreement, which we have, which Mr. Murphy went to Europe to negotiate before that was closed which provides that our rights in the variable fee items as of September 1960 are continued, and those entitlements remain.

Now as you know, the question of comparing compensation and rights under GATT rules is an extraordinarily complicated affair and there will be quite a problem of trying to define precisely what they are.

We have tried initially to impress upon the Commission and the Six as a whole that, first, in the case of poultry, their fees should be kept to a reasonable minimum; second, to urge that the application of the gate prices they have applied is, we think, illegal under GATT rules as well, and to urge a moderation in the application of these fees where poultry is concerned, and a number of things have been done, and some little things have been accomplished.

Where the grains are concerned, we have felt that our first target ought to be to try to urge upon them the establishment of a reasonable common internal price. This is vital because an arbitrarily high price will obviously encourage more production. These have been our initial points for pressing reasonable action on them.

We have also, at all times, reserved our legal rights. They don't necessarily agree as to the extent of those rights and this may very well be a matter of actual litigation, as we plan our course of action in the days immediately ahead.

Representative REUSS. I am delighted to hear you say that, not that I want to suborn litigation, but I think it should be recognized that here we are talking about a matter of legal rights. We are something more than just a suppliant at the mercy of our bargaining partners.

One more question on this whole matter of agricultural exports, again, a very general question, I am afraid. By and large, recognizing the differences that prevail between various commodities and having determined that we must see to it that the farm community of this country is not too far disadvantaged with respect to the rest of the community, we would do better, in our exports, would we not, by a farm program which supplements farmers' incomes by production payments direct to the farmer rather than by a system of high price supports, or price supports of any sort?

I realize that this isn't an either-or question, but do the best you can with it.

Secretary FREEMAN. I would rather respond to that question more in terms of particular commodities, I think, and might I preface my answer by saying I would like the record here to show, and I think the committee is aware of this fact, that in terms of its agriculture, we are a free-trade nation as compared to most nations of the world.

The restrictions on agricultural imports that we have are nominal as compared to most nations.

There are only a very few commodities where we have other than fairly low tariffs and those are ones where we do have price supports which necessitate some kind of internal protections, or we would be flooded from outside. As I say, most countries have many more protections and many more restrictions than we do.

Representative REUSS. If I may interrupt you at this point, Mr. Secretary, Would you furnish for the record at this point a summary of the U.S. restrictions on agricultural products compared with that of other leading agricultural countries?

Secretary FREEMAN. I would be very pleased to, because this is a point that is not generally recognized and it has been thought that we were highly protective by many people who are generally well informed in the economical realm, and now as we are seeking to negotiate with some other countries, it becomes important that this is understood. It is always, of course, important.

I would also like to make the point that what we are talking about in terms of our markets are two things:

First, our ability to compete in other markets on a price basis, where generally we can compete very well. This is not true of every commodity. Then, there, in the Common Market, we are not talking about price at all, we are talking about access to market, because the items we are having difficulty with in the Common Market are the items they produce themselves. In this instance, their internal prices are higher than ours. If we had access to that market on a competitive basis, why, we would be in clover.

Now to come to your other question, I would say: Yes; this recognizes some of the very practical problems of putting into effect a production payment program and we now see in our Federal grain program where there are other payments and where there has been, nor have we a need to have any export subsidy program under this arrangement.

We on the other hand, to take wheat for a moment, do have. But under the proposed program, the program called for in the wheat referendum, we would be moving toward a world price through, in this case, a two-price system.

Actually, the purpose of all farm programs is to bring about a fair balance between supply and demand so the farmer will get a fair price in the marketplace, not to give him any subsidy as such, but to give him some tools with which he can work as do other segments of our economy, so that he can balance out his supply in relation to demand, because there is a more inelastic demand for agricultural products than almost anything else.

If you wish, while you can have 10 houses and 10 cars and 10 lake places and 10 motorboats, but if you eat 10 meals a day, you are not long for this world.

So there is a very real difference. Therefore, when we seek to establish this balance and do it through only the medium of a price support without any adjustment mechanism by way of production, this is where we then find the Government taking on substantial stocks of commodities, because we have not accomplished the real purpose, which is to bring about an effective balance between supply and demand, which generally is done by other prime suppliers in our free enterprise economy.

Representative REUSS. Thank you, Mr. Chairman.

(The following was later received for the record:)

DEPARTMENT OF AGRICULTURE,
OFFICE OF THE SECRETARY,
Washington, February 4, 1963.

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

DEAR SENATOR DOUGLAS: Enclosed is the material which I promised to furnish in response to a question by Representative Henry S. Reuss at the hearing on January 29, 1963. It shows a comparison of U.S. import restrictions on agricultural products and those maintained by certain foreign countries. We have limited the comparison to the restrictions maintained by the EEC since it is the policies of the EEC that are currently causing us the most serious concern. This Department is preparing a more complete summary which will be ready at the end of next week and which I will be glad to send you at that time.

Our sales of agricultural products to the EEC amount to $1.1 billion annually and account for almost one-third of our total commercial dollar exports of agricultural products. The policies of such a great trading bloc are, therefore, of major concern to us and will be the most important single factor in determining the direction which trade policies take. It will be difficult to move forward under a more liberal and open trading policy if the EEC insists on surrounding its agricultural industry with a high wall of protectionism. We could not bargain away further reductions in our own tariffs on industrial imports if at the same time we are denied access to major markets for our agricultural exports.

There are disturbing indications that the EEC is developing its agricultural policies along lines that maximize self-sufficiency and insulate her farmers from import competition. In the last round of tariff negotiations concluded with the EEC in March 1962 the EEC refused to give fixed tariff bindings on most imports that compete with its own production. These included products such as wheat, feed grains, rice, and poultry, in which the United States has a major export interest, as well as beef, pork, and dairy products. On all of these items the EEC plans to apply variable levies on minimum import prices. Regulations for several products have already been issued. The effects of these regulations are to make foreign producers residual suppliers. Producers within the EEC will be assured guaranteed prices. The variable levy simply provides that imports will always be priced above the like product of domestic origin. If world prices fall the competitive position of foreign suppliers is not improved. The variable levy will simply increase. Producers within the EEC will thus have unlimited opportunity to supply the domestic market at the guaranteed price.

The United States by contrast follows a fairly liberal policy with respect to agricultural imports. In past tariff negotiations conducted under the GATT, the United States has exposed its agricultural industry to a substantial volume of competitive agricultural imports. In these negotiations we have reduced tariff barriers on competitive agricultural imports into the United States often in exchange for concessions other countries gave us on industrial exports. About $2 billion of competitive imports enter the United States each year. These include fresh and frozen beef and lamb, pork, a large variety of canned meat products, vegetable oils, fruits and vegetables, tobacco, and feed grains. These products are permitted unrestricted entry into the United States and are generally subject only to moderate tariffs.

Section 22 of the Agricultural Adjustment Act, as amended, authorizes the establishment of import quotas where imports render or tend to render ineffective or materially interfere with a price support or other program relating to agricultural commodities.

There is a general misconception with respect to the restrictions imposed on agricultural imports under section 22. Only our imports of peanuts, cotton, wheat, and certain dairy products are now subject to import limitations under section 22 and on these products, except dairy, we also limit our domestic production and marketing. Sugar imports are limited by quotas under the Sugar Act. The United States obtained a waiver under the GATT, allowing it to invoke section 22 upon proper notification of the GATT contracting parties. As a practical matter, however, this waiver is at present needed only for dairy products. Article XI of the GATT allows any contracting party to impose import controls if domestic production of the item in question is limited. Import restrictions on cotton, sugar, peanuts, and wheat are thus permitted under article XI of the GATT.

Even where section 22 controls are applied, these imports cannot be restricted to less than half of the quantities which entered during a recent representative period. Existing quotas in many cases provide for entry of more than 100 percent of trade during a representative period. Even on our dairy products, which are extremely sensitive political items, our controls permit the entry of certain cheeses in quantities in as much as 400 percent of the base period. All U.S. cheese imports now are 50 percent larger than 10 years ago. There is enclosed the latest report on section 22 operations dated July 1962, showing a comparison between base period quotas and actual import quotas for each product under section 22 restrictions.

Problems of dairy surpluses plague almost every country of the world, including the EEC. The United States is not and never has been a major importer of dairy products. In fact, we still have significant commercial exports of some products such as canned milk and dry whole milk.

The variable fee system of the EEC contrasts sharply with the liberal import policy practiced by the United States under section 22. Under the EEC system, third country exporters would have no assurance of continued access to their former markets in the EEC. Indeed, the very purpose of the variable levy system is to assure that consumption will be supplied exclusively by domestic producers if they can do so at the established internal price level. Clearly, under the EEC system there would be no imports of a commodity that was in domestic surplus.

If the United States were to substitute for section 22 restrictions an EEC-type of variable levy system, our imports of section 22 commodities would in most years be completely eliminated.

For other commodities, the United States has consistently maintained a liberal trade policy—characterized by the absence of quantitative restrictions on imports, reductions in duties for most of the items over the past several years, and increasing volumes of imports. This policy contrasts sharply with that adopted—or planned—by the EEC.

For example, in past tariff negotiations, U.S. import duties on beef and veal, the major meat items imported, have been reduced to 3 cents per pound—less than 10 percent ad valorem—and half the 1930 rate. No quantitative restrictions are imposed on imports. U.S. imports of beef and veal have grown steadily over the past 10 years. In the past 3, they have averaged 6.5 percent of domestic production, compared with an average of 2.5 percent 10 years ago. In contrast, the EEC is planning to establish a minimum import price—to which duties will be added—to insulate the EEC market from the effects of world meat price levels.

For feed grains, U.S. import duties now are at half or less than half of their 1930 levels, depending on the grain. Imports are negligible in relation to total supplies, but at present are not subject to barriers other than the duties. In contrast, the EEC has established support prices averaging roughly three-quarters above the level of prices to U.S. growers and maintains these with variable levies.

The United States, by legislation, reserves 41 percent of its sugar consumption requirements to be supplied by foreign producers. The EEC, in contrast, gives first priority to domestic producers, making foreign producers residual suppliers.

The EEC is nearly self-sufficient in sugar production. The United States also could achieve self-sufficiency if all restraints were removed and domestic producers were freely allowed to expand production.

Fixed duties are levied on U.S. imports of fruits and vegetables, with no quantitative restrictions. In the EEC countries, practically all fruit and vegetable items produced in the member countries are protected by quantitative restrictions. In apples, for example, the U.S. duty of 12½ cents per bushel is about 3 or 4 percent ad valorem and half of its 1930 level, with no quantitative restrictions on imports. U.S. apple imports have remained relatively stable over the past decade. France, Belgium, and West Germany continue to prohibit imports from third countries of fresh apples each season until local supplies are largely sold. Even after they remove their "prohibition," they allow imports only if prices in local markets are at "satisfying" levels. Although these countries now allow "extra quality" apples to be admitted from their EEC partners, they authorize imports from third countries only when shortages appear at home.

For wines, the largest EEC agricultural export to the United States, the policies of the United States and the EEC sharply differ. The United States has cut its tariffs consistently since 1930 until they now range from about 20 to 40 percent of their 1930 levels. No other barriers to trade exist. EEC exports of wines to the United States have increased steadily. In contrast, the EEC solves its trade problems by prohibiting imports of U.S. wines.

Sincerely yours,

ORVILLE L. FREEMAN, *Secretary.*

ANNEX D

IMPORT CONTROLS UNDER SECTION 22 OF THE AGRICULTURAL ADJUSTMENT ACT, AS AMENDED

(U.S. Department of Agriculture Foreign Agricultural Service Import Staff, January 1963)

CONTENTS

Authority

Section 22 of the Agricultural Adjustment Act, as amended, directs the Secretary of Agriculture to advise the President whenever he has reason to believe that any article or articles are being imported under such conditions and in such quantities so as to render or tend to render ineffective or materially interfere with any price support or other program, relating to agricultural commodities, undertaken by the Department of Agriculture, or to reduce substantially the amount of any product processed in the United States from any agricultural commodity or product thereof with respect to which any such program or operation is being undertaken. If the President agrees there is reason for such belief, he directs the Tariff Commission to conduct an investigation including a public hearing, and to submit a report to him of its findings and recommendations. The President is authorized, based on such findings, to impose such fees or quotas in addition to the basic duty as he shall determine necessary. The additional fees may not exceed 50 percent ad valorem and the quotas proclaimed may not be less than 50 percent of the quantity imported during a previous representative period, as determined by the President. Furthermore, the President may designate the affected article or articles by physical qualities, value, use, or upon such other basis as he shall determine.

Whenever the Secretary of Agriculture reports to the President that a condition exists requiring emergency treatment, the President may take action without awaiting the report of the Tariff Commission. Any such action by the President shall continue in effect pending the report and recommendations of the Tariff Commission and action thereon by the President.

No trade agreement or other international agreement entered into at any time by the United States may be applied in a manner inconsistent with the requirements of section 22.

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The import quotas on specified dairy products and certain grain products, as explained further in this bulletin, are administered by the Import Staff, Foreign Agricultural Service, U.S. Department of Agriculture, Washington 25, D.C., through the issuance of import licenses and special permits. The import quotas for dairy products are prorated among, and import licenses are issued to, eligible applicants who had imported the commodity during a specified period. Import regulation 1, revision 2, issued by the Department of Agriculture, governs the granting of the import licenses. Quotas on the other commodities not requiring import licenses or special permits are administered by the Bureau of Customs, U.S. Treasury Department, Washington 25, D.C., on a first-come, first-served basis. The authority to import commodities under section 22 does not relieve the importer from compliance with other applicable laws and regulations.

History

Section 22 was originally added to the Agricultural Adjustment Act of 1933 by the act of August 24, 1935. It has been amended several times and was revised in its entirety by section 3 of the Agricultural Act of 1948 and again by section 3 of the act of June 28, 1950. It was further amended by sections 8(b) and 104 of the Trade Agreements Extension Acts of 1951 and 1953, respectively.

Since the section was enacted, import controls have been imposed with respect to 11 different commodities or groups of commodities. These include: (1) wheat and wheat flour; (2) cotton, certain cotton wastes, and cotton products; (3) specified dairy products; (4) rye, rye flour, and rye meal; (5) barley, hulled or unhulled, including rolled, ground, and barley malt; (6) oats, hulled or unhulled and unhulled ground oats; (7) shelled almonds; (8) shelled filberts; (9) peanuts and peanut oil; (10) tung nuts and tung oil; and (11) flaxseed and linseed oil. All or a part of nine of these commodities or groups of commodities have been removed from import controls. These are, by type of control and effective date, as follows:

Commodity	Type of control	Effective date
(1) Harsh or rough cotton less than ¾ inches in staple length.	Quota	Sept. 20, 1946–Jan. 28, 1958.
(2) Card strips made from cotton 1³⁄₁₆ inches or more in length.	do	Sept. 20, 1939–Mar. 31, 1942.
(3) Barley, hulled or unhulled, including rolled barley, ground barley, and barley malt.	do	Oct. 1, 1954–Sept. 30, 1955.
(4) Oats, hulled or unhulled and unhulled ground oats.	do	Do.
(5) Shelled almonds, and blanched, roasted, or otherwise prepared or preserved almonds (not including almond paste).	Fee	Oct. 1, 1951–Sept. 30, 1955; Oct. 23, 1957–Sept. 30, 1958.
(6) Shelled filberts, whether or not blanched	do	Oct. 1, 1952–Sept. 30, 1953; Oct. 1, 1954–Sept. 30, 1955.
(7) Peanut oil	do	July 1, 1953–Apr. 5, 1961.
(8) Tung nuts and tung oil:		
(*a*) Tung oil	Quota	Sept. 9, 1957–May 1, 1962.
(*b*) Tung nuts (oil equivalent)	do	Apr. 28, 1958–May 1, 1962.
(9) Flaxseed and linseed oil	Fee	July 1, 1953–Apr. 5, 1961.
(10) Rye, rye flour, and rye meal	Quota	Apr. 1, 1954–June 30, 1961.

Commodities currently under control

The commodities currently under control and the dates on which the initial controls were imposed are discussed in the following sections I through IV.

I. COTTON, CERTAIN COTTON WASTE, AND COTTON PRODUCTS

Nonlicensed country quotas on long-staple and short-staple cotton and on cotton waste were imposed on September 20, 1939. Cotton having a staple length of 1 11/16 inches or more was removed from the long-staple cotton quota on December 19, 1940, but was again included effective August 1, 1958, at which time this quota was subdivided on the basis of staple length. The country quota on long-staple cotton was changed to a global quota on July 29, 1952. The global quota on certain cotton products became effective on September 11, 1961.

Annual country and global quotas currently in effect are as follows:

A. Global quotas

[In pounds]

	Representative period average annual imports July 1, 1928–June 30, 1933	Quota	Annual quota period
1. Long-staple cotton (1⅛ inch or longer)	68,085,885	[1] 45,656,420	Aug. 1–July 31.
Subdivided as follows:			
(a) 1⅜ inch or longer		39,590,778	Do.
(b) 1⅛ inch or more but less than 1⅜ inch		6,065,642	
Provided that of the 6,065,642 pounds, not more than 1,500,000 pounds shall consist of harsh or rough cotton (except cotton of perished staple, grabbots, and cotton pickings), white in color and having a staple of 1 5/32 inch or more in length, and not more than 4,565,642 pounds shall consist of other cotton.			
	Jan. 1, 1940–Dec. 31, 1953		
2. Cotton products produced in any stage preceding the spinning into yarn (except cotton wastes).	(2)	[3] 1,000	Sept. 11–Sept. 10.

[1] 67.1 percent of base period.

[2] The exact quantity is unknown but adjudged to have been less than 1,000 pounds. See Tariff Commission Report to the President on "Certain Cotton Product," TC Publication 31, of September 1961.

[3] 100 percent of base period.

B. Country quotas

[In pounds]

	Representative period average annual imports July 1, 1928–June 30, 1933	Quota	Annual quota period
1. Short-staple cotton (less than 1⅛ inches)	15,504,403	[1] 14,516,882	Sept. 20–Sept. 19.
Subdivided as follows:			
Country:			
Egypt and the Sudan		783,816	
Peru		247,952	
India and Pakistan (first come, first served)		2,003,483	
China (Taiwan)		1,370,791	
Mexico		8,883,259	
Brazil		618,723	
USSR		475,124	
Argentina		5,203	
Haiti		237	
Ecuador		9,333	
Honduras		752	
Paraguay		871	
Colombia		124	
Iraq		195	
British East Africa		2,240	
Netherlands East Indies		71,388	
British West Indies (other than Barbados, Bermuda, Jamaica, Trinidad, and Tobago)		21,321	
British West Africa (other than Gold Coast and Nigeria)		16,004	
Nigeria		5,377	
French Africa (other than Algeria, Tunisia, and Madagascar)		689	
Total		14,516,882	
2. Cotton waste (card strips made from cotton under 1³⁄₁₆-inch comber waste, lap waste, sliver waste, roving waste).	(2)	[3] 5,482,509	Do.
Subdivided as follows:			
Country:			
United Kingdom		4,323,457	
Canada		239,690	
France		227,420	
India and Pakistan (first come, first served).		69,627	
Netherlands		68,240	
Switzerland		44,388	
Belgium		38,559	
Japan		341,535	
China (Taiwan)		17,322	
Egypt		8,135	
Cuba		6,544	
Germany		76,329	
Italy		21,263	
Total		5,482,509	

[1] 93.6 percent of base period.
[2] The annual average imports of 23,173,884 pounds of various types of cotton wastes during the representative period included receipts of waste types which were not put under quota. Data for all specific types of waste are not available.
[3] Not more than 33⅓ percent shall be filled by cotton wastes other than comber waste made from cotton of 1³⁄₁₆ inches or more in staple length in the case of United Kingdom, France, the Netherlands, Switzerland, Belgium, Germany, and Italy.

II. WHEAT AND WHEAT PRODUCTS

Importations of wheat and specified wheat products, with the exceptions listed, are subject to nonlicensed quota controls. The quotas were instituted by Presidential proclamation dated May 28, 1941. The basic quotas have not been changed, although certain exceptions were made during World War II.

Annual country quotas are currently in effect as follows:

	Representative period average annual imports Jan. 1, 1929–Dec. 31, 1933	Quota		Annual quota period
1. Wheat	[1] 25,923	[1] 800,000		May 29–May 28.[2]
2. Wheat products	[3] 237,137	[3] 4,000,000		May 29–May 28.[4]
		Wheat (bushels)	Wheat products (pounds)	
Subdivided as follows:				
Country of origin:				
Canada		795,000	3,815,000	
China (Taiwan)			24,000	
Hungary			13,000	
Hong Kong			13,000	
Japan			8,000	
United Kingdom		100	75,000	
Australia			1,000	
Germany		100	5,000	
Syria		100	5,000	
New Zealand			1,000	
Chile			1,000	
Netherlands		100	1,000	
Argentina		2,000	14,000	
Italy		100	2,000	
Cuba			12,000	
France		1,000	1,000	
Greece			1,000	
Mexico		100	1,000	
Panama			1,000	
Uruguay			1,000	
Poland and Danzig			1,000	
Sweden			1,000	
Yugoslavia			1,000	
Norway			1,000	
Canary Islands			1,000	
Rumania		1,000		
Guatemala		100		
Brazil		100		
USSR		100		
Belgium		100		
Total		800,000	4,000,000	

[1] Bushels.
[2] 3,086.1 percent of base period.
[3] Pounds.
[4] 1,686.8 percent of base period.

Wheat, wheat flour, semolina, crushed or cracked wheat, or similar wheat products, classified as "unfit for human consumption" are not subject to import quota controls. Likewise, samples of wheat or specified wheat products in lots of 10 pounds or less and certified or registered seed wheat in lots of 100 bushels or less are not subject to import quota controls. Wheat or specified wheat products in lots of 10 pounds or more for experimental purposes and certified or registered seed wheat in lots of more than 100 bushels for seeding and crop improvement purposes may be imported ex-quota if the importer requests such import authority from the Secretary of Agriculture and if written approval is granted by the Secretary. Such requests should be addressed to the Import Staff, Foreign Agricultural Service, U.S. Department of Agriculture, Washington 25, D.C.

III. SPECIFIED DAIRY PRODUCTS

Import controls under section 22 became effective July 1, 1953, for the dairy products Nos. 1–10, as listed below. The annual quota period for these commodities is from July 1 through June 30. The Import Staff, Foreign Agricultural Service, U.S. Department of Agriculture, Washington 25, D.C., issues import licenses to individual importers. The quotas are apportioned generally on the basis of the proportionate share of total imports imported by each individual importer from supplying countries during a representative base period when no restrictions were in effect.

Quota controls on items 11 (a) and (b) became effective April 15 and August 7, 1957, respectively. The quota year for item 11(a) is the calendar year and the quota is administered by the Bureau of Customs, U.S. Treasury Department, Washington 25, D.C. on a first-come, first-served basis. Butterfat as defined in 11(b) may not be imported. Importations not in excess of 100 pounds in the aggregate of the listed dairy commodities may be authorized ex-quota for display and sampling at trade fairs and for research, provided application is made to and written approval is granted by the Secretary of Agriculture. Such applications should be filed with the Import Staff, Foreign Agricultural Service, U.S. Department of Agriculture, Washington 25, D.C.

The following table shows a comparison of current quotas with importations during the representative periods. The representative periods are as indicated in parentheses. Effective July 1, 1960, the President's proclamation increased the annual quota for Edam and Gouda cheese from 4,600,200 to 9,200,400 pounds and on Italian-type cheese from 9,200,100 to 11,500,100 pounds.

	Representative period average annual imports (pounds)	Quota (pounds)	Quota as percent of base
1. Butter	1,411,525 (1930–34)	707,000	50.1
2. Dried whole milk	13,055 (1948–50)	7,000	53.6
3. Dried buttermilk	991,283 (1948–50)	496,000	50.0
4. Dried cream	[1] (1948–50)	500	100.0
5. Dried skimmed milk	3,613,279 (1948–50)	1,807,000	50.0
6. Malted milk, and compounds or mixtures of or substitutes for milk or cream	11,418 (1948–50)	6,000	52.5
7. Cheddar cheese and cheese and substitutes for cheese contained or processed from Cheddar cheese	5,490,262 (1948–50)	2,780,100	50.6
8. Edam and Gouda cheese	1,831,085 (1948–50)	9,200,400	502.5
9. Blue-mold cheese (except Stilton) and cheese and substitutes for cheese containing, or processed from blue-mold cheese	2,066,000 (1948–50)	[2] 5,016,999	242.8
10. Italian-type cheese made from cow's milk, original loaves (Romano made from cow's milk, Reggiano, Parmesano, Provolone, Provolette, and Sbrinz)	8,121,987 (1948–50)	11,500,100	141.6
11. Articles with 45 percent or more butterfat:			
(*a*) Butter substitutes, including butteroil containing 45 percent or more butterfat	1,800,000	[3] 1,200,000	66.7
(*b*) All articles containing 45 percent or more of butterfat, except those articles already subject to quotas, cheese, evaporated and condensed milk, and products imported in retail packages	([4])	0	----------

[1] Less than 500.
[2] Increased from 4,167,000 by Presidential Proclamation 3460, Mar. 30, 1962.
[3] Quota for calendar year 1957 only, set at 1,800,000 pounds.
[4] Not available.

IV. PEANUTS

Nonlicensed import controls were instituted July 1, 1953. The quota on peanuts is the same as that initially imposed. The ad valorem fee of 25 percent on imports of peanut oil in excess of 80 million pounds was terminated on April 5, 1961.

Annual global quotas are in effect as follows:

	Representative period average annual imports Jan. 1, 1936–Dec. 31, 1939 (pounds)	Quota	Annual quota period
Peanuts: whether shelled, not shelled, blanched, salted, prepared, or preserved (including roasted peanuts but not including peanut butter).	3,417,812	1,709,000 pounds peanuts in the shell charged against this quota on basis of 75 pounds for each 100 pounds of inshell peanuts.	Aug. 1–July 31.[1]

[1] 50 percent of base.

SECTION 22 OF THE AGRICULTURAL ADJUSTMENT ACT (OF 1933), AS REENACTED AND AMENDED (AS OF DECEMBER 15, 1959)

"SEC. 22 (a) Whenever the Secretary of Agriculture has reason to believe that any article or articles are being or are practically certain to be imported into the United States under such conditions and in such quantities as to render or tend to render ineffective or materially interfere with, any program or operation undertaken under this title or the Soil Conservation and Domestic Allotment Act, as amended, or section 32, Public Law No. 320, Seventy-fourth Congress, approved August 24, 1935, as amended, or any loan, purchase, or other program or operation undertaken by the Department of Agriculture, or any agency operating under its direction, with respect to any agricultural commodity or product thereof, or to reduce substantially the amount of any product processed in the United States from any agricultural commodity or product thereof with respect to which any such program or operation is being undertaken, he shall so advise the President, and, if the President agrees that there is reason for such belief, the President shall cause an immediate investigation to be made by the United States Tariff Commission, which shall give precedence to investigations under this section to determine such facts. Such investigation shall be made after due notice and opportunity for hearing to interested parties, and shall be conducted subject to such regulations as the President shall specify (7 U.S.C. 624(a)).

"(b) If, on the basis of such investigation and report to him of findings and recommendations made in connection therewith, the President finds the existence of such facts, he shall by proclamation impose such fees not in excess of 50 per centum ad valorem or such quantitative limitations on any article or articles which may be entered, or withdrawn from warehouse, for consumption as he finds and declares shown by such investigation to be necessary in order that the entry of such article or articles will not render or tend to render ineffective, or materially interfere with, any program or operation referred to in subsection (a) of this section, or reduce substantially the amount of any product processed in the United States from any such agricultural commodity or product thereof with respect to which any such program or operation is being undertaken: *Provided*, That no proclamation under this section shall impose any limitation on the total quantity of any article or articles which may be entered, or withdrawn from warehouse, for consumption which reduces such permissible total quantity to proportionately less than 50 per centum of the total quantity of such article or articles which was entered, or withdrawn from warehouse, for consumption during a representative period as determined by the President: *And provided further*, That in designating any article or articles, the President may describe them by physical qualities, value, use, or upon such other bases as he shall determine.

"In any case where the Secretary of Agriculture determines and reports to the President with regard to any article or articles that a condition exists requiring emergency treatment, the President may take immediate action under this section without awaiting the recommendations of the Tariff Commission, such action to continue in effect pending the report and recommendations of the Tariff Commission and action thereon by the President (7 U.S.C. 624(b)).

"(c) The fees and limitations imposed by the President by proclamation under this section and any revocation, suspension, or modification thereof, shall become effective on such date as shall be therein specified, and such fees shall be treated for administrative purposes and for the purposes of section 32 of Public Law No. 320, Seventy-fourth Congress, approved August 24, 1935, as amended, as duties imposed by the Tariff Act of 1930, but such fees shall not be considered as duties for the purpose of granting any preferential concession under any international obligation of the United States (7 U.S.C. 624(c)).

"(d) After investigation, report, findings, and declaration in the manner provided in the case of a proclamation issued pursuant to subsection (b) of this section, any proclamation or provision of such proclamation may be suspended or terminated by the President whenever he finds and proclaims that the circumstances requiring the proclamation or provision thereof no longer exist or may be modified by the President whenever he finds and proclaims that changed circumstances require such modification to carry out the purposes of this section (7 U.S.C. 624(d)).

"(e) Any decision of the President as to facts under this section shall be final (7 U.S.C. 624(e)).

"(f) No trade agreement or other international agreement heretofore or hereafter entered into by the United States shall be applied in a manner inconsistent with the requirements of this section (7 U.S.C. 624(f)).

Chairman Douglas. Senator Proxmire?

Senator Proxmire. Mr. Secretary, you may not appreciate it fully, but I have admired you for a long, long time for your eloquent pleas for the farmer.

I know I have caused you a lot of distress by my difference from your viewpoint on details of agriculture legislation. But I don't know anybody who has worked harder or done a finer job of representing the interests of the American farmer, who has been Secretary of Agriculture.

You have done a great job.

This presentation you have today is so typical, because you point out how very important the farmer is to our economy, and I think this is terribly neglected by Members of Congress as well as by the general public.

However, I would once again differ with you on a few things and I would like to ask you about these points of difference.

As a loyal member of the administration, you have made a fine case showing the benefits to the farmer directly from tax reduction. I contend that the farmer probably gets the least benefit of any group in our society—maybe the retired people get less.

But Mr. Patton of the Farmers Union last year argued that about 80 to 85 percent of our farmers pay no income tax at all.

Now, it is true that when farmers sell their farms, many of them would come under the somewhat more relaxed capital gains provisions of the law, but recognizing this, it would seem to me that the direct effect, beneficial effect to the farmer, most farmers, would be very small from this method of trying to increase and improve national income as compared to a method of directly trying to improve and increase farm income.

Secretary Freeman. May I respond, Senator, to that by pointing out that it is an old saw that farmers don't pay any income tax.

Senator Proxmire. I know they pay the taxes they should pay.

I am just saying their income is so low that the income tax they pay is nil in most cases, and small for the rest.

I don't question the figures you have here, $1\frac{1}{3}$ billion in Federal income taxes, but I say there are an awful lot of farmers who don't pay any income taxes at all, although some of the rich farmers do pay income taxes.

Secretary FREEMAN. This might be true. I think it would be worth putting into the record a statement on this. I thought the question might come up and I asked them to pull something together.

Completeness of income tax reporting by farmers: Comparison of reports published by IRS with statistics on farm income suggests that in recent years more than 90 percent of all cash receipts from farm marketings show up on income tax returns.

In 1958, for example, farm business receipts reported on tax returns amounted to $31.6 billion. This was 91.6 percent of the year's total of $34.5 billion in cash receipts from farm marketings. Not all the missing $2.9 billion necessarily represents underreporting of income on tax returns. A substantial part can be accounted for by the income to farmers who individually had gross incomes below the filing requirement and to farmers who were legally subject to filing but who had net incomes so low as not to be taxable. Rough estimates based on the census of agriculture suggests that about $2\frac{1}{4}$ million farmers fall in these two categories. Gross value of marketings from these farms exceeded $4 billion.

If gross income is substantially fully reported, there is reason to believe the same is true of net farm income. The missing gross income is probably largely offset by operating expenses that are not fully reported.

Operating expenses are disproportionately heavy on the low production farms where reporting is likely to be weakest. There is evidence, moreover, that inadequate bookkeeping leads many farmers to underclaim their operating expenses.

Senator PROXMIRE. I understand. And then of the farmers who do pay a tax, you pointed out in your statement that farmers' income is about 60 percent less than off-the-farm income.

So I think the assumption would be that as far as the income tax is concerned, and I stress income, that the taxes they pay would be much less than most because their income is less.

However, the property taxes the farmers pay, on the basis of my own experience in Wisconsin, is very heavy and this is the big tax a farmer has to cope with.

Secretary FREEMAN. No question about that. This is the tax that finances local government. But the depreciation schedules are a very important consideration, because a farmer has a great deal of equipment, and under new depreciation schedules, if he can write off a piece of equipment in 3 years instead of in 7 years, this means a significant difference.

Senator PROXMIRE. Now, I am also somewhat concerned. I suggested to Senator Douglas that we ask you to testify before us because—for many reasons, but partly because I was concerned by the import of the President's very brief dealing with the whole farm problem in his Economic Report. I consider the farm problem one of our top economic problems, perhaps one of the two or three along with unemployment.

The report does deal with that briefly on pages 10 and 11 in this foreign trade area, which has just been discussed so well by you and Mr. Reuss.

In other areas, as compared to what the Economic Report did last year, it seems to me there just isn't very much and there is no follow-up on the failure to achieve objectives which is set forth on page 9 of the 1962 Economic Report as follows:

> Objectives of agricultural policy as it develops in the future should encompass both (1) continuation of agriculture's historic role as a major contributor to national economic growth and (2) equitable distribution of gains in agricultural productivity between farmers and consumers. Achievement of these two objectives will require continued rapid transfers of labor from the farm to the nonfarm sector and reduction in resources devoted to the production, storage, and disposition of surplus production.

The fact is, you chose 1960 and 1962 in describing farm incomes. If you chose 1961 and 1962 for the comparisons of farm income, it appears on the basis of statistics I have, that there was no increase in income last year.

Now, the fourth quarter was a better quarter than the other three. But in aggregate, 1962 was not any better than 1961. It was about the same.

Secretary FREEMAN. The aggregate net was quite comparable. The gross was up, but the per capita net was up between 1962 and 1961.

Senator PROXMIRE. Yes; farmers are tending to leave the farm. But we still have, I think you might agree, failed dismally to achieve this second objective of equitable distribution of gains in agricultural productivity between farmer and consumer.

Secretary FREEMAN. We have a long, long way to go and I hope we can continue the progress we have made until we get there.

Senator PROXMIRE. This morning, Mr. Gordon pointed out that we are going to have stability in nondefense and nonspace Federal spending and this was largely because of the cut in spending in the agricultural area.

I am wondering what proposals you have, very briefly, to improve agricultural income in the coming year or two.

Secretary FREEMAN. Again, we get to a commodity by commodity appraisal and programming here. I am hopeful and I know you share this, that we can develop a program, particularly in dairy, that will bring about an increase in dairy farmers' income. The overwhelming majority of dairy farmers are those who are very efficient operators. Their per-hour return is very, very low indeed.

Specifically what recommendations the administration will make are a matter yet of some debate and not necessarily because of the economics of it, Senator, but because of the politics with which it can pass through the Congress of the United States.

Senator PROXMIRE. The concern that I have is that the proposals I have heard about—I am not saying you will come up with any of these—but the proposals I have heard about would stabilize income, perhaps increase it a bit, but would have its primary thrust at reducing the cost of supporting dairy farm income—would cut it. Farm income would remain about what it is now. Now, I would say that the first test of any agricultural legislation today ought to be, does it improve farm income.

Secretary FREEMAN. I would agree with you wholeheartedly.

Senator PROXMIRE. If it doesn't do that, it is no good, regardless of the other advantages it may have.

Secretary FREEMAN. I agree, but I would emphasize the point that I think a sound farm program will do both, increase farm income and reduce Government cost, because its main point is providing some mechanisms so that there can be a fair relationship between supply and demand.

The farmers' main problem has always been he has no bargaining power in the marketplace. Other producers do. He sells in a sellers' market, buys in a buyers' market. In every country in the history of the world, the farmer has been low man on the totem pole. That is one reason why we have so many restrictions in other types of farm programs around the world. So we are not dealing with a new problem. But fundamentally, this is a sound program that would provide this, as we see it, in some commodities now. In some commodities, the functioning of market orders, which are self-help, farmer-administered programs, are returning a reasonable return to the producers at a fair price to the consumer and at no cost to the taxpayer. This is the goal we seek to reach.

Senator PROXMIRE. I enthusiastically support the notion of getting the farmers' income in the marketplace, because with his diminishing political influence, it is the only long-term hope for the farmer, and I just hope and pray we can work out some method, as you say, of self-help organization so that the farmer can achieve this end, which he deserves so richly in view of his contribution.

My time is up but I might say that you have many times argued this, and I think it ought to be stressed once again on the record, the fact that the farmer is the No. 1 economic success story in this country, and for that matter, in the world.

The American farmer's contribution to our prosperity is perfectly enormous. As you have said, as I understand it, the average family now spends 20 percent of their income on food, whereas 10 years ago they spent 26 percent. The food-for-peace program, demonstrating our marvelous agricultural capacity compared to the dismal failures of Communists in country after country—communism goes in, hunger follows—is, I think, one of the great reasons for our successes, to the extent we have had successes in foreign policy.

This is something I think people somehow have to be reminded of because it is terribly hard, as you know better than I, to get this story told broadly so the American public appreciates it.

Secretary FREEMAN. The Senator states it very well and I would be happy to add to that 20-percent figure and state our latest economic analysis shows it is now 19 percent, and this compares with 30 to 40 percent in Western Europe; to 50 to 60 percent that the take-home pay goes for food in Russia; 80 to 90 percent in developing countries around the world; that fewer than 8 percent of the American people are involved in agriculture; that 1 farmer feeds 27 people; that fewer than 8 percent provide the food and fiber for this country, and they do it at the relative price, which actually, in terms of our diet of 25 years ago, would be about 12 percent of our take-home pay.

So it is a phenomenal, extraordinary accomplishment.

Senator PROXMIRE. They have made their contribution to the increased standard of living—people are freed that much income that they can spend on other things.

Chairman DOUGLAS. Mr. Curtis?

Representative CURTIS. There is great economic growth in this area. Am I not right?

Secretary FREEMAN. Tremendous increase in productivity on a per capita basis; yes, sir.

Representative CURTIS. Are you familiar, Mr. Secretary, with the administration's economic gap theory?

Secretary FREEMAN. I am not sure what the Congressman means by the "gap theory."

Representative CURTIS. That is the term Dr. Heller and others use, saying that we are not meeting the economic potential in our society. It is based upon our idle plant and idle manpower. They have used the term "tired blood" to describe it.

Secretary FREEMAN. I have not heard that description, but it is very descriptive.

Representative CURTIS. You think it is? Do you think that is descriptive of the agriculture sector, then?

Secretary FREEMAN. I did not say that, I think.

Representative CURTIS. I hope not, because we have just agreed that the growth has been dramatic, and we have had a lot of adjectives to describe it.

I agree with you. It is just the reverse of tired blood. The problems you have in agriculture are, to a large extent, the result of growing pains.

For example, in the agriculture sector, there is a tremendous idle plant. In fact, it is Government policy, not only under this administration but also the previous one, to try to make more of the plant idle. Am I not correct?

Secretary FREEMAN. No; Congressman, you are not, really, and this is a common misunderstanding. The policy of this administration is not to idle acres but to use them.

Representative CURTIS. What are you doing when you put them aside? Let's don't get into semantics. We want to retire these acres and get them out of production.

Secretary FREEMAN. Well, we want—what is production?

Representative CURTIS. That is right. We are talking about production of money crops, because this is a money economy. I happen to agree with the retirement program; do not misunderstand me. But, if we had to produce more wheat, corn, or cotton, we would be doing the reverse, would we not, of retiring lands that are perfectly capable of growing these crops. What do you put them into, by the way—grasslands or scenic parks?

Secretary FREEMAN. I would suggest, and I am not trying to be in any way argumentative or facetious about it, but fundamentally, what we are really trying to do is to accomplish an adjustment to make an economic use of land which is not being used economically if it is producing food and fiber for which we have no need.

Representative CURTIS. That is right.

Secretary FREEMAN. As such, then, it is actually the converse of productive.

Representative CURTIS. That is true.

Secretary FREEMAN. Now, what are those other uses?

Representative CURTIS. Let me ask another question. Are these other uses money producing?

Secretary FREEMAN. They may well be.

I am reminded of the rancher at our Land and People Conference in Denver who told me he made $2,500 running cattle and $17,000 off the elk hunters.

Representative CURTIS. Well, recreation, all right. If we are going to get into recreation, that is a good diversion. But let me pick up the next point of this so-called gap theory and tired blood theory; namely, idle manpower. If there ever is a place where we have people moving out of an area, it is in farming and agriculture; is that not so?

Secretary FREEMAN. That is correct, yes, sir.

Representative CURTIS. In fact, I have often said that I think commercial agriculture is doing all right, but because it is doing so well, we have created a very serious problem of rural unemployment.

People who used to be able to depend on agriculture for their livelihood find they can no longer, so we have idle manpower.

Now I come to the key point. The administration's policy that has been presented to this committee and the Congress is that the way to take care of idle plant and idle manpower is to increase consumer purchasing power. Consumer purchasing power would then increase demand in the agricultural sector, I suppose, along with the others.

Now, let me ask you, do you think such a basic policy is going to help the idle manpower in agriculture and the idle plant, or, rather, the excess produce that we have?

Is it going to make a dent or even any impression?

Secretary FREEMAN. No. 1, as I said earlier, the demand for food is highly inelastic.

Representative CURTIS. That is right.

Secretary FREEMAN. As such, increased income will not reflect itself very heavily in terms of increased consumption of food in this country.

Representative CURTIS. That is right.

Secretary FREEMAN. On the other hand, a full employment economy will obviously make much easier the adjustments in agriculture that does not need as much manpower as that previously did.

Representative CURTIS. Well, the adjustment is going out of agriculture. In other words, all I am trying to point out, is that the administration's program to hit at the problems of economy is certainly not going to help the problems in agriculture.

If anything, it is going to aggravate them, because you are putting more effort—and I am glad we are, by the way—into research and development to develop the efficiency in agriculture. But I think it is about time that we recognized that by encouraging this kind of healthy economic growth, we are creating problems in our economic system in another way.

But let's not look for solutions to those problems on the theory that it is tired blood. We are experiencing growing pains and I think the agriculture sector demonstrates this more clearly than any other I can think of.

Would you comment on that Mr. Secretary, because this is the theory that the administration is following and the base on which they are saying to the Congress that we must cut taxes—not expenditures. The administration wants to hold expenditures to the 1963 level in nondefense areas, thus creating bigger deficits. This, they say, is necessary to increase what they describe as a lagging consumer demand.

But you have just said in agriculture it is inelastic.

Secretary FREEMAN. Well. I have addressed myself to the question of agriculture, and there will be, there would be an expanding market with an increase of dollars in the pocket, because the choice of foods would probably involve those that were more processed and conceivably more expensive, but certainly no solution to the agriculture problem.

On the other hand, the solution would rest or would be significantly helped in terms of an expanding industry producing a number of things for which people would have demand, a part of which would involve the location of new plants in rural areas to which people not needed to produce food and fiber would find employment.

Representative CURTIS. I think that part is correct. In other words, the shift of people retraining out of agriculture, which to me is the key to this thing, and——

Secretary FREEMAN. I thought you said out of agriculture and not out of the country.

Representative CURTIS. I should say not out of the country, but rather out of agriculture.

I think one of the significant factors in the agricultural sector is in our economic indicators which reveal that the farmer, and I guess the definition is still one who derives 51 percent of his income from agriculture, obtains over 30 percent of his income from nonagricultural sources.

Secretary FREEMAN. An increasing amount of it is, yes.

Representative CURTIS. Yes; and I think I developed that point the way I wanted the record to show it.

Now, let me ask about expenditure side, which to me is a very disturbing aspect. The budget indicates that we are to cut $1 billion from agricultural expenditures in 1964 over 1963, is that not correct?

Secretary FREEMAN. That is correct.

Representative CURTIS. Actually, that's not quite true, is it?

We are spending $1.5 billion more, but we are going to pick up about $2.5 billion from the sale of Commodity Credit Corporation assets. Isn't that the real picture?

Secretary FREEMAN. Some percentage of it is accounting, yes, sir.

Representative CURTIS. Well, it is in the budget. The arithmetic is done. The entry of $2.5 billion ought to be, I think, in the receipts from the public side and the entry of an increase of $1.5 billion in payments to the public. But the two do produce a minus $1 billion. This is an important distinction to make, because the Commodity Credit Corporation is, in effect, somewhat in the nature of capital assets.

Secretary FREEMAN. Yes, sir.

Representative CURTIS. But we turn over to the real budget which Congress has no control over. We have already voted the authorization to spend. The President has complete control over this sector of payments to the public and receipts from the public. The only thing the Congress has to say is on page 40 of the budget, under new obligational authority by agency. There we see an entirely different picture for agriculture.

The estimates for new obligational authority in 1963 were $6.7 billion. In the request for fiscal 1964, they are $8.1 billion—an increase of $1.4 billion. I assume this is going to be a recurring expenditure, not the nonrecurring type.

So actually, agriculture expenditures are not being held at any 1963 level as far as the Congress is concerned, because once we turn this authority over to the Executive, he can spend it at any rate he chooses.

Now, I wonder if you would comment on why the statements of the President and other governmental officials to the public and Congress have been creating the impression that we are cutting back in Agriculture in light of these hard figures, when you are actually asking an increase of $1.4 billion to spend in fiscal 1964?

Secretary FREEMAN. Well, I do not have before me the budget figures and had not reviewed them for several weeks.

Representative CURTIS. Let me show them to you, because I am very interested in what you might say about them.

Secretary FREEMAN. The budget message that the President sent to the Congress was based upon the cash budgets and on cash expenditures. What he would have said in relation to the NOA budget, I don't know.

Representative CURTIS. But look. The budget you present to the Congress is for the Congress to act upon and the only thing we have to act upon is new obligational authority. The expenditures are completely within the control of the President and that is only a report to us, not a request.

The budget request is in new obligational authority and the Department of Agriculture is requesting a $1.4 billion increase for 1964.

Do not the figures reveal that?

Secretary FREEMAN. The comments that the President sent up were commenting upon the cash budget, as I have said earlier, and I have not seen any comments of the President on the NOA budget.

Representative CURTIS. Well, what are your comments? I see my time has run out, but please answer my question.

Secretary FREEMAN. The items—I would need to go down here. We in Agriculture are in the process of making a series of very basic adjustments as we are moving from the holding of a very significant surplus, items in a number of commodities to what we consider necessary security and stabilization reserves. I refer now to the Commodity Credit Corporation.

Let me finish now.

Representative CURTIS. But I want to ask would that not show a less amount than the other?

Secretary FREEMAN. No. What is involved here again is equally the kind of accounting which you pointed to a moment ago in deprecating the cut in the cash budget.

Representative CURTIS. That is right.

Secretary FREEMAN. This is to restore to the Commodity Credit Corporation losses, a substantial amount of which was for the food for peace program, which had been incurred in previous years. In other words, money that was expended in 1962 is included in these NOA estimates for 1964 to replenish the capital of the Commodity Credit Corporation.

So as such, the NOA estimate does not involve new expenditures, it involves expenditures or actually losses, already incurred, and is to replenish the capital of the corporation.

Representative CURTIS. If you are replenishing, though, you are not cutting back.

Secretary FREEMAN. But we are certainly not spending more, Congressman. I think you would have to agree with me on that if you are not going to be dealing in dialectics.

Representative CURTIS. You have raised it $1.4 billion, Mr. Freeman.

Secretary FREEMAN. This is money that has already been spent, in 1962, Congressman.

Representative CURTIS. No.

Chairman DOUGLAS. Mrs. Griffith?

Representative GRIFFITHS. No questions, Mr. Chairman.

Chairman DOUGLAS. Mr. Kilburn?

Representative KILBURN. I am from New York State, and I am sorry to keep the questioning on a local level for a minute, but our economy, of course, is part of the national economy.

We are interested in the whole economy. I have had a great many letters from New York State and I just want to read one short one and ask you about it.

It says:

> New York farmers have been discriminated against by the artificial corn pricing schedule recently announced by the Secretary of Agriculture. This schedule permits corn users in 12 Mid-Atlantic and Southern States to purchase CCC-owned corn at lower than market prices, thus adding to the competition already created by unrealistic Government programs which New York farmers are facing.
>
> The announced purpose of the plan is to keep the market price of corn from advancing in those States. This is the rankest kind of discrimination. We prefer less tinkering by the Government.

Now, Mr. Secretary, it has seemed to me that the Agricultural Department for years has discriminated against the dairy farmers of New York State, who comprise a large economic force in our State. Why do you do it?

Secretary FREEMAN. Well, may I say, Congressman, that I served as Governor of the State of Minnesota for 6 years and one of the things I repeated from one end of the country to the other is that in all our policies, why, Minnesota's dairy farmers were discriminated against in favor of the dairy farmers from New York State.

Representative KILBURN. That does not answer my question.

Secretary FREEMAN. Let me try to answer your question.

The letter, I am sure, is a very honest and sincere letter, but it is based on misinformation. The feed grain program of 1962 now in effect, and we will not have this problem with the program that is in effect in this 1963 crop year, involved the Government selling substantial amounts of corn at various times and places in both 1961 and 1962. I think I can say honestly and with some pride, we did a very skillful job, because there was a more stable price for corn, by and large, around the country and feed grains, than there had been in the history of the country. However, in certain places, there have been dislocations. For example, there would be a very heavy signup in a deficit area, and therefore not much production in that area. Then, if the relationship between prices got way out of line, let us say, and instead of corn selling at about, let's say, $1.20, it went up to $1.65, disturbing its historic relationship with, let us say, prices in the Midwest, why, then, we moved in and sold limited amounts in order to prevent hoarding and speculation and to maintain the same historical relationship based on a Midwest base pricing point.

Now, this has happened three times. It happened early in the program in the West, in Oregon, and we sent some corn out to Oregon to prevent that getting arbitrarily high there.

Otherwise, it happened last year and again is happening this year again in the Southeast. It has not happened in the Northwest.

If you check the historic relationship between the prices in the Northeast as compared to the base points in the Midwest and in the Southeast and the Far West, you will find that that relationship is a constant one, and that the reason that very small sales are now being made or were shorted in the Southeast is because there the prices soared way up in the air.

This was not true in the Northeast and I would want you to know that if you can make the case, which we have carefully reviewed, that prices have become arbitrarily high in the Northeast, the Department is prepared to act in the Northeast as we have recently in the Southeast.

Representative KILBURN. I am glad to know that. I am not a farmer myself, but we have some awfully good farmers up there——

Secretary FREEMAN. I would certainly agree with you on that.

Representative KILBURN (continuing). Who feel that you and other Secretaries of Agriculture discriminate against the farmers of New York State because you all want to keep farm prices up for the people in the Midwest.

Secretary FREEMAN. I can only comment that when I was Governor of Minnesota, I would feel the same thing in connection with practices in the Northeast where milk was concerned. My perspective on it has been broadened as Secretary of Agriculture.

Representative KILBURN. That is all, Mr. Chairman.

Chairman DOUGLAS. Mr. Widnall?

Representative WIDNALL. In your statement, you say that:

> This is a significant average increase of over 11 percent, raising the average income of $3,075 per farm in 1960 to an average of $3,525 in 1962.

What about the difference in the number of farms between 1960 and 1962?

Secretary FREEMAN. I am just estimating now. I do not have that number at my fingertips, but we have had about 200,000 fewer farms a year over the last 10 years.

Representative WIDNALL. So that means 400,000 farms fewer, when you consider income per farm?

Secretary FREEMAN. That is correct.

Representative WIDNALL. So actually, the income per farm is going up, because it is more concentrated income——

Secretary FREEMAN. Well, it is both, the total net income of agriculture as compared to 1960–61 and 1960–62 is up about a little over a billion.

That is a total net. There are fewer farms, so when you go on a per capita farm basis, you have a greater increase, because there are fewer to average it into.

Representative WIDNALL. I have in front of me a USDA issue of Current Business, December 1962.

Under an article entitled "Agricultural Production and Adjustment," by L. J. Atkinson, it says:

> In contrast to the rise in nonfarm economy, farm production, and income in 1962 are about even with 1961, but the average incomes on a per capita or per farm basis have shown a considerable rise in the past few years due to declining trends in the number of farms and farm population.

Would you like to comment on that?

Secretary FREEMAN. Yes. I would say—this is what I thought I would say earlier—two things.

Between 1961 and 1962, as Senator Proxmire brought out, the total net farm income remained about constant. Per capita farm income increased because there were fewer farmers.

In 1961, total net farm income went up in excess of $1 billion.

Representative WIDNALL. Does this not indicate that the practices of the Department of Agriculture are forcing small farmers out of business and forcing into production large corporate farms who get all the tax benefits, who get all the large subsidies that we are passing out in the agricultural sector of our economy?

Secretary FREEMAN. No; it does not. The truth of the matter is that the number of family farms has increased proportionately. The number of large farms, sometimes described as corporate farms, and the number of small farms have decreased. The number of family commercial farms proportionately have increased. In other words, the size of the family farm is increasing significantly, but it remains a family operation and the percentage of our farms in that category has significantly increased over the last 10 years. So over the last 10 years, the policies of the U.S. Department of Agriculture have had, in the overall, the desirable effect of increasing the family farm commercial structure.

There are—some of the changes that have taken place have resulted in fewer small farms and fewer larger farms.

Representative WIDNALL. Well, now, we are going back 10 years. While, in your statement, you are taking 1960 as against 1962, in some other areas—what would the relationship be between 1960 and 1962 in connection with the statement you just made, if you did not just go back the last 10 years?

Secretary FREEMAN. Well, the general trend has been pretty constant in terms of these adjustments going forward. The real question is, as we look into the future, is that if agriculture does not have an increased income, whether this rather healthy trend of increasing the percentage of commercial family farms will continue, because this is the economic mainstay of agriculture and that there are great adjustments taking place in rural America that one need only ride in the countryside to observe.

Representative WIDNALL. May I ask as a nonfarmer, How do you describe a commercial family farm today?

Is it one of 50 acres, 100 acres, 1,000 acres, 2,000 acres.

How does it become a commercial family farm—is it an individual name or a corporate name?

Secretary FREEMAN. That would make no difference as to whether or not it was incorporated. There are a number of descriptions that are slippery if one is not precise in how he uses those descriptions.

First of all, you have to relate it to the area and the nature of the farm. A 250-acre family farm in Minnesota today would probably have been 160 5 years ago. A wheat farm in western Minnesota, the Dakotas, or Montana would today be 1,200 or 1,500 acres.

It depends on what you are talking about.

Generally speaking, I suppose the most constant national definition would be an operation that grosses more than $10,000 a year and where the labor of the family itself provides most of the human manpower.

In other words, outside labor does not exceed that provided by the family. This is generally considered the definition of a family farm.

Representative WIDNALL. As I understand what you have just said there has been an increase in family farms.

Secretary FREEMAN. There has been an increase in the percentage of family farms as related to, let us say, the so-called big corporate farm.

Representative WIDNALL. I am interested in your statement where you say:

> We estimate that the 3-year reduction in tax rates will reduce the tax liability of farm people by $250 to $300 million, or about 20 percent, with a corresponding increase in the amount of income after taxes that the farmers have at their disposal.

As I understand that new tax bill—and I am not on the Ways and Means Committee, so I haven't gotten the first look at the proposals, nor do I have the staff to research it—the Government is going to take away some of the deductions that farmers have had in connection with interests on their mortgages, interest on their debt, and taxes which they are paying, which in my own area the small farmers find the most burdensome.

How are they going to benefit if on one hand you give them a so-called reduction in rate and at the same time take away the deductions they have had?

They are paying more and more taxes in my State primarily for support of schools. How is it going to benefit the small farmer? The corporate farm is going to benefit.

Secretary FREEMAN. I will only say that the drop in rates for the family that pays an income tax on the farm will be commensurate, if they have an income, and the point was made here earlier that there are maybe 2 million farmers that do not have an income—why, if they are not paying any tax now, obviously they are not going to be benefited by the tax bill.

The figures you have before you are our estimate under the tax bill of the tax savings to agriculture and to farmers in this country.

Representative WIDNALL. But then some of the small farmers who aren't paying taxes now will be paying taxes after you get through with the new tax bill.

Secretary FREEMAN. I do not think so.

Representative WIDNALL. You are going to be bringing into income certain things that today are not included in income.

Secretary FREEMAN. On balance, I think if you analyze the tax bill carefully, you will find that is not the case.

Representative WIDNALL. I am sure I am going to do that, and I am sure everyone else will also.

There are some things that puzzle me about our whole agricultural economy. We are constantly forcing out of production some of the finest soil in the United States.

We are taking it up sometimes for recreational purposes, and at the same time we are spending millions and millions of dollars in areas of the United States to bring into production what would be called foul land or less than average land by pouring in every kind of an agricultural incentive, chemical and other things, to grow products.

I am trying to personalize it as far as New Jersey is concerned. We are watching the farms vanish from New Jersey.

I realize in all fairness that part of this is due to the local tax problem, local taxes. But at the same time, I just do not understand why we do not get an overall picture in order to keep in production throughout the United States—not only in selected areas—farmland that is suited already by nature for production, that produces well without spending millions and millions.

Secretary FREEMAN. We are doing that, Congressman. First of all, I know you would agree that we have a kind of society where property is privately owned and that is the way we want it, and a farmer or landowner is free to develop that land for the most economic purposes to his own use.

The result is, we do not always have a completely economic maximum usage of land everywhere around the United States of America.

We are not putting land, generally speaking, into production which is foul land, as you express it. Quite the contrary. We are developing over the long run what we believe to be in a free property system a systematic effort to utilize the best land located in a place where it can produce the most efficiently, rather than to bring into production land which you describe as foul land.

Lots of land in many places today, certainly in New Jersey, which is a highly industrialized and growing State, is put into much more economic use, related even to a recreation or a public purpose, or an industrial expansion or a highway or whatever you might name, and some place else, in the Midwest or the Far West, with our modern transportation, can more efficiently and cheaply service the consumer needs for food and fiber of that State.

This is one of the great things of our country, that we can interchange in this fashion.

There is no policy to bring into production more land, except as individual people in their own land see fit to want to develop for a purpose, which I do not have the power, nor do I seek that, to tell them what they can do with their land.

Representative WIDNALL. Mr. Chairman, I understand my time is up. I would like to follow up this line of questioning a little bit further.

Chairman DOUGLAS. Certainly.

Representative WIDNALL. I just cannot follow your answer on that, when I know that under the present program, even under the program that occurred during the Eisenhower administration, wonderful soil is being taken out of production in our area, with payments from the Government, while we are still spending money to bring into production areas that cannot produce.

Also, I do not follow your argument that with improved transportation between States you can cover at less cost the transportation of fruits and vegetables and other things between the States. As cost of transportation goes up, I think we are going to be very unhappy to find that we become dependent on two or three major sources in the United States for our fruits and vegetables rather than some more localized sources.

I think we are making a great mistake when we go into just green acres for recreation purposes rather than keeping a lot of those green acres for production of fruits and vegetables and things that can be transported immediately fresh to the neighboring areas, and then become dependent on two or three major areas.

Secretary FREEMAN. I do not know of any land, Congressman, in New Jersey that is being paid to be taken out of production that is as productive as you indicate. If there were and it could be producing fruits and vegetables as efficiently as you say, it would be producing them.

If it is not, it is because the landholder has not seen fit to grow the commodity in question, and make a profit that is adequate in relation to the outlay in the return he can get on his capital. The Government has nothing to do with that.

Representative WIDNALL. I think the Government subsidy in our area has a lot to do with that, with alternative crops and everything that goes with it in the agricultural economy.

In the current report, there are around $360 million for reclamation. This is going to be tied in with bringing new land into production. At the same time, we are taking good land out of production and paying people for taking it out.

I think I am right.

Chairman DOUGLAS. If my good friend would yield——

Representative WIDNALL. It is $100 million over 1962.

Chairman DOUGLAS. If my friend will yield, this is due to the political power of the 17 irrigation States and the 34 Senators that they have.

This is a result of the action of Congress and cuts across both parties, particularly in the Mountain States. They insist on these reclamation projects at a high cost per acre. But I don't think you should charge this up against the Secretary. That comes out of the American political system.

Representative WIDNALL. Mr. Chairman, I can only charge against the Secretary a continuance of a policy which existed before.

I am not charging it as against one political party. But I think it is dead wrong, it is using our natural resources the wrong way. We can better use that money in other directions.

Secretary FREEMAN. Might I add in all fairness to some of the Western States and to the so-called reclamation projects, water on those projects is generally not used for any commodities that we have in surplus supply anywhere and it is so stated in the law.

Therefore, if the land to which you refer, Congressman, in New Jersey, is as effective, and could make a profit in the marketplace, it would continue to do so. There is no surplus in fruits and vegetables. These are perishables. There is no support program. There is no Government program, except as we seek to serve the economy by extensive research and marketing.

This has been a great contribution to the agriculture business community and to the people of this country.

But there is no kind of support program for these commodities at all.

Chairman DOUGLAS. I may extend an invitation to my good friend, Congressman Widnall. The Western States have a conference, with a secretariat, both Republican and Democratic Senators, and some Representatives, and they work for irrigation appropriations.

I would be very glad to join the Congressman in an invitation for the nonirrigation States to have a conference.

Senator PROXMIRE. I would be happy to apply for membership in that group.

Secretary FREEMAN. I am glad I do not qualify.

Chairman DOUGLAS. Because it is perfectly true that as a result of the policy of the Congress and both administrations and both political parties high cost land at high altitudes have been brought into cultivation at great expense to the taxpayer, and even though not directly competing with land in the Middle West and the vegetable belts, it is indirectly competing with such land.

So, Congressman, will you sign a joint appeal?

Representative WIDNALL. I will join you.

Chairman DOUGLAS. Then we have the nucleus of a bloc.

Representative WIDNALL. Mr. Chairman, one more question. Mr. Curtis received an answer to a question of his that the $1.4 billion that was going back in this new budget was for money that had been spent prior to this administration. Then I think it was qualified at the last by the fact that some of it was spent in 1960.

How much of that was in 1960 and how much was in 1961 and 1962?

Secretary FREEMAN. I would have to check and I would submit that for the record. I am obviously calling on my memory, but the system of financing of the Commodity Credit Corporation is to replenish the capital stock of the Corporation and it lags 2 or 3 years behind in doing that.

This system is adjusted from Congress to Congress and on occasion, there was the desire expressed by the Appropriation Committees to go on a current basis and to make an appropriation, which I welcome. Then, in the last Congress—I am calling on my memory now—why, this was not done, so we are kind of caught in a squeeze here, where you get a double-up of replenishment for previous years that makes the NOA budget look, as Congressman Curtis pointed out, like it is a walloping increase, when actually, it is a replenishment to try to get back for expenditures long since authorized.

(See p. 169.)

Chairman DOUGLAS. Mr. Secretary, doesn't a large part of the trouble which we have in agriculture come from a fact that you have already alluded to; namely, that the demand for farm products is highly inelastic?

Secretary FREEMAN. Yes, sir.

Chairman DOUGLAS. So that an increase of 5 percent in the total quantity of products produced will cause a reduction in the unit price, whether in bushels or pounds, not of 5 percent, but of 10 percent, 15 percent, or 20 percent, and you have the situation in which, if the farmers produce a larger total output, they receive a smaller total gross income and a still smaller total net income.

And this very fact of inelastic demand means that advancing technology may be a fine thing for the consumer or the middleman, but it works havoc upon the farmer. Furthermore, is it not true that if you were to allow the impersonal forces of the market to operate fully, the result would be a disastrous fall in farm prices, farm incomes, and instead of 200,000 farm families leaving the farm each year, the number would run up to half a million or a million. Isn't that true?

Secretary FREEMAN. The Senator has stated it very well indeed.

Chairman DOUGLAS. And this is what has been behind the farm policies of the last 30 years, really.

Secretary FREEMAN. Yes, sir.

Chairman DOUGLAS. Now, let me ask you another question.

In the feed grain proposals which you advanced last year, for which I voted, you were charged with trying to regiment American agriculture in determining how much they should produce. As I read your bill, you were not trying to do this, you were going to give the farmers the choice as to whether they wanted a completely free market or whether they wanted a market in which acreage, at least, would be controlled.

You took the position that you could not go along in the future half free and half nonfree, so to speak, that the farmers themselves should choose whichever program they wanted. Is that correct?

Secretary FREEMAN. That is correct.

Chairman DOUGLAS. How do you account for the misrepresentation which was given to your program?

Secretary FREEMAN. Well, the misrepresentation sometimes accompanies the effort to present a position and a program. It would appear to me obvious on the face of it that if two-thirds of the farmers see fit to vote for a program, this is a pretty democratic procedure and that they should have that opportunity. Certainly to me it could not be described as an effort to regiment or to dictate to them.

Chairman DOUGLAS. If more than one-third voted against the program, you would have had a so-called completely free market with no control over production and no support for prices; is that not correct?

Secretary FREEMAN. That is correct, and that is the situation now in wheat.

Chairman DOUGLAS. My good friend, Thomas Curtis, says yes, that is true but that you had the threat to dump. Is it not true that the bill had a provision that any surpluses would be disposed of in an orderly fashion?

Secretary FREEMAN. That is correct; and furthermore, the question would remain what we should do in connection with what were very substantial surpluses. As a very practical matter, you are either going to destroy them or you are going to try very carefully to work them into the marketplaces or continue to pay to hold them and store them. So we are stuck with this.

I would merely point out to this committee the situation, if I may, with a little pride, that today there are several hundred million fewer bushels of surplus grain in Government hands, and in this budget there are $250 to $300 million less than we would be spending if it had not been for the cutback in surpluses of both wheat and feed grains.

Further, there would have been an additional hundreds of millions of dollars if we had continued under legislation that was on the books when I became Secretary in 1961, because, under the laws then the surplus would have continued to climb very rapidly.

Now, it has been an expensive program to attempt to bring these surpluses into balance; but, I believe, at the end of this crop year, we shall have eliminated a surplus in feed grains. If the signup is what we expect it to be, we shall have dropped from about 87 million tons to 45 or 50 million tons of feed grains on hand, which we, in the Department, believe to be essential security and stabilization reserves. If the wheat program goes into effect following the referendum, within 3 years we shall have the wheat reserves from 1,200 million bushels down to about 6 million bushels, which we consider necessary reserves.

So although this program has been expensive, actually it has been more successful than we expected it to be, and we are pleased with the response of the American farmers to it.

Chairman DOUGLAS. That raises a question. In your statement, I did not find any outline of the new farm legislation which presumably Congress will be asked to pass. Does this mean that you have not yet made up your mind what type of a bill you are going to suggest to Congress?

Secretary FREEMAN. Yes, it does, Senator; in the sense that I have been trying very carefully to consult with Members of Congress in connection with, as a very practical matter, what this Congress is willing to entertain. I do not contemplate submitting an omnibus bill as we have before, but seeking, now that we have made some significant progress, to submit specific commodity programs at the proper time. I think there is a strong likelihood that, in the near future, the President will submit a general farm message, setting out the broad outlines he thinks we ought to follow in connection with particular programs, and I still have some more consulting to do in connection with specific commodity programs.

Chairman DOUGLAS. Mr. Secretary, since you have made this very fine statement, may I say that if you consult with congressional leaders and follow their advice, you are likely to come out with a program which will protect cotton and wheat, but which will leave the feed grains in the lurch, because there is a close alliance in Congress, as you well know, between cotton and wheat, which operates over a wide spectrum, in which the representatives of wheat customarily vote on civil rights with the defenders of cotton, and when the kissing takes place under the mistletoe, corn is never there.

Mr. Widnall has made a very eloquent plea for fruits and vegetables of New Jersey. I simply ask you not to forget the corn of the Mississippi Valley. We have been sold down the river a great many times. I know you do not want to do that yourself, but you sometimes get caught in a political bind.

Paraphrasing Winston Churchill, "I did not become a U.S. Senator to witness the liquidation of the corn democracy of the Middle West."

Senator Proxmire?

Senator PROXMIRE. I was not going to get into the specifics until the chairman pushed us into them, but since we are talking about feed grains, I would like to ask you a couple of things about it for the record.

No. 1, you talked about the improvement in the feed grain picture that was effected without the proposal which was turned down by the Congress last year, which I opposed and you proposed.

Secretary FREEMAN. That is right. We hope it will be. We do not know how this program will work yet.

Senator PROXMIRE. The program which was actually in operation was the Kennedy-Freeman program for 1961, which was an excellent proposal and which did, for the first time in a long time, reduce the feed grain surplus.

Secretary FREEMAN. Yes, sir.

Senator PROXMIRE. In the third place, there is considerable question on the part of certainly many polling experts, Sam Lubell being one example, and there being others I have seen, that the feed grain referendum could not have succeeded in view of the fact that 80 percent or so of the farmers growing feed grains feed them on the farm and do not sell them off the farm. Therefore the farmer would be faced with a referendum in which he would vote for reducing his production of what he would feed to his own animals, without being able to see any direct or immediate benefit that he would get.

This would be especially true with the dairy farmer, inasmuch as dairy farmers grow feed grain, as you know as well as I do, as a Minnesota Governor; they grow these feed grains and feed them on the farm, and the reduced feed grain production could not and would not increase the price of dairy products, firmly anchored at 75 percent of parity. So he would be voting against his interest if he voted for this bill, inasmuch as he would reduce his own production of feed grain and he would not get any greater income.

I can see the great benefits of your proposal if it worked out. It has a lot of merit. But the danger of submitting this to the farmers and not getting a two-thirds vote, and having no program at all if they voted no, it seems to me, was a terrible risk and would have resulted in disaster in our feed grains. That is why I voted against it.

Secretary FREEMAN. I can only comment that the Senator won the contest. The bill did not pass.

Senator PROXMIRE. Here in your statement you talk about the 3-year reduction in tax rates, saying that it will "reduce the tax liability of farm people by $250–$300 million or about 20 percent, with a corresponding increase in the amount of income, after taxes, that farmers have at their disposal."

Since it is an $11.1 billion tax cut, this would give the 8 percent of our population which are now on farms only 2.5 percent, roughly, of the tax cut. So in other words, they would get far less than a pro rata per capita share.

Secretary FREEMAN. I think that is right, because the income of agriculture is substantially less than the income of nonfarming segments.

Senator PROXMIRE. However, you would agree with me that they pay heavy taxes in other areas, and these would not be cut?

Secretary FREEMAN. They pay property taxes and local taxes, which would not be cut, and these are the heavy taxes which the farmer pays.

Senator PROXMIRE. And the farmer is a debtor. We learned that farm income has remained the same and interest charges have almost tripled.

Secretary FREEMAN. Yes, sir.

Senator PROXMIRE. If we follow a policy, which seems to be advocated by many, of a loose fiscal policy—in other words, spending more than we take in—and tight money, high interest rates, to restrain inflation, in your judgment would not this adversely affect the farmer, inasmuch as he would not get much benefit from the tax cut and would be really on the paying end of higher interest rates?

Secretary FREEMAN. I am not an economist, nor am I testifying as one. But I think a tight money policy, so-called tends to run contrary to the farmers' interest. Because as you pointed out, he normally uses credit heavily and pays very heavy interest charges.

Senator PROXMIRE. I am going to ask you a question which I would not ask if you were not so capable, and today I think you are doing even better than I have ever seen you do before. I think you are doing a superb job.

Chairman DOUGLAS. Be careful, now.

Senator PROXMIRE. I have the budget for 1964, page 48.

Page 48 shows that the Defense Department decreased the number of employees, will decrease them in the coming year. Other departments increased them, and the Agriculture Department increases its number of employees more than any other department of the government, with the exception of HEW, which increases about 5,900, and the Post Office, 9,600. The Post Office, of course, is far bigger.

Now, I can understand the difficulties in arriving at an agreement on increased spending in agriculture on the basis of the administrative budget, the cash budget, the obligational budget.

But here it seems is irrefutable evidence of an increase in the Agricultural Department bureaucracy, with 1963 having 116,268 employees and in 1964, 121,583 employees. What is the answer?

Secretary FREEMAN. I am glad you asked that question, Senator, because we shall show in our on-going programs, for example in our stabilization programs, by and large, a reduction in personnel and the application, I think, of as many and as effective administrative improvements and the use of modern data processing equipment and various modern administrative methods as any department in the Government, and I think as any private corporation in the country.

Our increases come simply in a program expansion in, particularly, our forests and our soil conservation programs.

Senator PROXMIRE. Why do you have an expansion here, in view of the fact that we have just argued and you seemed to concur, that we have had income disaster on the part of our farmer from the programs of the Department of Agriculture which have promoted research in soil conservation, and many of these other very instructive things.

I can see why we have to have them, but why expand them?

Secretary FREEMAN. First of all, the Nation's forests, we have 186 million acres of national forests.

Senator PROXMIRE. How much of this increase is in forests?

Secretary FREEMAN. Of 10,000, I would guess 6,000 is in forests. I would guess another 3,000 is in soil conservation, and I would guess that the remaining 1,000 is in agricultural research for staffing of laboratories which have been in the course of construction for some time, and go into the utilization research that Congressman Curtis referred to a moment ago.

Senator PROXMIRE. The 10,000 increase between fiscal 1962 and fiscal 1964?

Secretary FREEMAN. Yes. We have had, since I have been Secretary of Agriculture, a number of visits by people, for recreational purposes, to the Nation's forests; it has jumped from about 70 million to 110 million. It has been going up by leaps and bounds.

Senator PROXMIRE. How about conservation? Why is that?

Secretary FREEMAN. Because there have been going through this Congress many local watershed programs—in Illinois, all around the country—to prevent erosion. These take a long time.

First there is planning, and these are coordinated into upstream water control, prevention of erosion, and flood control on the stream beginnings. Now, a number of these programs that have been planned over the years now are reaching the culmination where Congress is acting on them and authorizing their construction.

We have a 10-year forestry program which involves an increase in expenditure to try to update these forests, to build roads into them, to make them available for both recreation and industrial purposes, to protect them in fire and all the rest of this, which involves a substantial capital investment.

This is the kind of thing, when you move dirt and when you need technicians and when you need people.

In terms of our on-going programs, I would want to repeat, I would be happy to submit an analysis, the number of personnel involved has been substantially decreased.

Senator PROXMIRE. Is any of this paid for by a trust fund? In other words, do you charge farmers for improvement in their land?

Secretary FREEMAN. This is not farmers; this would be a local conservation, a local soil conservation district, and they enter into cost-sharing as a part of it. But in the forests, we have the situation where—and I am just recalling now—a net of $175 million a year from receipts in timber goes into the general revenue account, and the budget will show an item of $350 million worth of expenditures for forests.

By the same token, in Agricultural Marketing Service, you will have an item—again I have forgotten precisely—of $50 to $100 million for research, where half of it or more is paid for in fees, which goes into the general revenue account, but for which the Agriculture Department is charged as if it were a total outlay.

Senator PROXMIRE. What percentage of this cost for personnel will be paid for in charges to the public or beneficiaries?

Secretary FREEMAN. Virtually none, in terms of additional personnel.

This pattern repeats itself. In this budget, you will find REA loans, maybe $400 million authorized; we shall have paid back this year $350 million in REA loans. That will not even show in our budget. That will go into the general account and we will be charged with those loans.

We do now have a revolving account in REA which we can draw on so the budget item no longer shows up. But the average increase in employees is within the Soil Conservation Service, the Forestry Service, for staffing, laboratories, research, long since authorized and just now coming into use.

Senator PROXMIRE. A couple of other quick things I would like to ask about.

On page 28 of the Economic Indicators, it shows that indexes of prices received by the farmers have dropped catastrophically since 1952, but have remained about the same steadily since 1957–59. But the prices paid by farmers—interest, wages, tax rates, all items—have gone up regularly and in a very consistent way from 1952 to date. This seems to me to imply that any inflationary bias of the economic policies of this administration—that is, if the tax cut results in higher prices, whereas the farmer would not benefit very much from the tax cut because his income is low—he would be hit hard by the increase in prices, because he has to buy so much just to operate his farm, he has to spend so much.

Inflation hits him harder, perhaps than any other group in our economy.

Secretary FREEMAN. You are absolutely right, and, of course, the economic fact of life is that we live in a highly-organized society, whether it be the business community, whether it be those who process and distribute, or whether it be labor; there are organized groups that have some muscle in connection with their percentage of the take.

Farmers have been not only an unorganized group, but as such, they have been low men on the totem pole because they cannot stand up and exercise the kind of muscle needed to get what they are entitled to.

So increased costs are passed off on them, and their increased production tends to have a depressive effect on prices, so their situation tends to become progressively worse.

Unless some kind of machinery is developed, and I emphasize, not necessarily government machinery—preferably self-help machinery that farmers can operate themselves so they can have comparable economic muscle in the marketplace, that will happen.

Senator PROXMIRE. I heard that the Department of Agriculture might have plans for distribution of our surplus, including the dairy surplus, widely in case of atomic attack; special packaging and so forth, so it would be available to our people if we had an atomic attack. This would take it out of commercial channels and, to some extent, prevent the price depressing surplus overhang, in a very constructive way, in view of the terrible situation we would be in just for food, in an atomic attack.

Can anything be said about this now?

Secretary FREEMAN. Yes, there will be proposals made to the Congress, and I think there is a good deal of discussion of this in the Congress, for the strategic location of both processed and semiprocessed foods which would be relatively inexpensive in terms of increasing the pipelines that now go to the school lunch programs and other appropriations.

Also, to try to place at strategic places around the country wheat and feed grains in deficit areas. This we are beginning in a modest way, and we are trying to administer and handle the Commodity Credit stocks in such a way that they will be located, so far as we can, consistent with sound business management, in places where they would be needed in the event of an emergency.

I would want the Senator to know that I think, as I was encouraged to discover in some depth at the time of the Cuban episode, we have quite a civil defense organization in agriculture. I have always believed in its importance, and we are prepared, I think, to meet any emergency.

Senator PROXMIRE. That is very encouraging. It will be a help, too, from the economic standpoint.

The only other question I have is why can't we have more dairy in our food-for-peace programs? It is my understanding that 32 percent of our wheat marketings goes into food for peace, and over 1 percent of our dairy marketings, although dairy is something that can be packaged as dried milk, and so forth, and can be used so constructively overseas.

Secretary FREEMAN. A good deal more is and should be used. The problem is a mechanical one, it is a very practical one, because the use of dry milk is something that many people are not familiar with and do not actually know how to use. We have to have the means to distribute and to get it where it is needed. When people sometimes, I think—what they do not stop to realize is that every country in the world has a commercial system of distribution. Almost no country has a concessional system of distribution. The net result is that it is a real challenge to get the food to the people who really need it without disrupting the economy of the country in question and without extensive amounts being diverted to misuse and black market and other places.

But the program has been substantially stepped up. The payment-in-kind program for work projects, the school lunch program for children, has been increased by 10 million children that are being reached. Today, over 90 countries around the world are receiving in one form or another American food. I think that there is going to be a substantial expansion where dairy is concerned, but it is a problem of teaching people how to use it.

Senator PROXMIRE. Thank you very much.

Chairman DOUGLAS. If our Republican friends would agree, I would suggest that they confine their questioning of Secretary Freeman to 10 additional minutes.

Representative CURTIS. Each?

Chairman DOUGLAS. Well, now——

Representative WIDNALL. I do not want that much.

Representative CURTIS. I have some questions here, Mr. Secretary.

Secretary FREEMAN. I am worried about you, the way you have been studying this budget.

Representative CURTIS. The only way I know to go at these things is to get to the details, Mr. Secretary.

While you were talking about forestry service, I am aware of the need for expansion here. Forestry service is an item that has a net cut from 1963 to 1964. Not much, but it goes from——

Secretary FREEMAN. Well, Congressman, if you would take a look at the emergency public works program in there, you would find that there have been about $20 million that have gone to the forests, and we have put unemployed people to work around the country building forest roads and trails and putting into practice some forestry management principles, and that gets to Senator Proxmire's question.

It is true that the 10-year forestry program that would have called for about a $20 million a year increase has been cut back and that we are not maintaining that level of expansion. The only increase that has been allowed has been the increase for forest roads and trails which was related to the economic condition of parts of the lumbering industry in the West, and the need to be able to get into these places to reach the timber.

Representative CURTIS. That goes up $5 million and access roads goes down $2 million.

Secretary FREEMAN. I do not want to dispute those figures in that budget.

Representative CURTIS. It is your own budget. One is on page 170, and page 171 is where Forestry Service starts.

Secretary FREEMAN. These must show someplace else then, because I am quite——

Representative CURTIS. It shows a $5 million increase of forest roads and trails from $80 to $85 million. Then just right below it, it shows access roads cut by $2 million. And the total for the Forestry Service is not very much less, but it is a minus figure, −$244,000 less than your previous budget.

Now, going on over, we can find out somewhere——

Secretary FREEMAN. I am sure the Congressman does not object to cutting the budget.

Representative CURTIS. No; I am simply trying to follow your figures, because you have told us where the increases were. I know where the increases were. I am going to come to them.

One of them, of course, is the Farm Home Administration, where increased salaries and expenses go up 20 percent—that is page 168—to a figure of almost $40 million.

Secretary FREEMAN. With an increased volume of loans of over 200 percent.

Representative CURTIS. No. As a matter of fact, it is not. You have a $50 million authorization to expend from debt receipts and that is eliminated. In place of that, you have your program of $100 million, so it goes up 100 percent.

Secretary FREEMAN. Supplemented by $300 million of repayments which you will find someplace else in this document.

Representative CURTIS. It does not show here. I know the expense is there.

But now I want to get to the real items that bring your new obligational authority up by $1.4 billion. That shows on page 166 in the total Commodity Credit Corporation fund for $428 million. Actually, the breakdown of that is on page 164, and it does relate to price supports and related programs in special bills. The big item is $520 million. Here is your notation: "Request is to cover 1962 realized losses. Decrease in expenditures caused largely by reduction of unusually large volume of cotton placed under price supports in 1963."

But there is your item of $428 million. It is really $520 million and it is from 1962.

Now, then, let us go over to the biggest item, which is really Public Law 480 funds. This is on page 163, at the bottom—"Foreign assistance programs, Public Law 480," an increase of $879 million. Let me read the note on this: "Appropriations made to cover estimated CCC losses."

It does not say anything about 1960. It says "estimated."

Expenditures for these purposes included a part which will be reimbursed to cover CCC later and are summarized in explanation under CCC below. But those are your two big items which, together, total about $1.3 billion.

We shall leave the record open, though, Mr. Secretary, so that any further explanation of this you would like to make I would be glad to receive.

(The following was later received for the record:)

The programs of the Commodity Credit Corporation are financed currently through use of the Corporation's borrowing authorization of $14.5 billion. Current expenditures are made from funds borrowed under this authorization and not from appropriations to the Corporation. Appropriations to restore the impairment of the Corporation's capital, resulting from losses incurred, are made (and, with minor exceptions, have been made for many years) 2 years after the year in which the losses were incurred. The 1964 budget includes a request for an appropriation of $2,799 million for the fiscal year 1964 to reimburse the Corporation for losses incurred under the price support and related programs in the fiscal year 1962. Because of the 2-year lag in these appropriations, the appropriation requested for 1964 does not in any sense represent a measure of the estimated expenditures or losses of the Corporation in the fiscal year 1964.

A similar situation is also involved in connection with the items shown in the budget under the heading "Foreign Assistance Programs." These include the Public Law 480 activities, the International Wheat Agreement, and the barter program. The basic laws which authorize these programs also authorize the use of CCC funds to finance them. In the beginning these programs were financed entirely from CCC funds and appropriations to restore the cost to CCC were made 2 years after the cost was incurred. For the past several years, in view of the need to relieve the Corporation's financial resources as much as possible of the burden of carrying the cost of the foreign assistance programs, appropriations have been provided on the basis of including (*a*) an amount to be applied to the current cost of the programs and (*b*) an amount to reimburse CCC for unrecovered costs of the prior year's programs. The 1964 NOA estimate for the foreign assistance programs includes $563 million representing estimated unrecovered prior year costs.

Of the total increase of $1.4 billion in NOA for 1964 for the Department of Agriculture, $1.3 billion relates to appropriations to restore losses on prior year CCC activities and appropriations for the foreign assistance programs.

Secretary FREEMAN. Thank you very much.

You will note the item of $1 billion which is called sale of commodities for foreign currencies. You will notice the item of $1,560 million. This is a restoration for sales that were contracted for a year ago.

Representative CURTIS. Your note says made to cover estimated CCC losses.

Secretary FREEMAN. This is——

Representative CURTIS. If they were incurred, they would not be estimated. They would be real. You see, I do not think we can escape the fact that——

Secretary FREEMAN. Estimated losses. I think this use in this document of "estimated losses" refers, you see, to sales under title I, which are estimated losses. Theoretically, we have acquired soft currencies for these sales at 1 day, and their value we can only conjecture about. But the replenishment of the capital stock of the Commodity Credit Corporation, it is my best recollection, reaches back to 1960. I would be glad to give the committee a breakdown on this.

Representative CURTIS. That is all I want, Mr. Secretary, so that we can understand this.

Secretary FREEMAN. Very well. It will be a good review for me. Every time Congress jiggles with it, we end up with something a little different.

Representative CURTIS. I never quite understood what accounting procedures you followed. In fact, I have been critical, as you know, of the procedure followed here in entering a minus $1 billion item instead of a $2.5 billion receipts from the public for the sale, and then a $1.5 billion increased expenditures to give you that minus $1 billion net. Would you explain the accounting procedures that you actually do follow?

Secretary FREEMAN. I shall try to do that, and if I might be presumptuous enough to make a suggestion, and I make it in all seriousness, this is a complicated business and Congress has had their reasons for doing it, and if you have had occasion to bump into the chairman of the Subcommittee on Agricultural Appropriations, I think he will give you a pretty good picture of what really happened.

Representative CURTIS. I know they are frustrated, Mr. Secretary, because I have talked to them. That is why I take this opportunity to go directly to you to ask this. I can assure you that Congress does not know what is going on here, or does not feel satisfied, because I have talked to the people who were supposed to try to follow these dollars.

Secretary FREEMAN. Let me get a narrative in connection with what has happened over the past 4 years in the Commodity Credit Corporation Act and submit it for your perusal.

Representative CURTIS. If you would, Mr. Secretary; thank you very much.

I have no more questions, Mr. Chairman.

Chariman DOUGLAS. Mr. Widnall?

Representative WIDNALL. I have one more thing to say. I remember last session, when the agriculture bill came up and was finally passed in whatever form it was finally passed, some questions were asked about the city consumer, whether support prices were going to hit the city consumer, and there was a denial of this.

I would like for the record to say that in the metropolitan area where I live, around New York, they have just increased the price of bread 2 cents a loaf. I hope the administration will crack down in this case the way it did in steel. This affects the consumer.

Secretary FREEMAN. May I comment on that, that this is a very odd situation, because the price support for wheat in 1961, or the 1962 crop year, was $2 a bushel. The current support price for wheat is $1.82 a bushel. In other words, as it now stands, the price of wheat, as far as Government support is concerned, is less. That being the case, there could not conceivably be attributable to the administration program that there is an increase in the cost of bread in your area.

Representative WIDNALL. I hope this is right.

Secretary FREEMAN. There is absolutely, in terms of any change in price, no justification whatsoever for the increase in bread price.

Representative WIDNALL. Have you seen the announcement of the price increase?

Secretary FREEMAN. No.

Representative WIDNALL. I think it would be a very interesting thing for the Department.

Senator PROXMIRE. Will you yield on that?

Representative WIDNALL. Yes. I have no more questions.

Senator PROXMIRE. Could I ask how much of the 2-cent increase in a loaf of bread, how much in the total cost of a loaf of bread does the farmer get?

Secretary FREEMAN. If that loaf of bread were selling for 23 or 25 cents, he would get 2.5 cents.

Senator PROXMIRE. So you would have to double what the farmer receives in order to justify this on the basis of a support price?

Secretary FREEMAN. Yes.

Chairman DOUGLAS. If there are no further questions, we want to thank you, Mr. Secretary.

Secretary FREEMAN. Thank you, Mr. Chairman and members of the committee.

(Whereupon, at 4:06 p.m., the committee recessed, to reconvene at 10 a.m. on Wednesday, January 30, 1963.)

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JANUARY 1963 ECONOMIC REPORT OF THE PRESIDENT

WEDNESDAY, JANUARY 30, 1963

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

The committee met at 10 a.m., pursuant to recess, in room AE-1, the Capitol, Senator Paul H. Douglas (chairman of the joint committee) presiding.

Present: Senators Douglas, Proxmire, Pell, and Miller; Representatives Reuss, Griffiths, and Curtis.

Also present: William Summers Johnson, executive director; John R. Stark, clerk; James W. Knowles, senior economist; and Roy E. Moor and Donald A. Webster, economists.

Chairman DOUGLAS. The hour of 10 o'clock having arrived, the committee will come to order.

We are very glad to welcome Mr. Willard Wirtz, the Secretary of Labor. We are very proud of Mr. Wirtz in the State of Illinois. We are proud indeed that we have furnished two successive Secretaries of Labor to the Cabinet.

STATEMENT OF HON. W. WILLARD WIRTZ, SECRETARY OF LABOR; ACCOMPANIED BY SEYMOUR L. WOLFBEIN, DIRECTOR, OFFICE OF MANPOWER, AUTOMATION, AND TRAINING, AND STANLEY RUTTENBERG, SPECIAL ASSISTANT FOR ECONOMIC AFFAIRS, U.S. DEPARTMENT OF LABOR

Secretary WIRTZ. Mr. Chairman, you know how very real and personal a pleasure it is to participate in the affairs of this committee under your chairmanship, sir. I am very grateful for this opportunity to meet with this committee.

I have submitted a statement and I should propose to follow that statement to a considerable extent, and yet I think perhaps in the interest of time it will be possible to shorten it a little bit.

I shall take that liberty, if it is all right with you, Mr. Chairman.

Chairman DOUGLAS. The statement as a whole will be printed and then any off-the-cuff remarks which you make will be added at the appropriate time.

(The statement referred to follows:)

TESTIMONY OF W. WILLARD WIRTZ, SECRETARY OF LABOR, BEFORE THE JOINT ECONOMIC COMMITTEE ON THE PRESIDENT'S ECONOMIC REPORT, JANUARY 30, 1963

I

I am very grateful for the opportunity to meet with this committee to discuss the country's economic future. I am especially gratified because the Economic

Report of the President which you are currently considering is, in my opinion, a notably frank, courageous, and able public document.

The report records the significant economic progress we made in 1962. This was reflected, so far as the manpower figures are concerned, by an increase in nonfarm employment of 1⅓ million, reaching by yearend a level 1.7 million above the best totals prior to 1961. The fraction of labor time lost through unemployment and part-time work has dropped from 8 percent in 1961 to about 6.7 percent in 1962. The number of major labor market areas with heavy unemployment fell from 76 in January 1961 to 41 in December 1962. These gains have been especially notable because they have been achieved without inflation and with a substantial improvement in our balance of payments position.

Yet, instead of complacently describing the underlying economic strengths, the report refuses to gloss over our economic shortcomings, and expresses dissatisfaction with the differences between where our economy is and where it can and should be. Instead of boasting about the role of the Government, it recognizes that the Government's tax system has been in effect a major factor in our inability to achieve a greater degree of economic well-being for a large number of our citizens.

This frankness comes not from despair but from strength and from the knowledge that a vigorous, well-though-out program of tax reduction and reform can give us the dynamic prosperity which no amount of exhortation could provide.

We have large numbers of workers without jobs, mainly because producers do not have markets; and producers do not have markets because purchasing power is too small, incentives for investment are inadequate, and the rate of operation is too low to permit the full benefits of our newest techniques and machinery to be reflected in competitive pricing. We have struck an equilibrium well below where it could be. A carefully conceived change in the tax structure will result in a higher level of business and personal purchasing power, adding incentives for risk taking and personal effort which will in turn enlarge the circle by providing new jobs and generating still larger markets and further investment.

My testimony here today will be set in the context of my own responsibilities. These relate principally, so far as the subject of the committee's central interest is concerned, to the subject of manpower. It is appropriate to point out in this connection that, as prescribed in the Manpower Development and Training Act which Congress passed last year, the President will shortly present to Congress the First Annual Manpower Report. That report will bring together for the first time the great variety of statistics and analytical information available on our manpower requirements, resources, and utilization. Some of what is touched on in my present statement, relating especially to the basic relationship between our economic growth and our manpower problems, will in all likelihood be the subject of more definitive development in the manpower report.

II

I note, as meriting the committee's attention and consideration, the relationship between the general economic condition, particularly as it affects the job situation and outlook, and the currently much publicized subject of labor-management disputes. This relationship involves more than the fairly obvious fact that wage raises are given most readily when business is good and when the job market is tight. I refer rather to the fact that today the lack of that adequate long-term growth which has characterized our economy in recent years is intensifying labor-management problems and is creating a new issue, job security, which is potentially as troublesome as the "rising cost of living" once was.

This issue is sometimes misconceived as a difference in attitudes toward the developments we describe, too roughly, as automation. It is not this. All Americans—businessmen and workers, economists, and the man in the street—have accepted new methods, new machines, new products as major factors contributing to our rapidly improving levels of living. They have recognized the historical fact that rising productivity brings with it more and better jobs than it takes away.

The difficulty is rather that improved technology accomplishes its whole purpose only when the economy is expanding strongly. The American workingman feels safe only when jobs are available and when incomes reflect his increasing value to the economy. When business is unable to expand, however, it cannot furnish new job opportunities for those affected by improved technology, much less for new jobseekers. Furthermore, when business is unable to expand, it cannot provide the increased incomes which are both the real fruit of rising productivity and the source of further demand. In an economy which is not sufficiently dynamic, business operates too near the break-even point and workers—particularly those who have become permanently attached to a particular occupation, industry, area, and even firm—fail to receive the security and to enjoy the rising standards of living which are the measure of a healthy economy. Another result is that the major emphasis of business investment is placed on labor-saving rather than expansion of capacity.

III

We face the fact today that a slowing up of the rate of growth in the economy in recent years has meant reduced opportunity for people to find and keep jobs.

I have just received from the Department of Labor's Office of Manpower, Automation, and Training, and am releasing today, a report on industrial employment since World War II. It makes the recent retardation of growth acutely clear.

This report confirms the general realization that job opportunities are declining significantly in certain major industries. Agriculture, for instance, is employing 3 million fewer workers now than in 1947; an average annual decline of 200,000. Mining employment is also declining steadily, and is now 300,000 below the 1947 levels. But what is not so well known; employment in contract construction, which advanced sharply until 1956–57, has since then fallen by 300,000; and the same trend, including the same numerical decline, has appeared in the transportation and public utilities group.

In manufacturing there has been a net loss of 425,000 jobs in the past 5 years, as contrasted with a gain of 1.6 million jobs in the previous decade. This job loss was entirely among production workers, whose number declined by 775,000.

Employment in the trade sector, which had also risen rapidly until about 1957, has advanced recently at a relatively slow pace. The rate of growth in the finance, insurance, and real estate industry has also slackened since 1957. Only in the service sector, of all the private nonfarm groups, has the rate of expansion in the past 5 years matched the earlier postwar rate.

Another exception to this disturbing picture of slackening growth is the public sector. While the rate of growth has slowed down in the Federal sector, there has been a sharp increase at the State and local level, largely in school systems, at an annual rate of 312,000 jobs a year since 1957, or about 100,000 more per year than in the previous decade.

Summarizing these figures, the stern fact emerges that the number of persons on nonfarm payrolls has been expanding in the past 5 years at barely half the rate of the first postwar decade even while the number of workers potentially available has been increasing more rapidly. The annual rate of increase in the last 5 years was only 0.9 percent, as contrasted with an annual rate of 1.9 percent between 1947 and 1957. In actual numbers, there were less than half a million new nonfarm jobs added to payrolls each year of the past 5, compared with 900,000 per year earlier. The contrast would be even sharper if we were to remove the Government employment figures and consider only the private nonfarm sector.

As a result of the reduction in the number of jobs available in our major industrial activities, the proportion of all workers in goods-producing industries has fallen from 51 percent in 1947 to 46 percent in 1957, and to 42 percent in 1962. In fact, there were actually 1.5 million fewer workers in the goods-producing industries—agriculture, manufacuring, construction, and mining—in 1962 than in 1947.

Along with this shift has come a change in the number of blue-collar or manual jobs available. In 1956, for the first time, there were more white-collar workers than blue-collar workers. In 1962, the number of manual workers was only 3 percent greater than in 1947. Within this group, skilled craftsmen were the only occupational group to experience an increase, although even this category has been growing at a rate slower than that for the economy as a whole.

Looking at job totals by industry, or by occupation, does not tell the whole story. Growth in service-type employment has been accompanied by a slowdown in the expansion of full-time scheduled jobs. In the private, nonfarm group as a whole, virtually the entire increase in employment since 1957 is accounted for by a rise in part-time employment, chiefly in the trade and service industries.

Small wonder, then, that we cannot be satisfied with our present rate of economic expansion. Small wonder, then, that increased productivity—the essential ingredient in our dynamic, competitive economy—has become a major complicating factor at our bargaining tables.

One of the byproducts of the slow growth in job opportunities and in incomes is the tendency to seek a shorter standard workweek as a solution. The common aim of current proposals is to spread existing employment opportunities among a larger number of persons, without reducing regular weekly earnings.

It is not hard to understand, with 4 million men and women unemployed, the reasons for proposing shorter hours of work. But merely distributing currently available man-hours of work among all members of the labor force is no solution. The additional costs resulting from reducing hours without reducing weekly wages would lead to higher prices, reducing real wages, and making more difficult the attainment of other economic objectives, including the improvement of the Nation's balance of payments. The infinitely preferable policy is to encourage the greater effective demand which will create jobs for unemployed workers. Many of those advocating the principle of a shorter workweek apparently prefer, in fact, expansionary fiscal and monetary policies to reduce unemployment, but they apparently believe that adequate policies to expand output either cannot or will not be applied.

I note, too, that any legislative advancement of the shorter workweek principle would have the defect that it would represent a program for the economy as a whole and would not take account of the diversity of economic conditions among firms and industries as well as the differing preferences for work schedules among employees. There has, of course, been a long-term trend resulting in a steady decline in the total time individuals spend at work. Gradual changes in working time reached through collective bargaining, whether in the form of a shorter scheduled workweek or more time off through longer vacations and more holidays, have been occurring for many years and have had an important beneficial effect both for workers and for the general economy. However, major abrupt changes which would have a serious impact on unit labor costs would be neither in the best interests of the parties nor helpful to the economy. The implementation of the President's tax program will greatly reduce pressures for working hours to spread employment. It will place the issue of shorter working time in proper perspective.

IV

I need not repeat here the details on the other side of the manpower ledger—unemployment. The President's Economic Report has made clear the heavy social costs, the damage to the individual and the family, and the irretrievable waste of manpower, all of which would be reduced immensely if the economy were to move upward at a faster pace.

I note, however, the implications of the fact that the unemployment rate of 5.6 percent in 1962—a nonrecession year—was exactly the same as in 1954—a recession year. There is no warrant for complacency in the face of the fact that the economy now leaves as much joblessness in a good year as it did not very long ago in a recession year.

Equally disquieting is the fact of a rise in the degree of joblessness which must be considered long-term unemployment. In 1957, out of every 100 jobless workers, 19 had been out of work 15 weeks or longer. In 1962, the ratio of long-term jobseekers had risen to 28 per 100.

The increase in long-term unemployment raises a serious question as to the adequacy of resources to tide jobless workers over their emergency. Studies by the Department of Labor of beneficiaries of the Temporary Extended Unemployment Compensation Act of 1961 (who were the long-term unemployed) showed that two-thirds were the sole or primary support of a household, two-thirds were between 25 and 54 years of age, and three-fourths had been in the labor force during every month of the 3 years preceding their first claim.

The President, in his Economic Report, has recognized that the Nation has a special responsibility to these people, most of whom are paying the price, not for their own inadequacy, but for the general failure to provide a sufficiently dynamic economy. We need an updated unemployment insurance system which will extend coverage to more workers, which will encourage the States to provide more adequate and equitable benefits, and which will extend the duration of unemployment benefits in recognition of the fact that the economy is not providing the opportunities for finding jobs which it is capable of providing. It will, at best, take time for a major push in employment to gain sufficient momentum to reduce long-term unemployment significantly.

Among the most serious, persistent, and intractable unemployment problems are those facing young people. In the past, the high rate of unemployment among young people has too often been accepted as inevitable. Joblessness is always higher among them than among adults, because they include a high proportion of new labor market entrants and job changers and because young people starting on their working careers tend to be more vulnerable to layoffs. But more recently the unemployment problems of young persons have become increasingly urgent. The number of unskilled and semiskilled jobs—those which frequently provide the first opportunities for new young workers—has been declining at an accelerating rate. The forthcoming manpower report will carry projections of future occupational needs which will demonstrate the growing demand for skilled, well-educated workers.

The rate of unemployment is especially high for youngsters who drop out of high school. Some 27 percent of the dropouts who left school in 1961 were unemployed in October of that year, as compared with 18 percent of the high school graduates.

There is urgent need for specific legislation intended to provide employment opportunities for the youths who are now or are in danger of being left out of the mainstream of employment. Last October there were 600,000 youths age 16 to 21 out of school and out of work. Out-of-school youth were 7 percent of our labor force—but 18 percent of our unemployed. They are a major problem today—and the problem can become steadily worse from year to year unless we lend them a hand. Constructive work opportunities are essential to give them a sense of belonging, a sense of responsibility, and the incentive to seek further education and training.

The Youth Employment Act can help provide opportunities to do necessary and meaningful work, both outdoors and in community facilities, such as hospitals and recreation centers. Serious needs exist, and these youngsters can be used constructively.

Passage of a Youth Employment Act in this session could well be an important companion piece to a tax bill. The latter would open new job vistas and the former would show discouraged and disillusioned youngsters that they, too, have a share in the burgeoning prosperity.

V

If a review of the past 5 years offers only incomplete reason for satisfaction, it is plain that the next 5 years will test our mettle more sternly. Let me put the problem in the plainest terms—not in GNP, not in unemployment rates, and not in goals—but simply in terms of the jobs needed and our efficiency in furnishing them.

Between 1957 and 1962, our total labor force increased by 3.8 million. Over the same 5 years, output per man-hour in the total economy rose a total of 12.5 percent. In order to avoid any net displacement resulting from the rise in productivity, 7.5 million job opportunities had to develop either in the same shops—in the form of increased output—or elsewhere in the economy. Thus, it was necessary for the economy to produce 11.3 million new jobs or job equivalents. It fell short of that task by 1.1 million jobs—the increase in unemployment—or 10 percent. In other words, the economy furnished 90 percent of the new jobs or the new job equivalents which were necessary simply to keep unemployment from rising above the 4.3 percent rate of 1957.

The 90-percent rate of achievement is probably too high a figure. Had the demand been adequate, the labor force would have risen by a larger amount than it actually did because more housewives would have taken jobs to supplement the family income and fewer older workers would have left the labor force because of inability to get jobs. In addition, a faster rate of growth would have brought with it economies of scale and incentives to modernize, which would have increased output per man-hour.

What does even the inadequate 90 percent mean for the future?

Between 1962 and 1967, the labor force will increase by an estimated 6.5 million. If productivity in the total economy rises at the postwar average of 2.7 percent a year—a very conservative rate—some 9.6 million new jobs or job equivalents will have to be provided to meet the effects of this increased productivity. This means a total need for 16.1 million new jobs—just to stay even.

A 90-percent rate of efficiency in meeting this need (the 1957–62 experience) would result in an increase of 1.6 million in unemployment. Total unemployment would, therefore, rise from the present 4 to 5.6 million—or to more than

7 percent of the 1967 labor force. This would be the intolerable price of just moving along as we have been.

One other aspect of this prospect for the future: Between 1950 and 1960 the labor force aged 14 to 24 increased by less than 400,000. Between 1960 and 1970, this group will increase by more than 6 million. The big push will occur around 1965. We have only 2 years to find the answer, and to get it working. Never before has this country had to train and provide jobs for so many youngsters in so short a time.

I cannot urge too strongly upon this committee the view, developed from what I recognize as an intensive, perhaps almost obsessive, preoccupation with the manpower supply and demand factors in the economy, that this situation makes it imperative that this economy be reinvigorated and strengthened by the adoption of the tax program which the President has placed before the Congress. I have presented this point of view in terms of statistics. I think of the need in terms of the human values of which these figures are only a cold reflection.

VI

I would not leave, with this committee, however, the impression that I find the total answer to our needs for new growth and full employment in an improved tax system, a better unemployment insurance system, and a Youth Employment Opportunities Act. The remaining factor, recognized by the President in his Economic Report, is the need, in this increasingly complex and rapidly changing economy for fuller assistance to workers in making the transition from declining to new industries, from contracting to expanding occupations, and from labor market areas in which job openings are being reduced to those of rising job opportunities.

In 1961, with the passage of the Area Redevelopment Act, the concept of Federal retraining for the unemployed came into being. This was followed, in 1962, by the Manpower Development and Training Act, which substantially broadened Federal activity in the field of occupational training and retraining. In addition, this 1962 statute laid the basis for a unified comprehensive manpower research program, designed to investigate the factors associated with unemployment and to develop methods for eliminating its causes and ameliorating its effects.

The Manpower Development and Training Act program has been in effect only a short time, but certain implications concerning its direction can be drawn from the record of the more than 500 projects which were approved between September 1962, when training operations under the act were begun, and January 24 1963, the latest week for which information is available.

Projects have now been approved in 50 States covering more than 20,000 workers. Training courses have been approved for well over 100 occupations, falling into all major occupational categories, predominantly white-collar and skilled occupations. This concentration reflects the prevailing shifts in our economy from goods producing to service industries, from blue-collar to white-collar occupations, and from less skilled to more skilled jobs which I have already described. Over a third of the trainees were enrolled in courses leading to professional, managerial, clerical, and sales jobs; over 16 percent were in training for such skilled service occupations as motor vehicle mechanics and repairmen.

Workers are trained only in occupations for which vacancies are available; even in areas of relatively substantial unemployment, 7 out of 10 of the persons in training are enrolled in courses leading to skilled occupations. Retraining programs can be fully effective only when a sufficient number of job opportunities are created.

VII

If I have dealt disproportionately here with what may seem the data of difficulty, the statistics of shortcomings, it is because the only possibility I see of default in the American economy is that we will underestimate the full proportions of the task and the opportunities at hand.

If most of the figures which I have used here seem large, it is an appropriate reminder that they have to do with only the 5- to 10-percent fringe of potential failure. The worst risk is that when so many are doing so well, grevious burdens on a comparative few will be overlooked.

I see every unemployed person in this country today not so much as a problem but rather as a wasted asset, a potential contributor to the productive force which would be pressed to its limit to meet presently unmet needs in this country and in the world.

My report to this committee is that we have the full capacity and competence to meet every problem which exists in the manpower field, and are dependent only upon the decisions to do it.

Secretary WIRTZ. I am especially glad to have this opportunity to comment on the Economic Report of the President because I count it very frankly a courageous, and I think, a very able public document, and I would hope very much to keep my remarks in the pattern of the approach which is taken by the President in his report.

My comments will be put very largely in the context of my particular responsibilities which are in the manpower area. I shall not attempt to cover those matters which have been covered in previous testimony before the committee.

I point, therefore, in the beginning at the remarkable progress, the economic progress, which has been made recently in terms of the manpower figures as we have them. This progress is reflected in the fact that there was an increase in nonfarm employment last year of 1⅓ million.

It is reflected in the fact that the fraction of the labor-force time lost through unemployment and part-time work has dropped from 8 percent in 1961 to about 6.7 percent in 1962.

Just as one other index of the same progress, I note that the number of major labor market areas with heavy unemployment fell from 76 in January 1961 to 41 in December of 1962.

Chairman DOUGLAS. I want to start off by congratulating you in your willingness to use the figure which includes time lost within employment; that is, part-time work, as well as time lost through complete unemployment. I never expected to find a government which would be willing to do this because it makes the figures worse. It is always advanced by the outs as a criticism of the ins. I have done that myself. I am very happy to see that you come out very frankly on this issue.

Secretary WIRTZ. You well know, sir, that is in large measure a result of your own stimulus in this direction. We appreciate the emphasis which has been placed on that.

This testimony will again, in the pattern of the Economic Report, be related to the very large emphasis which we place on the importance of a change in the tax system and in the tax structure. We have a very large number of workers in this country without jobs today. We think that this is mainly because the producers do not have the markets which are required and the producers do not have those markets because the purchasing power is too small.

We feel that we have struck an equilibrium which is well below where it ought to be. We feel a very carefully conceived change in the tax structure will result in a higher level of business and personal purchasing power. It will add incentives for risk taking and personal effort which will in turn enlarge the circle by providing new jobs and still enlarging the markets and further investment. It is to that possibility that I address particularly this testimony about the manpower aspects of this problem.

I call the committee's attention to the fact that the President will in accordance with the terms of the Manpower Development and Training Act be filing the First Annual Manpower Report in about 5 weeks and some of what I suggest here will be the subject of more definitive development in the manpower report.

I start in terms of particulars by noting the relationship between the general economic condition today, particularly as it affects the job situation and outlook, and the currently, much publicized subject of labor-management disputes. Too many of my hours recently, frankly, have been devoted to the working with some of these major labor disputes and controversies, a common characteristic of which is the emphasis today upon the manpower utilization and the job security problems. We would not have had a dock strike in this country this winter if it had not been for the problem of manpower utilization and job security which proved so difficult for those parties.

That same problem underlies a number of the other major disputes which have been the subject of so much attention in this country.

The issue which is involved here is sometimes misconceived as a difference in attitudes toward the development which we describe all too roughly as automation. There is developing something of a feeling that there is a position of labor of opposition to automation as distinguished from a different position on the part of industry.

This is not the case at all. We find in these major labor disputes a common attitude on the part of the working man and the manager, a common attitude which recognizes the essentiality of technological improvement.

The real problem is that under a situation where the economy is not expanding at a sufficiently fast rate, the whole fruits, the whole value of technological development cannot be realized, and there is created instead a pressure on the situation. When a business is unable to expand it cannot furnish new job opportunities for those affected by improved technology and much less for new jobseekers.

Then, of course, another result of this situation is that the major emphasis of business investment is placed on labor saving rather than on the expansion of capacity. We face the fact today that a slowing up of the rate of growth in the economy in recent years has meant substantially reduced opportunity for people to find and to keep jobs.

I have just received, Mr. Chairman, and Mr. Reuss, from the Department of Labor's Office of Manpower, Automation, and Training, and I am releasing today, a report on industrial employment since World War II. It makes the recent retardation of growth acutely and ominously clear. This report confirms the general realization that job opportunities are declining significantly in certain major industries.

Agriculture, for instance, is employing today 3 million fewer workers now than in 1947. That is an average annual decline of 200,000.

Mining employment is also declining steadily and is now 360,000 below the 1947 level.

But there are some other things appearing in this report which are not so well known. Employment in contract construction which advanced very sharply until 1956 and 1957 has since that time fallen by about 300,000, and this same trend including the same numerical decline has appeared in the transportation and the public utilities group.

Chairman DOUGLAS. Mr. Secretary, I wonder if you or one of your assistants could give the figures for transportation and for public utilities.

Secretary WIRTZ. Yes. There has been distributed to the committee, Mr. Chairman, I think the copies of this Manpower Report No. 5.

Chairman DOUGLAS. I am going to ask that this be made a part of the record at the conclusion of your remarks. I wondered if we could get these facts in the record at this point.

Secretary WIRTZ. The specific answer to your question, Mr. Chairman, appears on page 9 of this report in table No. 4, the item of contract construction appearing about two-thirds of the way down that sheet, and the change between 1947 and 1957 and the change between 1957 and 1962 is shown both in absolute figures and in percentage figures.

For contract construction this table would show that between 1947 and 1957 the annual employment change for contract construction was an increase of 4 percent a year. That is reflected in an absolute figure of 94,000. That since 1957 and for the last 5 years the annual rate of change has been −1.6 percent, with a resultant reflection in absolute figures of 45,000 workers.

Chairman DOUGLAS. On transportation, I notice a decrease of only about 240,000.

Secretary WIRTZ. That would be about right.

Chairman DOUGLAS. That is during this time. I assume that the decrease on the railways was much greater than this. Does this include taxi drivers?

Secretary WIRTZ. Mr. Chairman, may I introduce Dr. Seymour Wolfbein, the Director of our Office of Manpower, Automation, and Training; and accompanying me, too, Mr. Stanley Ruttenberg, Special Assistant to the Secretary for Economic Affairs. Dr. Wolfbein has been largely responsible for the preparation of Manpower Report No. 5 and would address himself to that question specifically.

Chairman DOUGLAS. I asked if it included taxi drivers. Did you say it included airline operatives?

Mr. WOLFBEIN. Yes, sir; it includes all forms of transportation, buslines.

Chairman DOUGLAS. Would it include taxi drivers?

Mr. WOLFBEIN. Yes, sir. Also this is a broad group which includes all the public utilities, Senator Douglas, as you know.

Chairman DOUGLAS. The decrease on the railways and electric lines has not been compensated for in this major branch by an increase in airlines, buses, or taxi drivers.

Mr. WOLFBEIN. No, sir.

Secretary WIRTZ. The same results, Mr. Chairman, are shown graphically in the chart which follows table No. 4, and you will notice with respect to transportation and public utilities with the bars appearing in about the middle of the chart there is reflected 0.2 percent annual increase from 1947 to 1957 as far as transportation and public utilities are concerned, and following that in the shaded area the drop of 1.5 percent per year since 1957.

Looking at manufacturing in terms of this same comparison there has been a net loss of 425,000 jobs in the past 5 years. That contrasts with a gain of 1.6 million jobs in the previous decade. This job loss was entirely among production workers. Their number declined by 775,000.

Employment in the trade sector which had also risen rapidly until about 1957 has advanced recently at a relatively slow pace.

The rate of growth in the finance, insurance, and real estate industry has also slackened since 1957. Only in the service sector of all the private nonfarm groups has the rate of expansion in the past 5 years matched the earlier postwar rate.

There is another exception to this picture and that is in the public sector. While the rate of growth has slowed down in the Federal sector, there has been a sharp increase at the State and local level, largely in the school systems at an annual rate of 312,000 jobs a year since 1957, and that is about 100,000 more per year than in the previous decade.

Chairman DOUGLAS. Your figure shows a percentage increase for Federal employment from 1947 to 1957 of 1.6 percent; State and local, 4.2 percent; 1957–62, an annual rate of increase of 1.1 percent Federal employment; State and local, 4.8 percent.

Secretary WIRTZ. That is correct.

Summarizing these figures, this very stern fact emerges. The number of persons on nonfarm payrolls has been expanding in the past 5 years at barely half the rate of the first postwar decade, and that is even while the number of workers potentially available has been increasing more rapidly.

The annual rate of increase in the last 5 years was only 0.9 percent, as contrasted with an annual rate of 1.9 percent between 1947 and 1957. In actual numbers, there were less than half a million new nonfarm jobs added to payrolls each year of the past 5, compared with 900,000 per year earlier.

I point out that that contrast would be even sharper if we were to remove the Government employment figures and consider only the private nonfarm sector. As a result of the reduction in the number of jobs available in our major industrial activities, the proportion of all workers in goods-producing industries has fallen from 51 percent in 1947 to 46 percent in 1957 and now down to 42 percent in 1962. In fact, there were actually a million and a half fewer workers in the goods-producing industries—agriculture, manufacturing, construction, and mining—in 1962 than in 1947.

Along with this shift there has come a change in the number of blue-collar or manual jobs available. In 1956, for the first time, there were more white-collar workers than blue-collar workers. In 1962, the number of manual workers was only 3 percent greater than in 1947. Within this group, skilled craftsmen were the only occupational group to experience an increase, although even this category has been growing at a rate slower than that for the economy as a whole.

Looking at the job totals by industry or by occupation does not tell the whole story. Growth in service-type employment has been accompanied by a slowdown in the expansion of full-time scheduled jobs.

I come here most pointedly to the fact to which you referred earlier, Mr. Chairman—in the private nonfarm group as a whole, virtually the entire increase in employment since 1957 is accounted for by a rise in part-time employment, chiefly in the trade and service industries. You will find in the Manpower Report No. 5 a fuller development of that particular fact.

So we suggest that it is small wonder that we can't be satisfied with our present rate of economic expansion. It is small wonder that increased productivity, the essential ingredient in our dynamic competitive economy, has become a major complicating fact at our bargaining tables.

I say although this point is developed here in terms of cold statistics, this is the point which has been causing us the most trouble in connection with these major industrywide critical emergency disputes which we have been facing.

A byproduct of the slow growth in job opportunities and in incomes is this tendency to seek a shorter standard workweek as a solution. The common aim of current proposals is to spread existing employment opportunities among a larger number of persons, without reducing regular weekly earnings. It is not hard to understand, with 4 million men and women unemployed, the reasons for proposing shorter hours of work. Yet merely distributing currently available man-hours of work among all members of the labor force is in our judgment no solution. The additional costs resulting from reducing hours without reducing weekly wages would lead to higher prices, reducing real wages, and making more difficult the attainment of other economic objectives, including the improvement of the Nation's balance of payments.

The infinitely preferable policy is to encourage the greater effective demand which will create jobs for unemployed workers. I think it is true from my conversations that a great many of those advocating the principle of a shorter workweek apparently prefer, in fact, expansionary fiscal and monetary policies to reduce unemployment. They apparently believe, though, that adequate policies to expand output either cannot or will not be applied.

Chairman DOUGLAS. I wonder if we could go into the arithmetic of the 35-hour week, Mr. Secretary.

Secretary WIRTZ. Yes, sir.

Chairman DOUGLAS. Assume hourly rates of $2.50 an hour, and full-time weekly earnings at 40 hours of a hundred dollars a week?

Secretary WIRTZ. Your assumption was at what rate per hour?

Chairman DOUGLAS. $2.50 an hour. And full-time weekly rates, therefore, of a hundred dollars. In the 35-hour week, in order to get a hundred dollars, the hourly rate according to my computations, which I have not checked, would have to go up to approximately $2.86. Would someone check that?

Secretary WIRTZ. It should be in that area, $2.86.

Chairman DOUGLAS. That would be an increase of 36 cents an hour or slightly over 14 percent?

Secretary WIRTZ. Yes, sir.

Chairman DOUGLAS. Fourteen-plus percent?

Secretary WIRTZ. That is right, sir.

Chairman DOUGLAS. It would be the reciprocal of the reduction in hours. Would you think American manufacturing industry could stand this increase of 14 percent?

Secretary WIRTZ. The answer to that in general would be "no," Mr. Chairman, but I would respect the impossibility of a general answer. In that connection I should say to you that within the past 10 days we have asked the Bureau of Labor Statistics to make for us a complete, as far as the presently available information permits, study of the effects of a shorter workweek if it were established in different areas.

There would be some industries in which it could be absorbed a good deal more easily than others. There would be involved the question of the degree of international competition which is involved.

I don't mean to fuzzy-up the answer to your question. It would be my judgment that in the general form in which the question is put the general answer would be "no," given the present state of the economy.

Chairman DOUGLAS. President Roosevelt faced this same demand early in his administration when the high unemployment led to the demand for a 30-hour week with no reduction in weekly earnings, which would have meant an increase of 40 percent in hourly rates. He tried to head this off by the NRA rather than to raise hourly costs. I happen to think that the NRA was an incorrect answer. It was a device or an attempt to expand employment which I think was largely unsuccessful.

Secretary WIRTZ. This is a problem with which we are familiar in general as a result of the changes in the Fair Labor Standards Act. I am obligated by law to report to the Congress, I think tomorrow or the next day, what evidence it has been possible to collect as to the effect of the last change in the Fair Labor Standards Act. I feel no restraint or constraint by saying to you that the results of that study would indicate that that degree of change in this area has not had a negative effect on the economy to any identifiable extent.

I would point out, too, just summarizing really the next point in my testimony, that we recognize that there has been a long-term definite trend toward a reduction in the workweek. We point out, too, the fact that there is going on in private collective bargaining today in connection with the paid holidays, the vacation, the workweek, the overtime provisions, a further development of that trend. That would seem to have in a good many cases an affirmative effect both in terms of the economics and in terms of the human values of the situation.

So it would be in my judgment a mistake to take any position of broad negative opposition to any further consideration or fluctuation of the workweek. It is not that simple. But if we were talking, as these proposals do, about reducing the workweek from 40 to 35 hours by legislation at one point, the case against it seems to me almost overpowering.

I have summarized the next part of the testimony and would therefore turn now to the other side of the manpower ledger and suggest to the committee those figures which seem most significant with respect to the unemployment problem.

The President's Economic Report has already gone into this. To the extent that any repetition of detail here would be unwarranted and inappropriate, I point to only two or three additional factors.

One, I note the implications of the fact that the unemployment rate of 5.6 percent in 1962, which was a nonrecession year, was exactly the same as the unemployment rate in 1954 which we considered at that point a recession year. I suggest that there is no warrant for complacency in the face of the fact that the economy now leaves as much joblessness in a good year as it did not very long ago in a recession year.

Equally disquieting is the fact of a rise in the degree of joblessness which must be considered long-term unemployment. In 1957, out of every 100 jobless workers, 19 had been out of work 15 weeks or longer. In 1962, the ratio of long-term jobseekers had risen to 28 per 100. This increase in long-term unemployment raises a serious question as to the adequacy of resources—present resources—to tide jobless workers over their emergency.

I want to make it perfectly clear that in general these long-term unemployed are responsible people with the closest attachment to the work force. Two-thirds, as nearly as our studies suggest, of these people are the sole or primary support of a household. Two-thirds are between 25 and 54 years of age. Three-fourths have been in the labor force during every month of the 3 years preceding their first claim.

Those figures are based on our analysis of the results of the administration of the Temporary Extended Unemployment Compensation Act. We feel very strongly that we need an updated employment insurance system. The President has covered this matter in his Economic Report in general terms, and there will be submitted to the Congress, for its consideration, the proposals of the administration in this area.

I point next to the exceedingly serious persistent and intractable unemployment problem that today faces young people. In the past, the high rate of unemployment in young people has too often been accepted as inevitable. I don't think it is. The number of unskilled and semiskilled jobs, however, those which frequently provide the first opportunities for new workers, have been declining at an accelerating rate, and we recognize and emphasize the impact of that development upon the problem of the untrained child, youngster, leaving school.

The rate of unemployment is especially high today for youngsters who drop out of high school. Some 27 percent of the dropouts, although I should like to say, Mr. Chairman, that is a phrase which bothers me terribly, the dropout phrase. We had reference yesterday to the pushouts. I am inclined to think, sometimes, it is as much one as it is the other. I say that against the background of 20 years or more of teaching.

Representative CURTIS. What do you mean by "pushouts"?

Secretary WIRTZ. I mean, Congressman Curtis, that we are a little inclined to view this problem today in terms of shortcomings of the individual students and it is high time that we look very seriously at the question of whether the educational structure is such that there is an element of pushout on that side as well as dropout on the side of the individual.

Representative CURTIS. Do you think it is motivation?

Secretary WIRTZ. I think it is lack of motivation on the part of the individual. I think it is lack of proper direction in some cases on the part of the educational system. But I don't like the dropout phrase anyway.

Some 27 percent of these students who left school in 1961 were unemployed in October of that same year, and that compares with only 18 percent of those who are high school graduates. There is an urgent need, in our judgment, for specific legislation intended to provide employment opportunities for the youths who are now or are in danger of being left out of the mainstream of employment.

Last October, there were 600,000 youths, ages 16 to 21, out of school and out of work.

Chairman DOUGLAS. Mr. Wirtz, Dr. James Conant in the book which he published last year, which was based upon several years of inquiry, estimated the number of youths in this age group who were neither in school nor at work at approximately a million. Your figure is somewhat lower than this.

Secretary WIRTZ. Yes, it is for a different period. There is not a precise reconciliation of the figures. The figure that I have here is for last October. Dr. Conant's book covered a different period. We could furnish you a reconciliation of that to the fullest extent possible, Mr. Chairman, if that is appropriate.

Chairman DOUGLAS. If it is not too much trouble, it may be appended to your testimony.

Secretary WIRTZ. Surely.

(The information referred to follows:)

The number of unemployed youth, aged 16 to 21, who were not in school was 600,000 in October 1962, a month when unemployment is generally low. This group of unemployed youth ranged from 600,000 to 800,000 (except during the summer months), and averaged 700,000 in 1962.

It is my impression that Dr. Conant's figure of 1 million out-of-school unemployed youth refers to the ages 16 to 24, the number the Bureau of Labor Statistics reported for October 1961.

Senator PROXMIRE. It seems to me the age range was 14 to 19.

Secretary WIRTZ. We have tried to break this down in as many different ways as possible. We understand that question was raised here on Monday of this week. These figures would vary depending on what age group you took. But the general impact remains starkly clear. They are taking a beating.

So we are very much interested this year in the advancement by the administration of the Youth Employment Opportunities Act to which we attach very real significance in terms of meeting this particular part of the problems. We think the passage of the Youth Employment Act at this session is a very important companion piece to the tax bill.

Now talking about the past, if a review of the past 5 years offers surely most incomplete reason for satisfaction, it is even plainer that the next 5 years is going to test our national mettle even more sternly.

Let me put this problem in the plainest possible terms, not gross national product, not unemployment rates, but simply in terms of the jobs that are going to be needed and our efficiency in furnishing them. I apologize for the intricacy of these figures which follow, but it is the best way we know to develop a picture of this situation.

Between 1957 and 1962, our total labor force increased in this country by 3.8 million. Over that same 5 years, output per man-hour in the total economy rose a total of 12.5 percent. In order to avoid any net displacement resulting from the rise in productivity 7.5 million job opportunities had to develop either in the same shops in the form of increased output, or elsewhere in the economy.

So it was necessary for the economy to produce during that period 11.3 million new jobs, or job equivalents, to cover both the additional entries into the work force and the results of increased productivity.

We fell short of that task by 1.1 million jobs. That is between 1957 and 1962. That was the increase in unemployment. It amounted to 10 percent. In other words, the economy furnished 90 percent of the new jobs or job equivalents which were necessary simply to keep unemployment from rising above the 4.3-percent rate of 1957.

Now that 90-percent rate of achievement is probably too high a figure, for had the demand been adequate the labor force would undoubtedly have risen by a larger amount than it actually did because more housewives would have taken jobs to supplement the family income, fewer older workers would have left the labor force because of inability to get jobs.

In addition, a faster rate of growth would have brought with it economies of skill and incentives to modernize which would have increased output per man-hour.

What does this inadequate 90 percent mean for the future? Between 1962 and 1967 the labor force would increase by an estimated 6.5 million. If productivity in the total economy rises at the postwar average of 2.7 percent a year, and that is a very conservative rate, some 9.6 million new jobs or job equivalents will have to be provided to meet the effects of this increased productivity. This means a total need in the next 5 years of 16.1 million new jobs just to stay even.

Now a 90-percent rate of efficiency in meeting this need, that is the 1957–62 experience, would result in an increase of 1.6 million in unemployment. Total unemployment would therefore rise from the present 4 million to 5.6 million, or to more than 7 percent of the 1967 labor force. This would be the intolerable price of just moving along as we have been.

There is one other aspect to this prospect for the future. Between 1950 and 1960 the labor force, aged 14 to 24 group, increased by less than 400,000. Between 1960 and 1970 this group will increase by more than 6 million.

Chairman DOUGLAS. Mr. Wirtz, this is due to the low birth rates of the thirties and the high birth rates of the forties?

Secretary WIRTZ. That is right; immediately following the war.

Chairman DOUGLAS. Even before the war?

Secretary WIRTZ. That is correct. The big push will come about 1965.

Representative CURTIS. In order to get that in context, the rate is now declining from this high peak.

Secretary WIRTZ. Has there been a decline?

Representative CURTIS. The birth rate has been going down for the past 3 or 4 years. So maybe we are dealing with a hump.

Secretary WIRTZ. I will check that, Congressman. It would not square with my general impression.

Representative CURTIS. I am sure I am correct.

Secretary WIRTZ. I don't believe it has gone down, Congressman Curtis. It has fluctuated a good deal.

Representative CURTIS. I think you will see in the past 3 or 4 years it has. There has been comment on this. I will get the statistics, so go ahead.

Representative REUSS. I have a question on this. By the labor force in the 1950–60 period, you mean those who were in the age group?

Secretary WIRTZ. That is correct.

Representative REUSS. You don't mean those who were actually working or anything of the sort?

Secretary WIRTZ. I mean those who were in that age group either working or looking for work.

Representative CURTIS. If I may interrupt, this is Health, Education, and Welfare Indicators, January 1963. Our rates, beginning in the fifties—they don't show the forties—were 24 percent, and they have now gone down to 23 percent. It was 24.1 percent in 1959, 23.7 percent in 1960, 23.3 percent in 1961. In other words, it looks as if there is a curve. We don't know for sure.

Chairman DOUGLAS. We all hope the problems will be less in the 1990's.

Secretary WIRTZ. That covers most of the specific figures. I am sorry there are so many of them. Yet I simply cannot urge too strongly on this committee the view which develops, I know, from what is an intensive, almost obsessive, preoccupation with this manpower supply and demand situation in the economy. I cannot urge too strongly the view that this situation makes it imperative that the economy needs to be reinvigorated and strengthened by the adoption of the tax program which the President has placed before the Congress.

I always feel apologetic for presenting a view of this sort in terms of statistics. I know that you will realize that my thinking about the views as yours is much more in terms of the human values of which these figures are readily only a very cold reflection.

There is one other point. I won't leave this committee with the impression that I find the total answer to our needs for new growth and full employment in an improved tax system or better unemployment insurance system or Youth Employment Opportunities Act. There is a very, very important remaining factor. It was recognized by the President in his Economic Report. It has been the subject of special attention by some of the members of this committee. It is a matter of very great concern in the administration of the affairs of the Department of Labor: It is this need in this increasingly complex and rapidly changing economy for fuller assistance to workers in making the transition from declining to new industries, from contracting to expanding occupations, and from labor market areas in which job openings are being reduced to those of rising job opportunities.

We are developing an experience in this area which started with the Area Redevelopment Act of 1961, followed by the enactment in 1962 of the Manpower Development and Training Act, and there are provisions now, too, in the same area in the Trade Expansion Act of 1962.

I mention it just briefly because this will be the subject of a much fuller report in the manpower report in March including our starting experience with the manpower development and training program.

We have approved now in conjunction with the Department of Health, Education, and Welfare and working with the State agencies some 500 projects. This is under the Manpower Development and Training Act. That program started in September. The latest figures are for January 24, 1963. We have approved new projects in all 50 States. They cover 20,000 workers.

Chairman DOUGLAS. Are those workers actually under training, or are those workers who would be trained when the programs went into effect?

Secretary WIRTZ. It is the latter. The number of people actually in training so far is about 8,000, Mr. Chairman. The approved programs are about 20,000. Then there is another substantially even larger group of projects which are in the pipeline and will be subject to approval.

The total figures are these: The projects approved are about 20,000. The workers who are in training now or have been trained are about 8,000. We have so far about 1,800 alumni who have completed their training program.

These training programs have been approved for over a hundred occupations. They cover a wide gamut of work types.

I point to the fact that the workers are trained only in occupations for which there is reason to believe that vacancies will be available. This is a very truncated report on this act. As I say, there will be a much fuller development in the forthcoming manpower report.

Now, in conclusion, Mr. Chairman and members of the committee, just a word of reorientation for myself, and perhaps for you, of what I have said.

I have a strong feeling of having dealt here disproportionately with what may seem to be the data of difficulty and statistics of shortcoming. That is only because the one possibility I see of default in the American economy is that we may underestimate the full proportions of the task and of the opportunity which is at hand. Most of the figures which I have used here sound large, and yet it is an appropriate reminder that they have to do with only the 5- to 10-percent fringe of potential failure in the economy. I point out that the worst risk is that when so many in this country are doing so well, grievous burdens on a comparatively few may be overlooked.

Chairman DOUGLAS. I am glad you used the verb "may" rather than the verb "will," which is in your manuscript.

Secretary WIRTZ. May the record stand as "may."

I approach this matter in terms of concern, Mr. Chairman, but complete confidence. I see every unemployed person in this country today, not really as a problem, but really as a wasted asset and a potential contributor to the productive force that would be pressed to its very limit if we were to meet the presently unmet needs in this country and the world.

So my report to this committee is that we have the full capacity and the full competence to meet every single problem which exists in the manpower field, and we are dependent only upon our decision to do it.

Thank you.

(Manpower Report No. 5 follows:)

[Manpower Report No. 5, Jan. 30, 1963]

INDUSTRY EMPLOYMENT GROWTH SINCE WORLD WAR II

A high rate of employment growth is a fundamental requirement if the American economy is to provide jobs for its increasing population and also continue to raise the standard of living of its workers. The growth of American industry in the past has been one of the sources of American strength, but the growth in the past 5 years has raised questions regarding its adequacy. Moreover, the growth which has taken place has led to changes in the structure of employment which pose a challenge to workers seeking to adapt to industry's job needs.

Between 1947 and mid-1962, the number of nonfarm workers in the United States increased by more than one-fourth, with the addition of 11.4 million jobs to the economy. The gross national product rose by two-thirds in real dollars. Earnings of factory workers rose from about $50 per week in 1947 to close to $100 in 1962. Even with price increases discounted, the gains in factory workers' earnings were substantial, amounting to 45 percent between 1947 and 1962.

These advances, however, were concentrated in the first decade of this 15-year period. Industry employment growth during the past 5 years, in fact, has not kept up with the performance of the previous 10 years, either in magnitude or composition.

During the past 5 years, from 1957 to 1962:

The rate of job growth slowed down appreciably in the private sector of the economy.

Between 1947 and 1957, private nonfarm industries increased their employment by an average of 700,000 jobs, or 1.7 percent, each year; from 1957 to mid-1962 the annual rate of gain fell to 175,000 jobs, or 0.4 percent.

Structural changes were also taking place which added to the problem of reemployment of displaced workers.

As the rate of job growth slowed down, there was a speedup in the long-term shift in the pattern of job growth, away from the output of goods and toward more services. The proportion of all workers in the goods-producing industries—agriculture, manufacturing, construction, and mining—fell from 51.3 percent in 1947 to 45.9 percent in 1957, and to 41.8 percent in 1962 (table 3). The rate of decline in the latter period was two-thirds greater than in the earlier period.

And the overall rate of economic growth and employment also moved down.

From 1947 to 1957, the gross national product rose by 45 percent in constant dollars, or at an annual rate of 3¾ percent. During the past 5 years, however, the increase in gross national product has amounted to about 15 percent, or an annual rate of 2.9 percent. The slowdown has occurred primarily in the output of goods and in construction (see table 1).

An even greater slowdown in growth is reflected in employment. Between 1947 and mid-1962, the number of wage and salary workers on nonfarm payrolls rose to 55.3 million, a gain of 11.4 million, or 26 percent. Of this rise, 21 percentage points were gained in the 10-year period following 1947, and 5 percentage points in the past 5 years. The annual rate of increase in the last 5 years (0.9 percent) was only about half the rate during the previous 10 years (1.9 percent). During the early period, an average of 900,000 new jobs (including Government) was being added to nonfarm employment each year; during the recent period, the yearly increase was about 485,000. Moreover, the composition of this growth has changed radically. Between 1947 and 1957, 76 percent of the job growth was in the private sector of the nonfarm economy, the remainder in Government; between 1957 and 1962, only 36 percent of the job growth has been in the private sector (see tables 2 and 4).

EMPLOYMENT DISTRIBUTION

These different rates of growth have resulted in significant changes in the distribution of employment. As noted before, in 1947 the goods-producing industries (agriculture, manufacturing, mining, and construction) accounted for 51.3 percent of all industry employment; in 1957 they acounted for 45.9 percent; and by 1962 the proportion had been reduced to 41.8 percent. These proportions represent a significantly faster rate of decline from 1957 to 1962 than in the previous period. By contrast, very rapid job growth—accounting for an increasing share of total employment—has been taking place in State and local governments, in the service industry and in finance, insurance, and real estate. The big increase in Government employment is mainly in the school systems, reflecting not only population growth, but the rising demand for a better educated labor force.

The effect of recessions is one important explanation for the decline in growth and the shift in industry pattern: We had two recessions during the first 10-year period and two during the most recent 5-year period. Each recession affected mainly the goods-producing industries. Large numbers of production workers were laid off during each business downturn, and employment levels were never fully restored during the subsequent recoveries as a result both of rapid changes in technology and the lack of new gains in product demand.

However, in considering the periods as a whole, including both the recessions and the recoveries, it seems apparent that the private sector of the economy during the past 5 years has not continued to provide new jobs at the same rate as during the decade following World War II. Most of the industries which provided the lift to the job market in the first postwar decade have either slowed down or declined during the past 5 years. For the entire period since the end of World War II, the industries of major job growth in the private economy were construction, trade, services, and finance. But in both trade and construction the principal advances took place before 1957; since then, employment growth in trade has slackened substantially, and there has been an actual decline in construction.

SERVICE

Only the service industry has continued to expand employment at close to its former rate; this industry which includes personal, business, and professional services, has shown a total rise of more than 50 percent between 1947 and mid-1962. In the finance, insurance, and real estate industries, where total growth has amounted to about 60 percent since 1947, recent gains (since 1957) have been at a slower rate.

One of the accompanying features of the growth in service-type employment is reflected in a slowdown in the expansion of full-time scheduled jobs. While total nonagricultural employment (wage and salary and all other) increased by 4.3 percent, or 2.5 million, between 1957 and 1961, the number of workers on full-time schedules[1] increased by only 800,000, or 1.7 percent. In other words, only one-third of the employment increase since 1957 represents work on jobs having full-time schedules. Much of this undoubtedly represents the needs of the workers; many of the large numbers of women entering the labor market in recent years have been attracted by the availability of part-time jobs. However, it is not known to what extent full-time jobs would have been filled had more of them been available. Moreover, the nature of the increases in employment in recent years has a bearing on the extent of economic growth we have experienced.

GOVERNMENT

Only in the public sector of our economy has there been any increase in the rate of job growth since 1957 as compared with the earlier period. The growth in Government employment has been overwhelmingly at the State and local level and primarily in the school systems. Other public services have also required more workers as the population has expanded and our cities and urban areas have grown.

Each year between 1947 and 1957 State and local government employment grew by an average of 4.2 percent, accounting for 187,000 additional jobs yearly; each year from 1957 the growth rate has averaged 4.8 percent or 287,000 additional jobs yearly.

MANUFACTURING

Rates of employment growth in the largest sector of our economy, manufacturing, are difficult to appraise since recessions and prosperity alike have affected employment in this sector more drastically than elsewhere. However, between 1947 and 1957, both relatively good years, the manufacturing industries added 1.6 million new jobs, an increase of 10 percent; since 1957, the number of workers in manufacturing has declined by 425,000 or 2.5 percent.

The net result is, that over the entire 15-year period, the proportion of manufacturing employment to total nonfarm payroll employment declined from 35.4 percent in 1947 to 30.3 percent in 1962. Moreover, the brunt of these lost jobs was borne entirely by production workers; in the past 5 years alone, their number decreased by a total of 600,000.

WHITE-COLLAR VERSUS BLUE-COLLAR WORKERS

During the postwar period, employment of blue-collar production workers in manufacturing has fluctuated sharply, tending in general to decline, while the number of white-collar jobs within this sector has continued to increase. Manufacturing industries, which employed 13 million production workers in 1947, employed only 12.6 million in 1962. During the same period factory output rose by 80 percent. One reason for this dramatic increase in output with fewer workers lies in the equally dramatic rise in the importance of workers supporting the production workers. These nonproduction workers—executives, office personnel, engineers, and scientists—who help develop the improved techniques mak-

[1] That is, those actually working 35 hours or more per week, and those who could if they chose to work full time. The latter are usually full-time workers who are on part time for noneconomic reasons. The 1961 data are used because seasonally adjusted data are not available for 1962.

ing greater production possible, have risen from 2.6 million in 1947, 16 percent of total factory employment, to 4.3 million, or 26 percent of the total, in 1962.

Nonproduction workers in manufacturing have increased even during the past 5 years while total manufacturing employment has declined. However, the greatest rate of gain in nonproduction workers occurred during the 1947–57 period, at an annual rate of 4.5 percent, while during the past 5 years, annual nonproduction worker growth has slackened to about 1.7 percent.

OTHER INDUSTRY SECTORS

The remaining major sectors of the private economy are primarily those which are contracting—agriculture, which now has 37 percent fewer workers than in 1947, transportation and other utilities, which is 6 percent lower (mainly because of declines in the past 5 years), and mining, which is down by 32 percent.

TABLE 1.—*Gross national product, by major type of product, 1947–57 and 1957–62*

Gross national product	Output (billions of dollars, 1954 prices)			Annual rate of increase (percent)	
	1947	1957	1962	1947–57	1957–62
Total GNP	282.3	408.6	471.5	3.8	2.9
Goods	163.3	223.4	247.1	3.2	2.0
Services	94.7	141.2	137.2	4.1	4.2
Construction	24.3	44.0	51.2	6.1	3.1

TABLE 2.—*Changes in employment by industry sector, 1947–57 and 1957–62*

Industry sector[1]	Employment (in thousands)			Annual employment change			
				1947–57		1957–62	
	1947	1957	1962	Rate (percent)	Amount (thousands)	Rate (percent)	Amount (thousands)
Total nonfarm employment	43,881	52,904	55,325	1.9	902	0.9	464
Industries of recent job growth[2]	21,233	27,738	31,306	2.7	651	2.5	714
Private	15,759	20,112	22,121	2.5	435	1.9	402
Government	5,474	7,626	9,185	3.4	215	3.8	312
Federal	1,892	2,217	2,341	1.6	33	1.1	25
State and local	3,582	5,409	6,844	4.2	183	4.8	287
Industries of recent job decline[3]	22,648	25,166	24,018	1.1	252	−.9	−230
Agriculture	8,256	6,222	5,190	−2.8	−203	−3.6	−206

[1] Nonfarm employment totals are based on establishment payroll data; agricultural employment on household survey data.

[2] Industries of recent job growth in the private sector comprise service and miscellaneous, trade and finance, insurance and real estate.

[3] Industries of recent job decline comprise manufacturing, mining, contract construction, transportation, and public utilities.

TABLE 3.—*Distribution of industry employment (including agriculture), 1947, 1957, and 1962*

Industry	1947	1957	1962
Total (including agriculture):			
Number (thousands)[1]	52,137	59,126	60,515
Percent	100.0	100.0	100.0
Goods-producing industries	51.3	45.9	41.8
Manufacturing	29.8	29.0	27.7
Durable goods	16.1	16.7	15.6
Nondurable goods	13.7	12.4	12.1
Mining	1.8	1.4	1.1
Construction	3.8	4.9	4.5
Agriculture	15.8	10.5	8.6
Service-producing industries	48.7	54.1	58.2
Transportation and other utilities	8.0	7.2	6.5
Trade	17.2	18.4	19.1
Finance, insurance, and real estate	3.4	4.2	4.6
Services and miscellaneous	9.7	11.4	12.8
Government	10.5	12.9	15.2
Federal	3.6	3.7	3.9
State and local	6.9	9.1	11.3

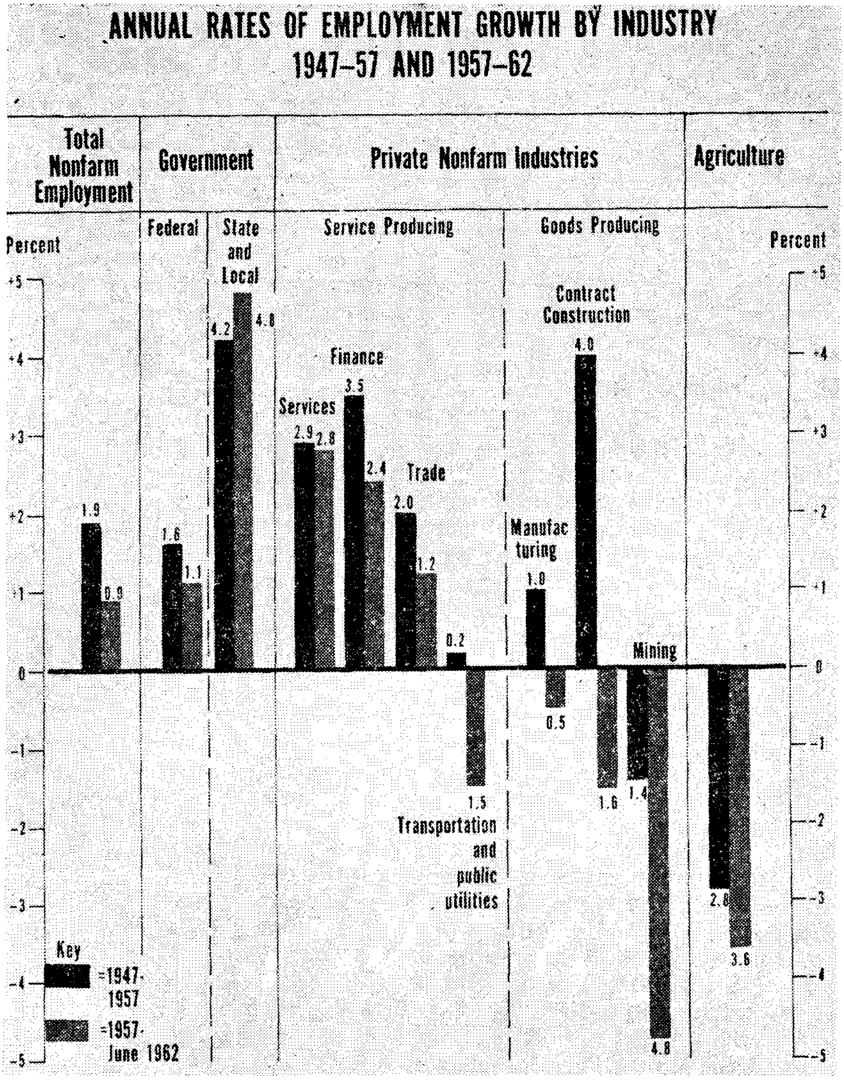
[1] Represents payroll employment in nonfarm industries and total employment in agriculture.

NOTE.—Sum of individual items may not add to totals because of rounding.

TABLE 4.—*Employment changes in nonfarm industries and in agriculture,*[1] *1947–57 and 1957–62*

Industry sector [2]	Employment (in thousands)			Annual employment change			
				1947–57		1957–62	
	1947	1957	1962 [1]	Rate (percent)	Amount (thousands)	Rate (percent)	Amount (thousands)
Total nonfarm employment	43,881	52,904	55,325	1.9	902	0.9	484
Manufacturing	15,545	17,174	16,750	1.0	163	−.5	−85
Durable goods	8,385	9,856	9,443	1.6	147	−.8	−83
Ordnance and accessories	27	140	215	17.9	11	9.0	15
Lumber and wood products	845	655	607	−2.4	−19	−1.5	−10
Furniture and fixtures	336	374	381	1.1	4	.4	1
Stone, clay, and glass products	537	595	572	1.0	6	−.8	−5
Primary metal industries	1,279	1,355	1,166	.6	8	−3.0	−38
Fabricated metal products	989	1,167	1,118	1.7	18	−.9	−10
Machinery	1,375	1,586	1,459	1.4	21	−1.7	−25
Electrical equipment	1,035	1,344	1,528	2.7	31	2.6	37
Transportation equipment	1,275	1,909	1,645	4.1	63	−2.9	−53
Instruments and related products	267	342	358	2.5	8	.9	3
Miscellaneous manufacturing	421	387	393	−.9	−3	.3	1
Nondurable goods	7,159	7,319	7,308	.2	16	(2)	−2
Food and kindred products	1,799	1,805	1,772	(2)	1	−.4	−7
Tobacco manufactures	118	97	89	−1.9	−2	−1.5	−2
Textile-mill products	1,299	981	881	−2.8	−32	−2.1	−20
Apparel and related products	1,154	1,210	1,235	.5	6	.4	5
Paper and allied products	465	571	602	2.1	11	1.1	6
Printing and publishing	721	870	933	1.9	15	1.4	13
Chemicals and allied products	649	810	850	2.2	16	1.0	8
Petroleum and related products	221	232	196	.5	1	−3.3	−7
Rubber and plastic products	323	372	389	1.4	5	.9	3
Leather and leather products	412	373	361	−1.0	−4	−.6	−2
Mining	955	828	647	−1.4	−13	−4.8	−36
Contract construction	1,982	2,923	2,696	4.0	94	−1.6	−45
Transportation and public utilities	4,166	4,241	3,925	.2	8	−1.5	−63
Trade	8,955	10,886	11,571	2.0	193	1.2	137
Finance, insurance, and real estate	1,754	2,477	2,793	3.5	72	2.4	63
Services and miscellaneous	5,050	6,749	7,757	2.9	170	2.8	202
Government	5,474	7,626	9,185	3.4	215	3.8	312
Federal	1,892	2,217	2,341	1.6	33	1.1	25
State and local	3,582	5,409	6,844	4.2	183	4.8	287
Total agricultural employment	8,256	6,222	5,190	−2.8	−203	−3.6	−206

[1] Nonfarm employment based on establishment payroll data, agricultural employment on household survey data.
[2] Less than 0.05 percent.



Representative REUSS. This is a magnificent job, Mr. Wirtz, and I am glad you did allow your emotions to invigorate your statistics. I think this is a matter where both emotion and statistics are needed.

Secretary WIRTZ. Thank you.

Representative REUSS. Among the many arresting things in your report is its observations about young people. I gather that unemployment of 18-year-olds, looking for jobs now, nationwide, is something around 20 percent. You said 18 percent of high school graduates in 1961.

Secretary WIRTZ. That is about right.

Representative REUSS. If it is true for high school graduates, the actual figure must be something worse because that doesn't include the dropouts.

Secretary WIRTZ. Let me set the specific answer in this broader context. We have been fighting recently against the impact in the public consciousness for which we are probably responsible in the Department of Labor—the impact on the public consciousness of a single unemployment figure of about $5\frac{1}{2}$ percent. That has been a mistake which we must undo because the truth of the matter is that we don't have a single overall unemployment problem. We have principally two or three specific unemployment problems which we have to start hitting with rifles instead of with a shotgun.

Approaching more directly the answer to your question, when we think of unemployment in terms of $5\frac{1}{2}$ percent, we ought to immediately think specifically of an unemployment problem of about 12 percent for three groups. One is children. Just in round terms, if unemployment, which I think of as the infantile paralysis of the economy, the unemployment figure for youngsters in round figures comes to the refinements of age groups as 12 percent instead of 5 percent: the unemployment for racial minority groups is about 12 percent instead of 5 percent: the unemployment problem for unskilled workers is about 12 percent instead of the 5 percent.

Representative REUSS. When you get a young, unskilled Negro, then you get a little more arithmetic on those 12 percents, don't you?

Secretary WIRTZ. It is one out of five. We ought to face the fact when you get into that area, one out of five in this country, in that category, don't have a chance.

Representative REUSS. Let me ask you this: A lot of people are going around saying, "Five or six percent unemployment; this is tolerable. Maybe we should just pay that 5 or 6 percent unemployment compensation, and accept this as a normal condition." Would you agree with me that kind of talk is hogwash for a variety of reasons, including the fact that young people aren't eligible for unemployment compensation? If they are looking for a job for the first time, as I understand it, in many States at least, they are not entitled even though they are registered in an employment office.

Secretary WIRTZ. You must have work experience, I am advised, in a good many of these situations.

Chairman DOUGLAS. The chairman says in all States. Is that true?

Secretary WIRTZ. That is correct.

Representative REUSS. Then the result of an acceptance, and God forbid that we should accept it, of a 5.6 average unemployment figure means that we are condemning young people to a very much higher unemployment figure, with no provision made for unemployment compensation for them. We are doing this in a social system where, due to union seniority and a lot of other built-in rigidities, you don't have what you used to have years ago, when employers would hire a lot of younger people because there was no such thing as seniority, and you could get younger people cheaper and put them on the payroll.

Aren't we in effect, by tolerating an average level of unemployment of 5 or 6 percent, contributing greatly to a demoralizing situation for our young people which is an important part of the juvenile delinquency in this country which everybody is talking about?

Secretary WIRTZ. I don't mean to let my agreement with your question, Congressman Reuss, stimulate my adrenalin too much, but I frankly find it almost intolerable that the country takes with the degree of acquiescence it does an unemployment situation of the kind we presently have.

I would like to make one other comparison. I think strikes are a waste and most unfortunate. I never mind a bit the public reaction against strikes. But I am appalled by the realization that we lost more potential man-hours of production in 1 year last year from unemployment than we have in over 35 years from strikes. I can't help realize what we could do about unemployment if people got as much worked up about it as they do about strikes.

With respect to the children question, I can only say that any feeling anybody has about unemployment has to be increased just 300 percent if you start thinking about the child, because that is about the relationship between the general unemployment and the younger worker.

I point out only one other thing. You said, if I understood you, we are condemning them to this situation. I would like to point out that I think a very large part of this problem results from the fact that we are in a period of rapidly increasing automation and technological development with a resultant diminution in the number of unskilled jobs in the economy. It is to those jobs that a good many of these people used to go. I think there are ways of adjusting to this situation. I feel perhaps less self-critical than some statements might suggest, but I do point out that if we are to take advantage or be able to take advantage of the technological development which is available to us and on which we depend, we are going to have to make these human adjustments to the problem.

Six hundred thousand unemployed youths can't be part of the price for technological advance in this country. I think we can meet it.

Representative REUSS. Certainly one of the obvious components of any program to deal with this situation must be, in my opinion—and I would like your view—a great expansion of the system of vocational education that some cities of this country have.

My own hometown of Milwaukee, as you know, has a particularly fine system, and its record of preventing dropouts happens to be particularly admirable. While simply having vocational schools in and of itself is not going to solve the problem, you would agree, I trust, with my observation that somehow or other there ought to be evolved a system so that all the cities of the country have at least as good a vocational school system as the city of Milwaukee.

Secretary WIRTZ. Of course, I agree completely. I would simply call attention for the record to the advice of the President's panel of consultants on Vocational Education which reported the shortcomings in that area, and would supplement that only by reference to my conversation last evening with Dr. Wolfbein in which he tells me that in connection with the administration of the Manpower Development and Training Act we are encountering most immediately a shortage of teachers as distinguished from facilities in this particular area, although both shortages are pressing in upon us. We are very much concerned about this shortage.

Representative REUSS. Thank you, Mr. Chairman.

Chairman DOUGLAS. Congressman Curtis.

Representative CURTIS. That is a happy note to end on because there are some jobs going begging in the teaching profession. I am very sorry you didn't comment on the new series of statistics I understand the Bureau of Labor Statistics is preparing on available jobs. When will that be available?

Secretary WIRTZ. That is correct.

When will be it available? I am advised that any definitive results on the study are somewhat ahead. It proceeds from the Gordon Committee last fall. It is not in a comprehensive form at the present.

Representative CURTIS. Here is where we need to concentrate, in my opinion. Actually, and study will bear this out, technological advance and automation create more jobs than they displace. But frequently these new jobs are in a different geographical area from the displaced jobs. Furthermore, they are usually outside the area of previous union jurisdiction and endeavor.

Mr. Reuss, you made the statement that certain unidentified people were willing to accept 5 or 6 percent unemployment as a bearable amount. I have never heard that in the circles in which I travel and I am wondering if the gentleman would identify who in our society has been suggesting that a 5- or 6-percent rate is bearable.

Representative REUSS. I suggested that there is a school of thought which says that a rather substantial level of unemployment is bearable and that the remedy is to pay unemployment compensation to them. Among the holders of that view are a lot of Republicans on the one hand and Ken Galbraith on the other. It is quite bipartisan.

Representative CURTIS. That is what I want to find out. I am aware of a school of thought, and this administration is part of it, that says 4-percent unemployment is bearable. I happen to disagree with that school of thought.

Representative REUSS. For the record, I think the testimony of Mr. Heller is that 4 percent is an immediate goal to which it is sought to reduce unemployment, but not the ultimate.

Representative CURTIS. I want the gentleman to identify the school of thought that said 5 or 6 percent was acceptable, because I frankly have never heard anyone make such a statement. I don't think there is any public statement to that effect. Maybe there is. I thought the gentlemen, having stated that as a fact, would give us the benefit of identifying whom he was talking about.

Representative REUSS. My point, without reference to 5 or 6 percent, was that there is a school of thought which says that a considerable level of unemployment can be tolerated and that the humane remedy is to pay the unemployed endless unemployment compensation. I happen to differ from that.

Representative CURTIS. I will let it rest, but I wanted identification because I am always a little queasy about statements not attached to an actual person. The figure of 5 to 6 percent was used. I am aware of the fact that this administration takes that philosophy at 4 percent and I happen to disagree.

Representative REUSS. I will append a list of believers.

Representative CURTIS. Yes, I would be very interested in that.

Secretary WIRTZ. Would you tell me, Mr. Chairman, when it is appropriate to clear the record on the point which has just been made, because this administration in no respects accepts the 4 percent as acceptable, tolerable, or anything else. I don't mean to interrupt.

Representative CURTIS. You are perfectly right to interrupt to make that statement. All I say is that the record has been made. It appears in the Economic Report of the President's Council of Economic Advisers time and time again. I will let others judge whether or not that is their conclusion. I take exception to it and I am glad the Secretary feels that we should not be satisfied.

Secretary WIRTZ. May I, Mr Chairman, note for the record, the following statement which is taken from page 42 of the Council of Economic Advisers' Economic Report. The quotation is——

Representative CURTIS. Just a minute, Mr. Secretary, please let me go on.

Secretary WIRTZ. Surely.

Representative CURTIS. The administration has ample time to present its case. I have 10 minutes each day to try to put in one little voice to point out a few different ideas.

Secretary WIRTZ. I beg your pardon, sir.

Representative CURTIS. The record is there and I think the gentleman is perfectly proper in saying that, from his standpoint, the record does not support my position.

Chairman DOUGLAS. This is not to be charged to the Congressman's time, but I will say that I made a point to allow the Congressman generally 5 minutes more on his questioning than the rest of us have taken and will continue to do so.

Representative CURTIS. The chairman has been very generous, but in this context I think everyone should be aware of the pitiful amount of time that the loyal opposition has in this national debate. However, we will gain time.

Chairman DOUGLAS. If that is so, it is only because the Republican members have not been as assiduous in their attendance as the Democratic members.

Representative CURTIS. That part is a fair criticism. But it still doesn't get at the basic problem, and I am not blaming anyone for this. This is the nature of the situation. When my party had the executive department, we had a similar imbalance. Today we are interested in the facts involved here.

Mr. Secretary, allow me to comment. You ended your testimony on a note with which I certainly agree. But I want to turn it around the other way so that we get agreement there, too. I don't want to forget the 5 percent unemployed, because we have 95 percent doing well. But in trying to meet the problems of these 5 percent, I don't want to damage the success of the system that has produced the highest standard of living that any society has achieved.

I am happy to see that there has been a great deal of attention paid to these 5 percent. It is far from forgotten. There are people in political life today who are certainly going to continue picking up the problems of these 5 percent. But I do urge that while paying attention to the 5 percent we must not damage our basic system. From the suggestions that have been made to help the 5 percent, I feel we are actually damaging the basic system that has produced the good life for the 95 percent.

I am going to conduct my interrogation in such a way as to leave the record open for your further comments on areas needing additional study.

One is the impact of military draft on the young people entering the labor market. The impact of the draft hits two ways. First, it unsettles the employment situation of our younger people. Secondly, and this is part of the first, the employer feels uneasy when dealing with a young man who is subject to the draft.

The second, and equally important, factor is that a major part of the funds for civilian vocational education is spent under military control. The biggest operators of vocational education today are our military establishments. The draft law is going to be extended. The last time it was up for extension, no educator or labor leader, no one in the field of this problem, testified on its impact upon our work force—our young people.

I am very hopeful that this time there will be some intelligent review of the impact of this method of procuring manpower for our Military Establishment, and how it affects these problems that we are discussing. I am going to testify again myself and try to bring out the same ideas I tried to emphasize under the previous administration. I hope a few educators will take the trouble of giving us the benefit of their views on this subject.

I think this area should be mentioned in your original report. Certainly, when you ask for a Youth Employment Opportunities Act without discussing or referring to this draft act, it lacks basic context.

I would like to leave the record open on that point, Mr. Secretary, but you may make a preliminary comment.

Secretary WIRTZ. It would only be this: The Office of Manpower, Automation, and Training is now making a study of the military manpower aspects of this problem and it will be very easy for us to bring this to the attention of the committee in its present form, and I would like to have appended to my testimony a summary of that report.

I should also say, reflecting some of the views that you have expressed, that we are working very closely with the Deputy Assistant Secretary of Defense for Manpower and we are meshing our training program with theirs and are taking advantage of the large experience which there is in that area. But we will add a supplemental statement.

Representative CURTIS. I hope HEW, which is also in this field of vocational education, and you, in apprenticeship training, will do a similar thing.

Secretary WIRTZ. They are working with us, Congressman, in precisely this area.

Representative CURTIS. I personally am looking forward very much to the manpower report which is due in March. I am urging my friends on the Labor and Education Committee to upgrade that report and hold public hearings on the report. Of course, they will be doing that in a narrow context.

Mr. Chairman, I think it would be very advisable for the Joint Economic Committee, or one of our subcommittees, to hold hearings on this forthcoming report. I share the Secretary's view that this problem of manpower, employment and unemployment, is one of the most vital affecting us today.

Incidentally, I also hope that if either of the committees, or both, hold public hearings in this area, we invite State and local officials in this area. In fact, that is where most of the work is being done. Essentially, the Federal Government coordinates the activities of the private sector and at the local community and State levels. We frequently lose sight of these components in our discussion here at the Federal level.

Secretary WIRTZ. You know how much we will welcome such hearings and how glad we would be to cooperate in any way we can.

Representative CURTIS. I believe that, Mr. Secretary. I have just itemized some of the data and material that I would have liked to have seen in this year's Economic Report. Maybe some of it is here, but I have not had a chance to go through it carefully. For the record, I would like to raise a few points.

First, I would like to have the figures on the average age at which a person now enters the labor force. Our definition of the work force begins at age 14. That definition goes back into the early 1900's. I think the average figure is around 19 years and some months.

Mr. WOLFBEIN. The average American male makes his first full-time entry into the labor force at age 18.

Representative CURTIS. That is a figure that I know has changed and it is continuing to go upward. I am glad it is. It is natural that it would, because our young people are staying in school longer. This is the counterpart to your study and I have seen these figures.

I would like to get both studies into the record. What is the average length of time a person stays in school? I think our average is almost the third year of high school. I would like those figures before 1962 because I think the importance of them is to watch the trend.

I know the trend has been to increase the amount of education in our society. At the same time, that increases the age at which young people enter the work force. The counterpart of this is the age of retirement.

I would like to see those figures to see if there is a trend. As I recall from what I have seen and read about this, I think we have a continuing trend lowering the age. That is significant, because it bears on the composition of the work force, and gives us a better insight into what we might be facing in the future.

Secretary WIRTZ. Both sets of figures are available, Congressman Curtis, and I would have just one question. That would be the period for which you would like that.

Representative CURTIS. I am looking for trends.

Secretary WIRTZ. Starting with what, sir?

Representative CURTIS. Whatever period would show a meaningful trend. I don't know how accurate figures are in the past.

Secretary WIRTZ. They go back to 1900.

Representative CURTIS. It would be good to show 1900, because when we are dealing with estimating the labor force and talking about the decades ahead, these figures become important.

My next point discusses that. Senator Douglas has already indicated the significance of the low birth rate of the thirties. I thought that some of this so-called sluggishness, which I don't agree exists, results from this very fact. Today, we have a small 22 to 30 year age group. Shortly, this age group will increase as a result of the higher birth rate of the forties and fifties. That is why I called attention to the fact that it looked like the trend was going down. I think these factors are important.

Secretary WIRTZ. You would like on this last point a projection of net additional entries into the work force over a period as far ahead as we can give it to you, is that correct?

Representative CURTIS. Yes. Also, I would like your projection of what is going to happen as far as the age of entry into the labor force is concerned. Considering levels of education. What is going to happen with retirement? Is this trend going to continue downward? This, too, is another important ingredient.

Secretary WIRTZ. Our data will give you that figure, Congressman Curtis, up to 1975.

Representative CURTIS. The other ingredient that has been mentioned is almost a post-World War II phenomenon—namely, the entry of women into our labor force. What are the projections there?

My time is over and I will come back on these later.

(The following was later received for the record:)

CHANGE IN THE AGE OF ENTRY INTO THE LABOR FORCE, 1900–1960

In 1900 when about 40 percent of our work force was employed on farms, the average young man entered the work force at about age 15. By 1940, the age of entry had risen to age 17 partially as a result of longer schooling and other legal restraints on the employment of young people. Even then, the age of entry into the work force might have been less if the country had not been in a severe depression which greatly limited employment opportunities. Between 1940 and 1960, the trend toward longer schooling further reduced the number of young people not in school and who were working or looking for work; but opportunities for part-time work for students has kept the age of labor force entry from falling much below the 1940 level. Currently, the average age of entry into the American labor force for a male occurs between his 17th and 18th year.

The reduction in labor market participation by the young is shown by the following figures for boys 14 to 19 years of age:

	Percent in labor force
1900	62.1
1940	35.4
1960	38.1

CHANGES IN THE AGE OF RETIREMENT, 1900–1960

In 1900, most men worked almost as long as they lived and retirement as it is known today was very unusual. Between 1900 and 1940, a drop in the age of retirement for 60-year-old workers from age 72 to 69 resulted at least in part from the decline in the proportion of the work force on farms where men could work almost as long as they lived. Undoubtedly in 1940, the scarcity of employment opportunities resulting from the depression brought about a somewhat earlier retirement than would otherwise have occurred. Between 1940 and 1960, the age of retirement declined again to age 68 as retirement benefits under the social security system were liberalized and as private pension plans were developed.

Because life expectancy has been increasing in the United States at the same time that the age of retirement has been decreasing the average number of years spent in retirement for 60-year-old men has increased from about 3 years in 1900 to over 7 years in 1960.

INCREASE IN EDUCATION, 1900–1960

In 1900, young persons just completing their education averaged about a grade school education; now they average a little over high school graduation.

The following table shows the average years of schooling for persons completing their education about 1900, 1940, and 1960.

1900	8.2
1940	10.3
1960	12.3

Source: Decennial census reports for 1950 and 1960. Data for 1900 estimated on basis of educational attainment of persons 65 to 69 in 1940 who had been 25 to 29 at the time of the 1900 census.

THE CHANGING AGE AND SEX COMPOSITION OF THE LABOR FORCE, 1900–1975

In 1900, the American labor force was much younger than it is today. Over 55 out of 100 workers were under 35 years of age. By 1960, this figure had dropped to 38 out of 100 because the population was older and a smaller proportion of young people was at work. As a result of the very large number of young people born since World War II who can be expected to enter the labor force in the years ahead, the proportion under 35 is expected to rise to about 45 out of 100 by 1975 despite an expected continuation of the trend toward earlier retirement.

Along with the growth of urban centers and nonfarm industries, the proportion of women in the labor force has risen more or less steadily from 18 percent in 1900 to 32 percent in 1960 and is expected to continue to rise to about 34 percent by 1975.

Distribution of the total labor force, by age, 1900–1975

	1900	1940	1960	1975
	In thousands			
Total, both sexes, 14 years and over	27,640	53,297	69,078	93,031
14 to 19 years	4,064	4,014	4,980	9,208
20 to 24 years	4,481	7,723	7,029	12,579
25 to 34 years	7,072	13,683	14,721	20,806
35 to 44 years	5,279	11,241	16,491	16,217
45 to 54 years	3,599	9,072	14,361	17,871
55 to 64 years	2,031	5,431	9,146	12,639
65 years and over	1,114	2,133	3,150	3,711
	Percent distribution			
Total, both sexes, 14 years and over	100.0	100.0	100.0	100.0
14 to 19 years	14.7	7.5	7.1	9.9
20 to 24 years	16.2	14.5	10.1	13.5
25 to 34 years	25.6	25.7	21.1	22.3
35 to 44 years	19.1	21.1	23.6	17.5
45 to 54 years	13.0	17.0	20.5	19.2
55 to 64 years	7.4	10.2	13.1	13.6
65 years and over	4.0	4.0	4.5	4.0

Source: 1900–1940 from "The American Labor Force," by Gertrude Bancroft, table D–1; 1960 Census of Population, Supplementary Reports, PC(S1)–35, table 194; 1975 Special Labor Force Report, No. 24, table 2.

Percent distribution of total labor force, by sex and age, 1900–1975

	1900	1940	1960	1975
Total, both sexes	100.0	100.0	100.0	100.0
Male, 14 years and over	81.9	75.6	67.9	65 5
14 to 19 years	10.3	4 9	4 4	6.0
20 to 24 years	11.9	9 5	6.5	8 8
25–34 years	21.5	18 9	15 2	16.0
35 to 44 years	16.7	16.4	16.1	11.6
45 to 54 years	11.5	13.8	13 5	11.8
55 to 64 years	6.5	8.6	9.0	8.7
65 years and over	3 5	3 5	3 2	2.6
Female, 14 years and over	18 1	24 4	32.1	34.5
14 to 19 years	4.4	2.6	2.7	3 9
20 to 24 years	4 3	5.0	3 6	4.7
25 to 34 years	4.1	6.8	5.9	6.3
35 to 44 years	2.4	4 7	7.5	5 9
45 to 54 years	1.5	3 2	7.0	7.4
55 to 64 years	.9	1.6	4.1	4.9
65 years and over	.5	.5	1.3	1.4

Source: 1900–1940 from "The American Labor Force," by Gertrude Bancroft, table D-1; 1960 Census of Population, Supplementary Reports, PC (S1)–35, table 194; 1975 Special Labor Force Report, No. 24, table 2.

Chairman DOUGLAS. I know it is not good taste to call attention to one's generosity, but I would like to point out we have allowed Congressman Curtis 18 minutes. I am going to ask Senator Proxmire to confine himself to 10 minutes.

Representative CURTIS. At this point let me make this remark. I would rather not have the generosity if that is the manner in which it is going to be handed out. I will again make this statement, Mr. Chairman. The inequity of the administration is evident in conducting a national debate. It has issued message after message, press release after press release. The entire testimony this week is taken up with Government witnesses who take most of the time. Those of us who want to try to interject a contrary note for examination get 10 minutes and, when we get an additional 4, it is pointed out as generosity. I do not regard it as generosity.

Chairman DOUGLAS. Do you think you should have more time than the other members of the committee?

Representative CURTIS. Yes, in order to present a point of view. If you are trying to conduct a debate, yes. If you are trying a snow job on the public, no.

Chairman DOUGLAS. May I say any Republican who comes here will be given 10 minutes, or more than 10 minutes. Congressman Curtis has done extremely well in presenting his own point of view. I only regret he has not had sufficient companions to balance this.

Representative CURTIS. Let me say this: I have not done well in presenting my point of view. No one could possibly do well in these complicated matters in 14 or 20 minutes.

Chairman DOUGLAS. Eighteen.

Representative CURTIS. Or 18. At least, without this kind of heckling, we could lay the groundwork.

Chairman DOUGLAS. I only mention this because the Congressman both on the floor of the House and here has been complaining about the restrictions which have been imposed on the Republican Party. I would like to point out that if there have been restrictions they have been self-imposed by the failure of Republican members to attend, that we have certainly given Congressman Curtis more time than we have accorded to our Democratic colleagues. Perhaps it was bad form of me to mention this, but I was somewhat pricked into this by his charge that he was being muzzled. That is the last thing that I wish.

Representative CURTIS. Mr. Chairman, let us get this in context. My criticism has not been directed against the chairman of the committee or the committee's rules, which I helped write and think are good rules.

Chairman DOUGLAS. Which you don't follow.

Representative CURTIS. Which I try to follow. What I am trying to point out is that what we are really engaged in is not a little contest to see who can get a leg on the other as far as the techniques we have. We are really engaged in a very serious matter that affects the welfare of this Nation.

There are two points of view. It is important, I think, if we are going to have healthy debate, to get the other point of view discussed. That is the basis of my remarks. I have no complaint against you, but against the situation.

As I pointed out this imbalance was also true under the Eisenhower administration, particularly in the 83d Congress when we controlled both the executive and the Congress. That is all I want to point out, because I think the people must know this imbalance exists in national debate today. It is not healthy.

Chairman DOUGLAS. I don't wish to take up precious time on this, but I would like to point out that we invited two witnesses who are former members of the Eisenhower Council of Economic Advisers, Messrs. Burns and Jacoby. We did this at the request of the minority.

Representative CURTIS. Very generous.

Chairman DOUGLAS. Not generous; fair. We wish to be both generous and fair.

Representative CURTIS. Do you think that is a balance with this whole week of Government officials?

Next week we have two people, in a panel, I might say, who will express a different point of view.

No; I think, Mr. Chairman, you must recognize the basic inequity of this national debate. As far as you personally are concerned, you have been very fair and I appreciate it.

Chairman DOUGLAS. On this note of personal reconciliation, let us continue.

Senator PROXMIRE. Let me add to the reconciliation that this Democratic Party of ours is a democracy. It has much diversification of opinion. I happen to oppose the tax cut. You may not have been able to tell by my questioning today.

Chairman DOUGLAS. I think that was evident yesterday.

Senator PROXMIRE. I am inclined to oppose it, but my mind is not closed any more than Congressman Curtis'.

Mr. Secretary, I would like to read from an article that appeared in the Post this morning and got my adrenalin pumping. I would like to indicate why I think it is unfair and I would like your comments:

> Despite the grumbling, mutterings, and even screams of Capitol Hill about fiscal irresponsibility, President Kennedy's $13.5 billion tax cutting program faces almost no organized opposition. But the opposition it does face is nonetheless formidable even though scattered, inarticulate, and amorphous. This opposition rarely makes itself felt in systematic economic arguments. In general, rather, it is sloganeering or throwback to old-fashioned Puritanism.

This is a news article; it is not an editorial. I would like to ask if it is not perfectly logical and proper for Members of Congress to challenge the tax cut which is in fact a drastic change in American economic policy since it is being proposed in a period of relative prosperity, a period in which we have a high deficit, a period in which the President is going to ask for more spending and has told us so. Should we not consider alternative methods of solving the unemployment problems, alternatives which it seems to me have significant and substantial promise?

I am talking about the possibility of earlier retirement. I am talking about the possibility of increasing the school-leaving age, which I admit has to be done on a local basis. I am talking also about the possibility that organized labor has proposed, which you discussed very ably in your paper, of a shorter workweek.

It seems to me these alternative possibilities should be considered along with the possibility of a tax cut. Also the alternative, to which I am not inclined, of increased Government spending.

I think you would find substantial economic support, intelligent and thoughtful economic support, not based on sloganeering. That since so much of our unemployment is a special problem with the three 12-percent categories you can rifle-shot it. Not a scatter-gun approach of a broad, general tax cut, increasing all demand, but perhaps more emphasis on seeing what we can do about our minorities and opening jobs to them, seeing what we can do about more opportunities for our young people. Also, more training for the unskilled.

What is the matter with that kind of an approach? Do you consider this to be irresponsible sloganeering, or isn't it sensible for Members of the Congress to demand justification?

Secretary Wirtz. Senator, it would be presumptuous of me to answer a question as to the reasonableness of the exercise of any congressional prerogative of that sort, and I decline to answer only on the basis that I am sure I am not a proper judge of that.

Your question included also a point addressed to what we recognize is a matter of very real concern and that has to do with the relationship between what has been referred to as structural unemployment, which would be susceptible to the approach of the Manpower Retraining Development Act on the one hand and the broader problem of unemployment on the other.

I can only say respecting the time limitations which are involved here, that it seems to us that the answer to that is very clearly that we have to take both approaches to this problem. We see it every day in connection with the administration of the programs which we administer and in connection with the labor disputes which arise.

We think and feel very strongly that there are two things necessary. One is the development of an invigorated demand in the economy and the other is the development of a manpower program of the kind in which we are all here interested.

As between the two, priority is, in our judgment, attached to the first. But it is equally our view that both are absolutely essential.

Senator Proxmire. First on the structural aspect, I would agree that you have to work on both fronts although I am not convinced yet that the tax cut is the best way.

Secretary Wirtz. I understand.

Senator PROXMIRE. It is certainly not the only way to increase demand. On the structural approach, are you satisfied that the area redevelopment bill which we passed, the public works bills which we have passed, the provisions which we have for channeling some defense contracts into the area of unemployment, are sufficiently forceful to provide the answer here?

What I am getting at here is, should we step up these programs, give them more emphasis, expand them, to a greater extent than we have today?

Secretary WIRTZ. Are you talking about those parts of these programs which have to do with the stimulation of particular projects or those parts of these programs which have to do with the training or retraining? I am not quite clear.

Senator PROXMIRE. I am talking about both. I am particularly talking about the fact that we not only have the three categories you talked about, of 12-percent unemployment. We also have area problems.

Secretary WIRTZ. That would be the fourth I would add.

Senator PROXMIRE. Pennsylvania, West Virginia, southern Illinois, northern Wisconsin, and so forth. Those are a few tough spots. If we could solve these specific problems, we would not have such serious unemployment situations.

My question is: Should we look to area redevelopment with more reliance than we have in the past? It seems to me this is a terribly small program. It started off with $395 million. We may end up with about a half billion dollar program this year.

In terms of the job it has to do, I am wondering if this is enough.

Secretary WIRTZ. I would like to answer in terms of the training and retraining parts of these programs which are within our particular competence and responsibility, and the answer is very clearly that there is not enough of a program of this kind yet.

I should like to divide my answer into two parts. I think there has been extraordinary, fantastic, unprecedented advance in the development of this program in the last 2 years. We started with this, with the area redevelopment program. This is a new program in America today. But recognizing that advance, the situation is presently this: The area redevelopment program has a training aspect to it which is of limited numbers. The Manpower Development and Training Act of 1962 provided for our training and retraining this year through the State offices of 70,000 people. We will do that before the fiscal year is completed. That 1962 act provides for the increase in that number to 100,000 next year, eventually to 400,000 in the 3-year period of the program.

We think that is probably an appropriate program and perhaps all that can be done in this particular area at this point. However, we feel it essential to add to this same program, and it really is the same program, the Youth Employment Act which is of a closely related nature. I think it is probably true that with the Area Redevelopment Act, the Trade Expansion Act, which has limited training and retraining features, with the present Manpower Development and Training Act, assuming the appropriation for the next 2 years which is provided in the original statute, and assuming the administration's Youth Employment Act, we will have taken gigantic strides in this direction and perhaps the largest steps that we can take in the period at hand.

Senator PROXMIRE. Now how about the placement of the retrained people? Of course, I subscribe to the whole thing. I think one of the reasons this has worked so well in Milwaukee, as Congressman Reuss said, is that it is run by people who understand the job situation, top labor and industrial leaders. They have keyed the program to the needs of the local industry. They know that local industry needs a certain number of skilled people in categories, the Milwaukee vocational schools train for it and zero in on it. They don't train people so they can acquire a skill and go someplace and find a job, maybe.

Secretary WIRTZ. I would be glad to answer that, but I have with me the director of that office and perhaps you would prefer his answer.

Dr. Wolfbein.

Mr. WOLFBEIN. As the Secretary indicated, we have a very small number of alumni so far. So perhaps we should not generalize. With that caveat, we have already, for these 1,800 alumni, placed about 2 out of 3, which we think is an excellent record, since some of these graduated just within the last few days.

Our placements have been best, as you might expect, in the situation where you indicated, where you see a job right smack in a particular company and you place the person. I would say, all in all, our experience is very satisfactory on the placement side. But I underscore the fact, Senator, that you mentioned. That in this particular program what you do is first find out where the jobs are at the local level.

Senator PROXMIRE. I wonder if you gentlemen are in any position to tell us the extent to which this problem could be solved by structural measures of the kind you describe. Many of us feel that there are jobs going begging, jobs that are never filled, simply because we don't have people trained to fill them. I think we may be able to solve a part of our unemployment problem through training people to do the kind of jobs for which people are not trained today.

To the extent that we can do this, it seems to me we would have to have less of a deficit and less of a burden which many of us feel we will have to otherwise carry in the future.

Secretary WIRTZ. May I emphasize a point in Dr. Wolfbein's statement? It is not only that two out of three of these trainees will be placed. It is in this period we have already placed two out of three. In some cases they are only a few days out of training. I don't want any misunderstanding. This is simply the first interim result.

I can answer that question better than I can the second one. I don't believe there is any good basis for identifying specifically, or really very meaningfully or precisely, the number, or the amount of this job which we can accomplish through purely structural changes. There are various mathematical ways of approaching that problem, and frankly, I have experimented with most of them. They don't satisfy me. The arithmetic becomes so complicated. I am not an economist. I must without that advantage or with that advantage, whichever it may be, fall back——.

Senator PROXMIRE. I hope we can get statistics that will help us in this.

Secretary WIRTZ. I wish we could.

Senator PROXMIRE. It would be a very useful and helpful investment.

Secretary WIRTZ. We have replied affirmatively with every other request for statistics. But I would be less than frank with you if I were to suggest that I have yet seen a reliable breakdown in terms of the projection of the answer to the question of how much of this can be done by an approach through a training program and how much of it can be done by an approach through an invigoration of the economy and stimulation of demand.

I have not satisfied myself on that. But I am dead clear on one thing, and that is that both are absolutely essential. So the only difficulty is in answering the division between the two.

Senator PROXMIRE. I will come to the demand side in a minute but my time is up. I yield to Congressman Curtis.

Representative CURTIS. I think it is true that if demand is up, the other job is easier. If, on the other hand, the demand is really there or could be there through purchasing power, you could increase purchasing power as you suggest and it would not be beneficial in one of the biggest areas of technological growth, the agricultural sector. That is where we are gaining the most. That is why I worry about the administration's undue concentration on the demand side of this problem and why I have tried to emphasize the other side, the structural or frictional one.

Although it is a difficult task to identify new skills I want to ask how is this dictionary of skills coming along that you are updating?

Secretary WIRTZ. The Dictionary of Occupational Titles. Is your question as to when it will be released?

Representative CURTIS. It is a continuing thing.

Secretary WIRTZ. That is correct.

Representative CURTIS. You have had it. There was an extra effort made to try to bring it up to date.

Secretary WIRTZ. It is in a state of constant revision and updating.

Representative CURTIS. How is it at this point? I think there has been a neglect. I say that as one who might have to bear the political consequences because the previous 8 years were under my administration.

Secretary WIRTZ. Congressman, you well know how very grateful we are in the administration of the manpower development training and the employment security programs for the emphasis that you place on this aspect of the problem, and for your suggesting even such things as the desirability of being sure it is up to date.

I am completely sincere in saying that and with no qualification at all.

Representative CURTIS. You are very kind. I am only trying to dig in here. This is just a specific case.

This gets into another area and I know it will embarrass you to comment, but I want it on the record. One of the biggest problems we have is in the division of jurisdiction between the Labor Department and the Department of Health, Education, and Welfare in this area. HEW has a Federal vocational education program and you have the apprenticeship training one. I have been very much concerned about possible overlap here, especially since many people have been trained in skills already obsolete.

In fact, I would like to see vocational education put under one roof within the Labor Department. For example, one skill that is going begging all over the country is tailoring. If you talk to any tailoring company or go through the plants, and I have, you will find that most of the tailors are immigrants. Not old immigrants, but young immigrants.

When I asked high schools in my own community why they didn't teach tailoring in high school they admitted they never considered it. Of course, that goes back to the community, but this is an example of the need to identify the skills that are going begging and relating them to vocational education.

As I understand the report that is coming to Congress in March about manpower training, it is to be a combined report of HEW's phase of it as well as yours. Am I not correct?

Mr. WOLFBEIN. The Secretary of Health, Education, and Welfare will issue a report by March 1 and the Secretary of Labor will on the operations of the act. This is in addition to the overall manpower report.

Representative CURTIS. It is not one single report.

Secretary WIRTZ. It is a report by the President to the Congress required by statute and then there are these additional reports by the Secretaries.

Representative CURTIS. The President's report will be a coordination of the two, I presume?

Secretary WIRTZ. That is correct. But if your question implied, as I thought it did at least at this point, any difficulty of working relationships in connection with this program between HEW and ourselves, it has been notably free of any friction of that kind at all. In fact, I can't think of a single instance in which I felt there was any diminution in efficiency or economy of operation or effectiveness as a result of division between the two Departments.

Representative CURTIS. I am referring to the testimony before the Labor and Education Committee in the House when we were considering the Manpower Training Act. It seems to me that this has been a basic problem although I do understand that your personal relationships have been good. It is the same problem you would run into in any division of jurisdiction.

I have several other areas for which I want statistics, if we have them.

One way you measure a forward-moving economy is through increased leisure time. A possible criteria of measurement would be the establishment of benchmarks of hours per worker by year. Certainly the 40-hour week and increased vacation time are indicative of real economic growth. These do not show up in gross national product, but mean a great deal. Use of our leisure time is another question. (See p. 221.)

If you could develop any meaningful trends in these areas, I would like to see them. Let me list them rather than comment, because you may already have the figures.

The amount of on-job training and retraining that is already going on.

Secretary WIRTZ. The amount of off or on?

Representative CURTIS. On-job training and retraining, and then the off, if there has been any trend. I am sure there have been some real increases here, but I don't know whether we have statistics.

Secretary WIRTZ. This would be hard to define. The amount of on-the-job training figures are difficult for us to come by. But we will do the best we can on that. That is because those are figures which the private employer has.

Representative CURTIS. That is right. It might be with one of the institutions, McGraw-Hill or some other research group.

Secretary WIRTZ. Our figures will be less complete on that.

Representative CURTIS. The same thing is true of off-the-job adult education. I separate that from vocational education of those entering the labor force for the first time. I am interested in those already in the labor market who take adult education. This number has grown by leaps and bounds and I would like to get some estimate of its increase.

Secretary WIRTZ. We will get that from HEW.

(The following was later secured for the record:)

In response to your questions (pp. 379–380) covering the extent of the training in the United States, I should first like to emphasize that our present information on this subject is inadequate. I am very happy that the Manpower Development and Training Act of 1962 specifically charges the Department of Labor to "appraise the adequacy of the Nation's manpower development efforts * * *." In order to determine the extent of the country's manpower development efforts, the Department is initiating studies which will enable us, for the first time, to view the entire field of skills development in the United States.

On the basis of the fragmentary information now available, we believe that about 62 million Americans are receiving some kind of formal training each year. Of this 62 million, over 55 million were enrolled in the Nation's school systems. In addition, a large number of employed workers are developing skills informally on the job. It has been estimated that 6 young persons out of every 10 go from secondary school directly to a job. Another two take some additional training before entering the labor market. Two of the ten complete college or university before starting their careers.

Essentially, six major institutions carry on training activities in the United States.

The Nation's schools are its primary training institutions. More than 55 million Americans, or 1 out of every 3 above the age of 5, are enrolled in a formal program of instruction. The number of students enrolled in schools has been increasing steadily over the years. This has resulted in a sharp rise in the educational achievement level of the population. In the 1962–63 school year almost 47 million youngsters were enrolled in regular day schools, kindergarten through grade 12. Another 4.6 million were attending schools of higher education which give degrees.

Also in the Nation's schools are more than 3 million adults taking evening classes offered by local public school systems and more than one-half a million enrolled in part-time programs offered by schools of higher education.

Federal-State programs of vocational education accounted for 1.7 million of the daytime students, and over 2 million of the part-time students in 1961.

Private industry is probably the Nation's second largest developer of skills. Although the full extent of the contribution of private industry to training is not known, a recent Department of Labor study indicates that about 2.6 million workers are receiving formal training in programs both on and off the job. This training is sponsored by more than 100,000 industrial establishments. This survey confirms earlier findings that the bulk of training is conducted in larger industrial firms. One of the most important of these formal programs is apprenticeship, sponsored by management and unions to train workers for the craft skills. More than 155,000 workers were being trained in apprenticeship programs registered with the U.S. Department of Labor in 1962. A considerable number of other workers were being trained in nonregistered programs.

Formal training represents only a small part of the total training carried on in industry. Informal on-the-job training is an extremely important training aspect contributing to the skill level of the American labor force. Unfortunately, little is known about the extent of informal training. The Department is now sponsoring a survey of how workers acquire skill. This study is expected to supply information about informal on-the-job training.

The U.S. Department of Defense is clearly one of the largest, best equipped, and one of the most important training institutions in the Nation. Many of the 12 million men and women who were in the Armed Forces during World War II received training which has contributed to the Nation's growth and development in the postwar period. This contribution has never been fully assessed. We do know that Armed Forces training has played an especially important role in preparing workers for jobs in air transportation, electronics, and in other newly developing technologies.

Since 1948, almost 6 million Americans have been drafted for military training. This training has become increasingly technical as a result of the demands of a modern army, including new weapons systems. A considerable amount of the training develops skills which can be used in civilian activities. In 1960, the Armed Forces reported an enrollment of 632,500 enlisted men and officers in educational programs while off duty. The total amount of Federal funds expended for academic training of military personnel amounted to almost $50 million, of which $7 million was spent in civilian institutions, including colleges, hospitals, and industries. In fiscal 1962 the Department of Defense spent almost $13 million for training in non-Government facilities.

Correspondence schools which offer home study courses also play an important role in developing the Nation's skills. According to the National Home Study Council, almost 2.3 million individuals were enrolled in correspondence courses in 1960. Most of these persons were taking occupationally related courses.

Almost all civilian Government agencies conduct or sponsor programs of training.

Some of these programs are carried on for particular groups in the United States. The Office of Vocational Rehabilitation helped return some 102,000 handicapped persons to employment in 1962. Approximately one-third of these individuals received some type of occupational training during the process of rehabilitation.

Federal correctional institutions train approximately 12,000 prisoners yearly, and State prison systems, it is estimated, train almost twice as many. The Veterans' Administration provided on-job and on-farm training for some 36,000 eligible veterans in fiscal year 1960. The Bureau of Indian Affairs trained some 600 youths and 1,200 adults in vocational programs during 1960.

Other programs sponsored by Government agencies are directed toward upgrading skills of Government employees. Among these are the management intern programs, refresher courses for secretaries, and the great variety of other specialized programs. In addition, civilian agencies of the Federal Government spent $5.7 million for training in nongovernmental facilities in fiscal year 1962.

National data are not available on the training activities of private social service organizations. Nevertheless, the contribution of these organzations is, in the aggregate, substantial as well as strategic. For example, Goodwill Industries, which has probably the largest network of sheltered workshops, provided training and work for an estimated 35,000 disadvantaged persons during 1960. Another organization, the American Federation for the Blind, reported serving over 70,000 persons through 400 agencies, with approximately one-fourth of them carrying on vocational training programs.

A recent directory lists 104 national, nonsectarian agencies which provide either direct services or indirect support to the handicapped. About one-third of them have regional, State, or local affiliates.

There is no question that the Nation's training activities are expanding. Where we have information on enrollments and expenditures, all signs point to increased training in all of the six major training institutions. Enrollments in the Nation's schools have increased sharply over the last decade. Industrial training, according to observers, is increasing rapidly with new classrooms opening each year in the factories and in the stores. Defense expenditures for all academic training have more than doubled since 1950. Correspondence school enrollments have grown by 300,000 yearly in recent years. Nondefense Federal financial expenditures for education rose by more than 50 percent between 1953 and 1959. Private social service organizations, according to scattered information, also are increasing their services to the special groups of citizens who are in need of training.

The increased amount of training does not offset the need for Federal training and retraining programs. These programs, such as those offered under the Manpower Development and Training Act and the Area Redevelopment Act, extend the opportunity for training to persons who otherwise might not be trained in the programs referred to above. The Manpower Act specifically aims at achieving a better matching between men and jobs. The labor market orientation of this program represents a new and necessary dimension to training.

Representative CURTIS. I guess they would have it, but won't you have some? I would regard union activities in the apprenticeship training programs as adult education.

The last area on this is statistics relating to the impact of improved health. That is what I call it. In other words, I am inquiring about the amount of time on the job or, turning it around the other way, the loss of hours through sickness and accident. Again, these would be trends that I am interested in.

Secretary WIRTZ. Would the absenteeism figures cover that? It is hard for us to know why a person is off the job. We do have the figures for absenteeism.

Representative CURTIS. I know. What I am trying to do is relate it to the tremendously improved health of our society which has cut down the incidence of loss of work for health reasons. Maybe HEW is the Department to ask. The accident rate I think you do have.

There are three reasons for absenteeism: one is health, the second is accident, and the third is unknown. The two I am concerned about would be the health and the accident factors. (See p. 221.)

I think my time is probably up and I will get to ask my final questions later.

Chairman DOUGLAS. You have another minute.

Representative CURTIS. Do I, really? Maybe I can complete it here, then.

There are three areas of reform that I am very anxious to promote. I am doing a little lobbying here now. I have introduced bills for these reforms in the past. First, under our present tax laws a worker's home is where his job is. That has a very deleterious impact on labor mobility in two ways. This came to my attention through the McDonnell Aircraft case when highly skilled employees were sent to Alamogordo, N. Mex., to follow the missile industry. They were on a per diem wage because they were away from home. After they had been there a while, the Internal Revenue Service said this wage was added pay, not per diem on the basis that your residence is where your job is. These people owned their own homes and had children in school in their home communities. They had to commute back and forth. This had a bad effect on labor mobility and an impact on defense. This is really a serious problem.

A second example can be seen in the Chrysler move from Evansville, Ind., to St. Louis. A lot of these workers could not sell their homes right away. They had to commute back and forth. They could not deduct the maintenance of two residences as a cost because your residence is where your job is. As a Congressman I can claim this expense. I maintain two residences and I am permitted to deduct the cost.

Secretary WIRTZ. The new tax bill has a new provision in it for increased recognition of moving expenses.

Representative CURTIS. I know they recognize moving expenses, but look what the Internal Revenue Service did the other day. They imputed part of the cost that the employer gave to a man for moving expenses as his income. It is obvious that today most workers own their own homes. Their residence is where their home is and not where their job might me. This is a real impediment to labor mobility.

We have a similar impediment in the area of upgrading skills. This process of matching jobs is not an easy one. You cannot take the unemployed, since they are usually unskilled, and match them with these highly skilled jobs that are going begging. It is more a process of taking a fellow with a job who will study, and upgrading his skill to a new level. Thus, his job is vacant for someone less skilled, often someone currently unemployed. Yet our tax laws say that if a person attends night school, and upgrades his skills, he cannot claim it as a tax deduction. I was made aware of the problem when a teacher asked me why she couldn't deduct attendance at summer school as a business expense. I said she could, but I was proven wrong. The principal could tell her, "You will be fired if you don't go to summer school," and she could deduct it. But, if she was doing it willingly, she couldn't claim it. I was able to persuade the Internal Revenue Service to consider teachers and the deduction was provided.

This deduction should apply across the board in our dynamic economy. I am lobbying to get that one now.

The third problem is to obtain help on unemployment insurance, so that we could reorient it toward retraining. I am happy that 20 States have now turned it around and, in effect, say that if a fellow doesn't retrain he might lose his unemployment insurance. But surely we shouldn't make him lose his unemployment insurance if he does retrain. I think we can do more to our unemployment insurance law to further facilitate this retraining process.

I suggest use of the experience rating. This gives credit to the companies who, knowing they are going to have to lay off certain people in 6 months, engage in retraining for a skill that perhaps they can't use, but could be used elsewhere. That is my lobbying.

Secretary WIRTZ. On the last point, we are actively in support of that same position and will continue to do everything we can to meet that problem. I will take up with Mr. Caplin or the appropriate authority the other point which you raise with respect to the expenses.

Representative CURTIS. There are two: labor mobility and upgrading of skills.

Secretary WIRTZ. Yes.

Mr. Chairman, I hope there will be an appropriate time for entering into the record, and I hope without offense to Congressman Curtis, one paragraph from the report of the Council of Economic Advisers.

Representative CURTIS. If I can have it open for rebuttal.

Chairman DOUGLAS. I take it, it is on page 42?

Secretary WIRTZ. Page 42, the third complete paragraph?

Representative CURTIS. May I have it open for rebuttal? I will put in the inserts.

Secretary WIRTZ. May I inquire of the chairman whether it is consistent with his conduct of this meeting in view of his request that I do this?

Representative CURTIS. The only rebuttal I want is to insert other quotations from the Economic Report.

Secretary WIRTZ. Then, from my standpoint, I am inclined to let the record stand as it is.

Chairman DOUGLAS. Thank you.

Secretary WIRTZ. I need not add it is only in the interest of the record.

Chairman DOUGLAS. I notice a natural tendency of the loyal opposition both outside and inside the Democratic Party to lay emphasis on structural unemployment, and to imply that if various impediments to transfer of labor, such as lack of skill, moving difficulties, and the rest, were removed, that unemployment itself would vanish. Now I would like to ask if the jobs are not there, to what types of employment will these people go?

Secretary WIRTZ. The act requires that we not establish the training program unless there is a reasonable possibility of employment. I have forgotten the precise form. We have not reached that problem yet in connection with these first 500 projects. But we see ahead of us as a very real limiting factor the almost certain prospect that we will not be able to offer that degree of assurance which the act requires.

Chairman DOUGLAS. There are openings, of course, for women in the field of nursing and stenographic help, openings for men as auto mechanics and certain other lines. But if there is a large percentage of unemployment caused by "a shortage in total aggregate money demand," the removal of these structural difficulties will not solve any large portion of the problem; isn't that true?

Secretary WIRTZ. I think it is both. It is perfectly true in those areas in which this is an acute problem—I am not speaking of the economy as a whole—it seems to be a problem of having both a flat tire and being out of gas and we are trying to do both things. We are trying to remedy both problems.

Chairman DOUGLAS. Let us go into this question of an alleged shortage in aggregate demand. I was remarking yesterday in questioning the Director of the Budget that I think this is equivalent to saying that the sum total of price tags on goods produced or which could be produced with substantially full employment is in excess of the sum total of monetary purchasing power in the pockets of consumers. If this is so, then there are two basic remedies. One is to reduce prices to the level of monetary purchasing power. The other is to pump up monetary purchasing power to the level of prices. Theoretically, I would favor the former policy.

But what do you think about the time which would be required and the prospects of success of carrying out this policy of reducing prices to the level of monetary purchasing power. You are an experienced lawyer. You made a fine reputation and very comfortable living in Chicago as a corporation lawyer. Do you think a vigorous enforcement of the antitrust laws would result in a speedy reduction in prices and would result in harmony with the business community?

Secretary WIRTZ. I think the largest interests of this committee are served when I say to you frankly that I feel I am over my depth, and I don't know the answer to the question you have asked. I don't thoroughly understand it. The last part of the question was with respect to the results of a vigorous enforcement of the antitrust laws.

Chairman DOUGLAS. With the aim of reducing prices to competitive levels.

Secretary WIRTZ. And the question specifically was whether I would feel there is a prospect or sufficient prospect of that being effective to meet the problem that we have before us?

Chairman DOUGLAS. That is correct.

Secretary WIRTZ. I would hope it was appropriate to defer to other departments of Government the answer to the question as to how much prospect there is of effective relief in that direction. I don't mean for a moment to suggest an unfamiliarity with the field. The whole administered price problem and so on and so forth. But I really think it is in the interests of the committee if I profess incomplete knowledge of how far that would be effective. I don't think it will do the whole job or we wouldn't be urging these other things. But I don't want to pretend to you that I can translate into any kind of specific figures the effectiveness of that program.

Chairman DOUGLAS. It so happens that a third of a century ago I wrote an article proving that under a competitive economic system you would not have what was termed technological unemployment, namely, that improvements in productivity would translate themselves into reductions in unit labor costs per hour if not accompanied with increases in wages, and that under a competitive system this should result in a lowering of prices and an increase in quantities demanded.

In the industries where the elasticity of demand was greater than unity, this would result, as my confrere said, in an increase in employment. In industries with elasticity less than unity, it would result in diminution. But the average elasticity for the economy as a whole is equal to unity, and therefore for the economy as a whole there would be reabsorption. I think I demonstrated that perfectly, if we had a competitive economic system. But we know we don't have a competitive economic system.

A former colleague of mine at Chicago has written a very able book called "Capitalism and Freedom." If we had a perfectly competitive system most of the consequences which he describes would be true. We know we don't have it.

Do you want to turn to the question of pumping up purchasing power to the level of prices? We had some exercises on Monday in working out the probable numerical magnitude of the so-called multiplier. I wonder if your advisers down at the Department of Labor have worked on that question?

Secretary WIRTZ. We have gone over the fullest record we have of Monday's testimony and know the colloquy to which you refer. So far as I can tell, not on the basis of just general suggestion, but on the basis of reviewing that testimony, the position which Dr. Heller took would be in every respect the position which I would be inclined to take.

Chairman DOUGLAS. As a matter of fact, he took a much more conservative position than I took. I think he would only claim a multiplier of 2-plus, with plus an unknown magnitude from the investment accelerating factor. We made a rough estimate of the accelerator factor and we came out with a multiplier of from 3 to 4.

I would like to point out that if you do have a multiplier of 4 and an $8 billion tax cut produces a $32 billion increase in the gross national product, that this will mean greater tax revenues at the reduced rates in the second year of not far from $6 billion. And the net loss in revenue is therefore only $2 billion. It will probably create an increase in employment of somewhere around 2 million.

I wish we could get some informed discussion on the magnitude of this multiplier, because this is crucial. If the multiplier is only 2, and you get an increase in gross national product of only $16 billion, then the increase in net governmental revenue is only a little over $3 billion, and you lose close to $5 billion in revenues from a total of an $8 billion cut, and your reemployment is much nearer 1 million than 2 million. I wish we would grapple with this question of the multiplier. Very frankly, one of our difficulties in this whole matter which Congresswoman Griffiths referred to yesterday in her most witty and penetrating examination is that while the theory of the multiplier has permeated the ranks of the economists in the last 30 years, it has not permeated the mind of the general public. Even among the economists, the multiplier has been used as an offset to recessions, not as a stimulus to retarded growth.

You have a great deal of ability, Mr. Wirtz, yourself, and you have surrounded yourself with able men both to your left and right down in the Department. I wish they would work on the quantitative magnitude of the multiplier combined with the accelerator principle.

People laugh at this and say these are extravagant terms, but I would like to remind them that the atomic bomb was worked out with mathematical values, and if the theoretical work which Einstein started and which Fermi and the others carried out had not been previously done we never would have had the atomic bomb.

Now we are engaged in a great experiment to help mankind. Many people regard it as dangerous as the one which was carried out in our home city. It is important that we know what we are talking about. So I am going to urge you to get your experts to work on the multiplier and accelerator and translate it into increased employment.

I have taken up my 10 minutes, and I will yield to Senator Proxmire.

Senator PROXMIRE. I want to get on this demand situation which is much the most fascinating part of our discussion, but I do want to ask about a couple of specific details on the Labor Department itself.

To what extent do labor bottlenecks stem recovery, assuming that the tax cut would stimulate the economy and would provide increased employment? Would labor bottlenecks, lack of training, force pressure on prices and wages to such an extent that we would suffer inflation before we achieved the 4-percent or the 3-percent level of unemployment?

Secretary WIRTZ. It is not a quick or political answer. It is a considered and responsible answer to the limits of our fullest consideration of that problem. The answer is "No"; there will not be, assuming effective administration of the training and development program, assuming the exercise of responsibility all the way along. We think that aspect of the problem can be met so that there will be neither a seriously limiting factor resulting from lack of sufficient trained manpower, nor any inflationary pressures which will present serious problems.

Senator PROXMIRE. Is this true with regard to services?

Secretary WIRTZ. I was just going to say the answer is clearer in some areas than with respect to others. Just by illustration, we face the clear realization that there will be, in the construction industry, serious shortages of skilled journeymen unless we increase, very rapidly, the amount of training which goes on fairly fast. There will be other particular situations where we will feel an acute concern.

Senator PROXMIRE. How about the terrific expansion of the space program and the great need for technicians in this area as well as professionals?

Secretary WIRTZ. My latest advice is that the most serious shortage is the semitechnical level. May I inquire of Dr. Wolfbein as to whether there is an identifiable shortage there?

Mr. WOLFBEIN. Yes. This will be detailed in the manpower report.

Senator PROXMIRE. The same thing would apply to health?

Mr. WOLFBEIN. Health, teaching.

Senator PROXMIRE. Education?

Secretary WIRTZ. Those are the principal areas.

Senator PROXMIRE. You think that these would not interfere with the overall economic objectives? That is, you feel that you would be able to reduce unemployment to the goal level and below it, which we all want to do, to 3 or even less percent, before we get into serious inflationary problems?

Secretary WIRTZ. Yes, sir.

Senator PROXMIRE. As far as labor is concerned?

Secretary WIRTZ. Yes, sir.

Senator PROXMIRE. That answers the second question which was to what extent are your training programs, with their present scope, likely to solve this problem. You say the scope is adequate, and you think you can do it.

Secretary WIRTZ. Yes.

Senator PROXMIRE. From the papers I read, I think we have been subjected to a big brainwash on this tax-reduction theory. I think that this is most unprecedented. I challenge you or anyone else to give me an instance where the President of the United States has ever asked for a tax cut at a time when we have a big deficit. He is increasing spending when the country is moving ahead, and when the proposed deficit will be even bigger. We have had nine tax cuts in the last 40 years. After two of them, business remained about the same. After four of them, I understand business improved over what it had been. After three of them, business declined.

After the 1954 tax cut, for example, the business improved. After the 1948 tax cut, it declined. On the basis of this uncertain record, and on the basis of the lack of precedent for a tax cut under these circumstances, I am wondering why we shouldn't give greater consideration to such alternatives as interest rate stimulation.

The distinguished chairman of this committee, the only professional economist in the Senate, has just told us that, in his judgment, it is a matter of getting adequate monetary purchasing power in the hands of the public. Isn't it perfectly possible that we could provide this adequate monetary purchasing power by increasing the money supply moderately, bringing down the interest rate? In the construction industry this would help far more than a tax cut. A man ends up with a tax cut, as we pointed out the other day, as the President proposed, with $3 or $4 more every 2 weeks, maybe $5 or $6 more every 2 weeks, in his pocket. If interest rates, the biggest single cost in the construction of a home, are cut, wouldn't it help more? One of the costs in purchasing an automobile is interest. With interest rate reduction there would be far more incentive to building homes which really put people to work, to buy automobiles which put people to work, rather than the kind of tax cut we are talking about which may or may not have a direct stimulating effect.

I doubt if many people would buy a home if they found $4 or $5 a week more in their pocket.

My question is, Would you feel that monetary stimulation offers a possible alternative?

Secretary WIRTZ. Senator, it is hard for me to answer. I have come here with a presentation of what seemed to me as the result of the most serious, responsible consideration I can afford a picture of this situation as far as its manpower aspects are concerned. There was no thought of brainwashing anybody.

Senator PROXMIRE. I am not saying the administration has brainwashed anyone. Of course, the administration in a free society could not if it wanted to do so. I am simply saying that most of the commentators I read, the newspapers I read, the editorials I read, in the newspapers I get, are on one side and the argument they make is that the only people who oppose the tax cut are idiots, who are mouthing slogans and don't understand what the score is.

That was the brainwashing I was talking about. The President has every right and a duty to fight for his viewpoint as powerfully as he can. He is doing a good job of it. I would not criticize him or you for being a polemicist. It is your job.

Secretary WIRTZ. Perhaps I can lighten the moment by referring to something I just saw last night: Anybody who tries to brainwash me is involved in a job of a light rinse.

On the point of whether there could be an approach by the administration of different monetary policies which would be more effective than the tax reduction approach, I again am not qualified on that point. I don't know. I respect any variety of judgment in that field. I have tried to stay within the competence of my official responsibility, and that includes not only the development of the details of the problem but also responsible consideration of what to do about it.

I must say that in my most honest conviction the tax reduction is the most direct, most immediate, most equitable, most effective approach to the stimulation of the demand which seems to me imperative if we are to put the full manpower resources of the country to work. I think we sometimes make a mistake when we talk about the manpower problem in terms of unemployment, or when we talk about it as a manpower problem at all. I thought we would perhaps do much better if we started from the unmet needs of this country as a whole and worked back from that.

There is not anything very constructive I guess in this particular approach at the moment, yet it bears on your question and on the relevance of increasing demand and so forth. I realize that if we decide, not overnight but in a year or two, to do the things both in the private sector and in the public sector which we need so much to do to meet the demands which we need to meet to pull up the 30 million people, the purchasing power of the 30 million people who are today living in this country at almost marginal levels, to build the schools we need, the roads, the parks, the water supply system which only the League of Women Voters seems to be very much concerned about, if we started from that standpoint and decided to do those things which we need so much to do, we would have a manpower shortage in this country.

It is from that conviction and no more lightly that I answer your question that the tax reduction approach does seem to me within the limits of my understanding of those things right because it is directed at the demand, the increasing of the demand, which seems to me identifiable with what ought to be the right approach to this manpower problem. But I cannot answer more expertly than that.

Senator PROXMIRE. I think that is a very impressive answer. My reaction, however, is this: The matter of meeting that need is a matter of time and a matter of disposition on the part of consumers, especially when you are relying on a tax cut. It is something we proceed gradually on. We have solved this problem of utilizing manpower over the years in a sensible way. We could still have the 60- or 70-hour week. We could still have no social security and no retiring at 65. We could still have most children leaving school at 14. We don't have. We have reduced the potential work force in all these areas.

Therefore, it seems to me we might give some attention before abandoning the fundamental Puritan ethic, which is pretty good ethic, of relying on balanced budgets in prosperity and unbalanced budgets in periods of recession. We ought to give some consideration to the possibility of solving this problem, No. 1, by earlier retirement. There is nothing sacred about 65. A whale of a lot of people would like to retire at 60; of raising the school age limit. I introduced a resolution 2 days ago in the Congress to increase it to 17 uniformly, appealing to school boards all over the country to do it.

We can do far more to promote economic growth by relying as much as we can on the traditional method of governmental stimulation in free societies, a method we have used repeatedly in this country of increasing our money supply.

The only other question I would like to leave, because my time is up, is when you come in with these very persuasive estimates which you as a Secretary of Labor and highly able and responsible man on the effect of the tax cut in stimulating employment, I hope you will specify very clearly so that it can be underlined that these are based on assumptions that may not work out. The fact is that if we have an increase in the propensity to save from 6 percent to 8 percent as a result of this tax cut, we could wipe out the whole effect of the tax cut and this is well within the areas that have been given to us by the Council of Economic Advisers.

So if the consumer spends 92 percent of his income instead of 94 and continues to do that because he has a little more and his spending does not grow, then there is no stimulation at all. If, furthermore, we get action on the part of the monetary authority to stem inflation by selling bonds to the public, that combined with the attitude toward the tax cut might very well result in savings that would wipe out the whole thing.

So I would stress that when you come in with these estimates, spell out that these are based on assumptions, that there is no economic experience of having this kind of a tax cut under these conditions.

Secretary WIRTZ. I am grateful for the suggestion. I mean that sincerely. I think it is very important that we not pretend to know more about the certain applications of these things than we actually know and we will respect that.

Chairman DOUGLAS. Thank you very much, Mr. Wirtz. Your testimony has been very interesting.

We will recess until 2:30 this afternoon when Secretary Hodges will be the witness.

Secretary WIRTZ. Thank you very much, Mr. Chairman and gentlemen of the committee.

(The following was subsequently received for the record:)

U.S. DEPARTMENT OF LABOR,
OFFICE OF THE SECRETARY,
Washington, February 8, 1963.

MR. JOHN STARK,
Clerk, Joint Economic Committee,
Washington, D.C.

DEAR MR. STARK: Following are further data in response to inquiries raised by Congressman Curtis at the hearings on January 30.

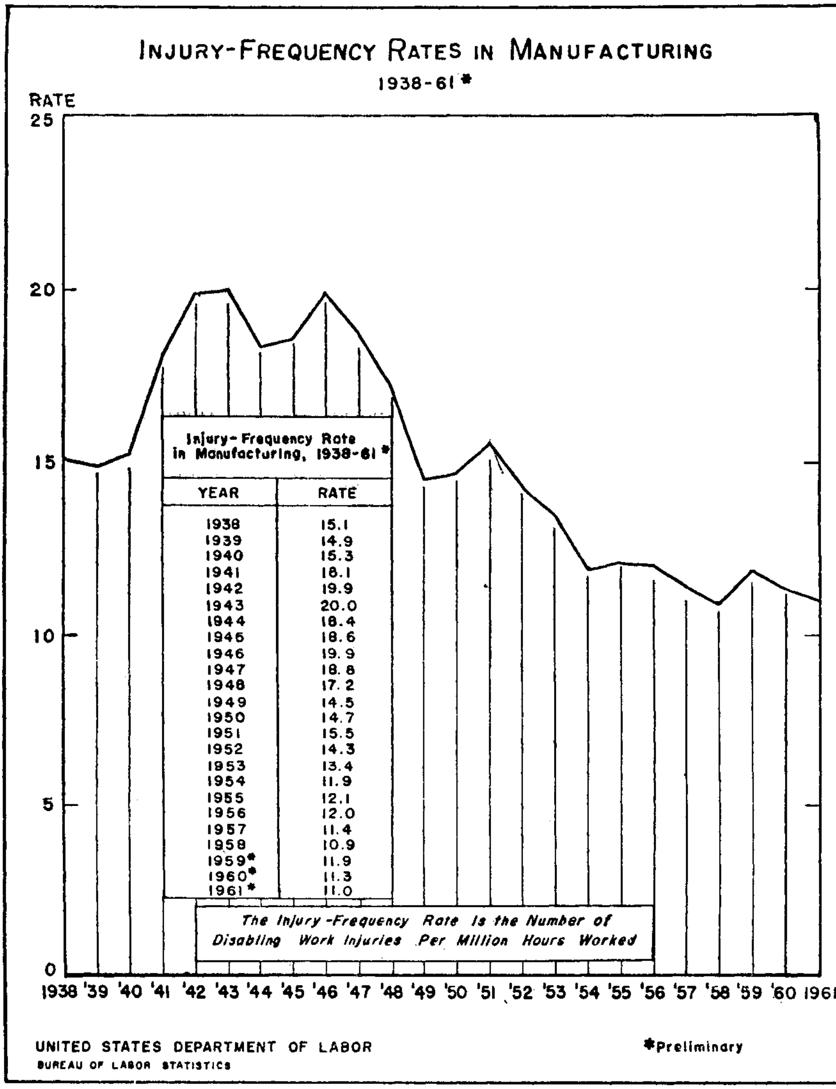
Work injuries.—As the enclosed chart 1 shows, work-injury rates have been reduced from the high wartime rates and now are well below prewar levels. Employment in 1961 was up 42 percent above the 1940 average, but total disabling injuries were up only 6 percent, as shown in chart 2.

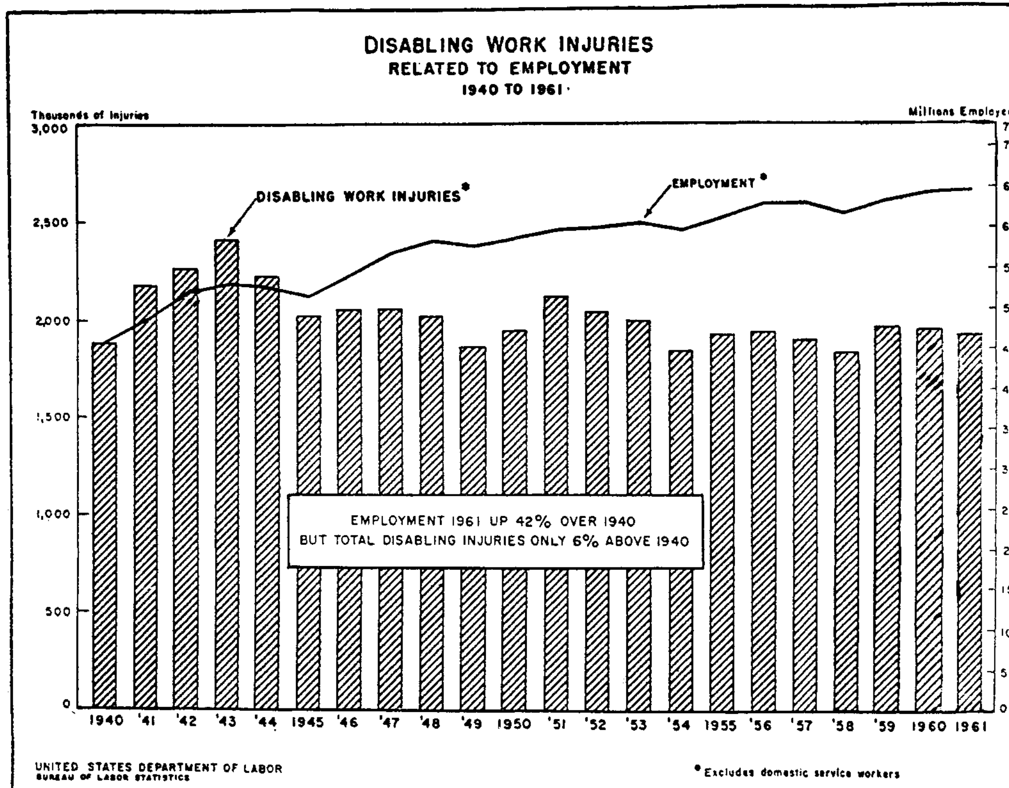
Absenteeism due to illness.—Statistics do not seem to show a downtrend in absenteeism to correspond with improvements in health. The rate of absence from work (of 1 week or more) because of illness was the same in 1960 as in 1948. (See enclosed table.) It is possible that the effects of generally improved health have been offset to some extent by the rising average age of the labor force, and by the increasing degree to which health insurance and medical services are available.

Leisure time.—Enclosed is a report from the Monthly Labor Review, March 1962, entitled "Recent Growth of Paid Leisure for U.S. Workers," by Peter Henle. The section headed "How Much More Leisure?" beginning on page 255, indicates that in two decades there has been an increase of 155 hours of leisure time per full-time employed person per year.

Sincerely,

STANLEY H. RUTTENBERG,
Special Assistant.


INJURY-FREQUENCY RATES IN MANUFACTURING
1938-61*
RATE
25
20
15
10
5
0
Injury-Frequency Rate in Manufacturing, 1938-61*
YEAR RATE
1938 15.1
1939 14.9
1940 15.3
1941 18.1
1942 19.9
1943 20.0
1944 18.4
1946 18.6
1946 19.9
1947 18.8
1948 17.2
1949 14.5
1950 14.7
1951 15.5
1952 14.3
1953 13.4
1954 11.9
1955 12.1
1956 12.0
1957 11.4
1958 10.9
1959* 11.9
1960* 11.3
1961* 11.0
The Injury-Frequency Rate Is the Number of Disabling Work Injuries Per Million Hours Worked
1938 '39 '40 '41 '42 '43 '44 '45 '46 '47 '48 '49 '50 '51 '52 '53 '54 '55 '56 '57 '58 '59 '60 1961
UNITED STATES DEPARTMENT OF LABOR
BUREAU OF LABOR STATISTICS
*Preliminary



DISABLING WORK INJURIES
RELATED TO EMPLOYMENT
1940 TO 1961
Thousands of Injuries
Millions Employed
3,000
2,500
2,000
1,500
1,000
500
0
72
70
65
60
55
50
45
40
35
30
25
20
15
10
5
0
DISABLING WORK INJURIES*
EMPLOYMENT*
EMPLOYMENT 1961 UP 42% OVER 1940
BUT TOTAL DISABLING INJURIES ONLY 6% ABOVE 1940
1940 '41 '42 '43 '44 1945 '46 '47 '48 '49 1950 '51 '52 '53 '54 1955 '56 '57 '58 '59 1960 1961
UNITED STATES DEPARTMENT OF LABOR
BUREAU OF LABOR STATISTICS
*Excludes domestic service workers

Employed civilians absent from work on an average day, owing to illness

Year	Duration of absence					
	Number (thousands)			Percent		
	Total	Less than 1 workweek	1 workweek or more	Total	Less than 1 workweek	1 workweek or more
1948			843			1.42
1949			719			1.22
1950			717			1.20
1951			782			1.29
1952			775			1.27
1953			783			1.26
1954			752			1.23
1955			835			1.32
1956	1,257	356	901	1.94	0.55	1.39
1957	1,352	390	962	2.08	.60	1.48
1958	1,204	322	882	1.88	.50	1.38
1959	1,251	344	907	1.91	.52	1.39
1960	1,315	373	942	1.98	.56	1.42
1961	1,250	351	898	1.87	.53	1.34

Source: Health, Education, and Welfare Indicators, December 1962. Based on U.S. Department of Labor, Bureau of Labor Statistics, Employment and Earnings.

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RECENT GROWTH OF PAID LEISURE FOR U.S. WORKERS

(By Peter Henle [1])

Traditionally, the American economy has been oriented more toward work than leisure. American habits of living and American cultural standards have tended to emphasize the virtues of work and the vices of idleness. Of course, in the Nation's earlier years, there was litle choice; only through constant toil could the early settlers provide for themselves and their families. Long working hours were the accepted practice for the early industrial enterprises as well.

Gradually, a productive economy and a changing climate of public opinion amde possible more leisure time. One of the primary goals of early union activity was a shorter workday and workweek. The value of rest away from work and the adverse effects on health of long hours became recognized. The accepted standard for hours of work declined slowly, through voluntary action by employers, collective bargaining, and State and Federal legislation. The 12-hour day gave way to the 10- and then the 8-hour standard, and eventually the 40-hour, 5-day week became the norm. A more recent development has been the emphasis on other forms of leisure—the paid vacation and the paid holiday. Before World War II, these were quite limited for hourly paid workers, although many salaried workers had been receiving this type of benefit.

Increased leisure has also been a byproduct of various shifts within the economy. The decline in employment in agriculture and small retail stores, both of which traditionally have involved long hours, has meant an automatic drop in average working hours.

This growth of leisure time has played a major role in shifting the patterns of family living and in stimulating more widespread travel, sports, and recreation activity throughout the country. Much of the output of the American economy now consists of end products for leisure-time use or consumption. For example, while the gross national product grew by 14 percent between 1957 and 1960, consumer expenditures for foreign travel were up 34 percent; books and maps, 28 percent; theater and opera, 26 percent; and commercial participant amusements (such as bowling), 30 percent.

The purpose of this article is to bring together statistics which the Bureau of Labor Statistics has compiled from time to time on various aspects of leisure time, primarily hours of work, paid vacations, and paid holidays. It also attempts, for the first time, to measure changes in the average worker's available leisure time in the 20 years 1940–60. In doing so, leisure time is not defined

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simply as time away from work because, in an economic sense, leisure has little meaning unless it represents paid time taken voluntarily. The individual concerned has to be assured that he can spend time away from work without sacrificing living standards for himself and his family. It is in this sense that leisure time is used in this article.

HOURS OF WORK

Hours of work have been declining for over a century.[2] The most marked reductions occurred between 1900 and 1930, when average weekly hours dropped from about 67 to 55 in agriculture and from 56 to 43 for nonagricultural workers.

During the depression of the 1930's, working hours were further reduced, but by necessity rather than choice. Most of the industry codes promulgated under the National Industrial Recovery Act between 1933 and 1935 included provisions limiting the workweek to 40 hours (in some cases, 35) in an effort to stimulate greater employment. The enactment of the Fair Labor Standards Act in 1938 represented legislative decision that 40 hours a week constituted a desirable standard, with certain exceptions, for workers in interstate commerce. Work after 40 hours was not prohibited, but was made expensive to schedule by requiring that such hours be paid for at the penalty rate of time and one-half. The new standard was introduced gradually, beginning with 44 hours for the first year of the new law. The 40-hour standard became effective in October 1940, and at that time, workweeks exceeding this standard were found almost exclusively in industry groups either partially or wholly exempt from the Fair Labor Standards Act—retail trade and class I railroads, for example.

The most significant change since 1940 has been the more widespread adoption of the 40-hour week. Far more workers have seen their hours shortened to 40 than reduced below this level. While there have been some reductions of work schedules below 40 hours, these have taken place only in a few industries, largely those in which unions have made shorter hours a primary objective in collective bargaining. In effect, the standard set in the Fair Labor Standards Act for firms in interstate commerce had, by 1960, been extended to the vast majority of nonfarm wage and salary workers.[3]

These are conclusions reached after an examination of available BLS data on hours of work during the period 1940–60. Three types of data have been involved in this examination:

1. Hours worked by individuals in the labor force as reported by a sample of the Nation's households and published in the Monthly Report on the Labor Force. (Data for periods prior to July 1959 were published by the Bureau of the Census.)
2. Scheduled hours of work as reported by employers in response to surveys of wage rates covering wage and salary workers in particular localities and industries.
3. Straight-time hours as reported by labor unions in four industries in which the Bureau conducts surveys of union scale wage rates.

The basic figures for average hours worked are shown in table 1 for May of 1948, 1956, and 1960 for the various classes of workers in the economy. (Comparable data for earlier years are not available.) These months were chosen because they represent months of generally high economic activity. By choosing the same month of each year, problems of seasonal adjustment were avoided.

These figures make it clear that hours are still longer in agricultural than in nonagricultural pursuits. Moreover, those who set their own hours, the self-employed, work longer hours than those whose hours are set by their employer or through collective bargaining.

Between 1948 and 1960, average weekly hours worked by all employed persons declined by 2.6 hours, or 6 percent. However, since part-time workers have been forming a considerably higher portion of the labor force, the figures for all workers exaggerate the trend toward a shorter workweek. In 1960, almost 6 million workers voluntarily were working at jobs of less than 35 hours a week.[4]

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[2] "The Workweek in American Industry, 1850–1956," Monthly Labor Review, January 1958, pp. 23–29.

[3] A 1961 amendment to the Fair Labor Standards Act extended coverage to about 3.6 million workers, most of whom are in retail, service, and construction industries. Beginning Sept. 3, 1963, most newly covered workers must be paid overtime after 44 hours, 1 year later, after 42 hours, and in 1965, after 40 hours.

[4] "Labor Force and Employment in 1960," Monthly Labor Review, April 1961, pp. 344–354.

The decline for full-time workers was only 1.3 hours, or 2.8 percent. The drop in working hours for full-time workers was quite marked in agriculture; in fact, several times the decline for nonagricultural workers. On the other hand, there was no decline for full-time self-employed persons in nonagricultural industries.

TABLE 1.—*Average weekly hours worked by persons at work, 1948, 1956, and 1960*

Class of worker	All workers			Full-time workers [1]		
	May 1948	May 1956	May 1960	May 1948	May 1956	May 1960
Total at work	43.4	41.6	40.8	46.8	46.0	45.5
Agriculture	52.5	49.6	48.0	58.3	56.4	55.5
Wage and salary workers	49.4	42.8	43.3	56.9	53.5	52.3
Self-employed workers	57.9	58.7	56.5	59.6	59.2	58.6
Unpaid family workers	39.4	35.8	35.4	54.0	49.3	49.4
Nonagricultural industries	41.9	40.7	40.1	45.2	44.8	44.6
Wage and salary workers	41.1	39.7	39.3	44.2	43.8	43.7
Private employers	41.1	(2)	39.1	44.3	(2)	43.8
Government	41.3	(2)	40.3	43.1	(2)	43.1
Self-employed workers	47.9	49.1	47.1	52.7	53.1	52.7
Unpaid family workers	39.4	39.4	40.0	50.1	50.2	49.4

[1] Persons who worked 35 hours or more during the survey week.
[2] Not available.

The distribution of full-time wage and salary workers by hours worked in table 2 confirms the continuing slow decline in the average workweek. Yet for most workers there has been little, if any, change in working hours. The majority of nonfarm workers were on a 40-hour workweek in 1948 and have remained so. By 1960, those working fewer than 40 hours had increased from 5 to 8 percent of all full-time nonagricultural wage and salary workers. Each of the industry divisions also showed an increase in the proportion of those with workweeks of less than 40 hours. However, only in nondurable manufactures and the service, finance, insurance, and real estate division was this proportion higher than 10 percent.

More significant perhaps was the drop in the proportion of those working more than 40 hours, from 43 percent in 1948 to 33 percent in 1960. The drop was sharpest for agriculture, where the proportion working 48 or more hours declined from 81 to 60 percent. In manufacturing, where the 40-hour week was standard by 1940, the decline was slight; but in mining, transportation, trade, and services, the continuing shift toward the 40-hour week was quite marked.

These figures, of course, represent hours actually worked, as reported by a member of the households included in the survey. An individual working longer than 40 hours may be doing so because he has been assigned overtime work, because those are his regular hours, or because he has more than one job. (In December 1960, 3 million workers held more than 1 job.[5]) Similarly, a person working 35 to 39 hours may have a work schedule calling for those hours, may have begun or quit a job during the survey week, or may have missed certain scheduled hours for such reasons as illness, bad weather, or cutbacks in production. However, the years selected were years of relatively high economic activity, so that differences in the amount of both overtime and short time would be slight. In any case, the definition of full-time workers as those working 35 hours or more would exclude most short-time workers. Moreover, the proportion of multiple jobholders has not changed significantly.[6] Consequently, there is little doubt that the 1948–60 decline in hours worked reflected, for the most part, changes in scheduled hours.

[5] "Multiple Jobholders in December 1960," Monthly Labor Review, October 1961, pp. 1066–1073.
[6] Ibid.

TABLE 2.—*Full-time wage and salary workers, by hours of work during the survey week and industry, May of 1948, 1952, 1956, and 1960*

[Percent distribution]

May of—	Total, 35 hours or more	35 to 39 hours	40 hours	41 to 47 hours	48 hours or more
AGRICULTURE					
1948	100.0	3.6	10.7	5.2	80.5
1952	100.0	6.2	14.0	7.4	72.4
1956	100.0	7.9	13.6	10.7	67.8
1960	100.0	6.2	18.2	15.9	59.7
NONAGRICULTURAL INDUSTRIES, TOTAL					
1948	100.0	4.8	51.8	12.3	31.1
1952	100.0	6.1	55.0	11.3	27.7
1956	100.0	7.4	56.3	11.1	25.2
1960	100.0	7.6	59.6	9.4	23.3
MINING					
1948	100.0	.7	41.8	5.4	52.1
1952	100.0	1.4	48.9	6.0	43.7
1956	100.0	3.5	56.3	8.7	31.5
1960	100.0	7.4	59.1	5.4	28.1
CONSTRUCTION					
1948	100.0	4.9	54.4	12.3	28.5
1952	100.0	4.8	54.9	9.6	30.7
1956	100.0	8.5	58.9	10.8	21.8
1960	100.0	6.9	64.8	10.0	18.3
MANUFACTURING, TOTAL					
1948	100.0	4.1	66.7	11.2	18.0
1952	100.0	5.7	65.5	10.1	18.7
1956	100.0	6.4	66.3	9.1	18.2
1960	100.0	6.7	68.4	8.2	16.7
Durable goods					
1948	100.0	2.2	68.7	12.4	16.7
1952	100.0	2.7	66.3	10.5	20.5
1956	100.0	3.6	68.3	9.0	19.2
1960	100.0	3.4	73.4	7.8	15.4
Nondurable goods					
1948	100.0	6.4	64.5	8.6	19.5
1952	100.0	9.9	64.3	9.6	16.2
1956	100.0	10.7	63.4	9.2	16.7
1960	100.0	11.0	61.7	8.8	18.4
TRANSPORTATION AND PUBLIC UTILITIES					
1948	100.0	2.1	42.5	11.2	44.2
1952	100.0	2.8	65.9	7.1	24.3
1956	100.0	4.3	67.9	7.9	19.9
1960	100.0	4.3	69.3	6.8	19.6
WHOLESALE AND RETAIL TRADE					
1948	100.0	3.3	34.8	15.5	46.5
1952	100.0	4.2	36.5	16.8	42.4
1956	100.0	5.5	40.0	14.9	39.6
1960	100.0	6.1	44.1	13.0	36.8
SERVICES AND FINANCE [1]					
1948	100.0	10.3	40.8	13.8	35.1
1952	100.0	11.3	44.7	13.3	30.6
1956	100.0	12.3	45.6	13.4	28.7
1960	100.0	12.0	51.3	10.3	26.5
PUBLIC ADMINISTRATION					
1948	100.0	2.0	67.2	8.8	22.0
1952	100.0	4.7	68.5	6.0	20.7
1956	100.0	5.3	68.5	7.6	18.6
1960	100.0	4.8	71.3	6.3	17.6

[1] Includes insurance and real estate.

These figures on hours actually worked can be compared with BLS studies providing data on scheduled hours. Such figures for the year ending June 30, 1961, are available for 13.8 million workers in the country's standard metropolitan areas (table 3).[7] Almost two-thirds of all office workers and over four-fifths of all plant workers in metropolitan areas were employed in establishments in which a 40-hour schedule predominated. Practically all the remaining office workers had schedules of less than 40 hours (mostly 35 or 37½), while most of the other plant workers had hours longer than 40. As a general rule, office workers had shorter scheduled hours than plant workers.

The figures for scheduled hours generally fall below those for hours actually worked by full-time workers but follow a similar pattern of industry variations. The incidence of overtime work and dual jobholding would tend to make working hours longer than scheduled hours. In addition, the scheduled hours data cover only metropolitan areas, where hours are often shorter than in the smaller cities and rural areas.

No comparable information on scheduled hours is available for years prior to 1960, but the Bureau's union wage-scale studies provide hours' information dating back to earlier years for four industries (table 4).

In the printing trades, nearly all unions have succeeded in their attempts to reduce scheduled hours below 40. In 1940, 64 percent of the union workers in the industry were scheduled to work a 40-hour week, while only 13 percent had workweeks below 37½. By 1960, only 2 percent were on a 40-hour week. while 54 percent had schedules of less than 37½ hours. The average workweek had dropped to 36.6 hours.

TABLE 3.—*Work schedules of 1st-shift plant and office workers in metropolitan areas,[1] by industry division, year ending June 30, 1961*

[Percent of workers]

Scheduled weekly hours	All industries	Manufacturing	Public utilities [2]	Wholesale trade	Retail trade	Finance [3]	Services [4]
OFFICEWORKERS							
All schedules	100	100	100	100	100	100	100
Under 40 hours [5]	35	21	23	29	23	64	49
35 hours	10	7	9	9	5	17	18
36¼ hours	3	1	(6)	2	2	8	3
37½ hours	13	8	13	13	10	21	19
38¾ hours	4	4	1	3	2	7	4
40 hours	64	78	76	66	70	36	46
Over 40 hours	2	1	(6)	5	7	(6)	5
Average hours	38.9	39.4	39.2	39.2	39.6	37.9	38.6
PLANTWORKERS							
All schedules	100	100	100	100	100	----------	100
Under 40 hours [5]	7	7	1	4	10	----------	8
37½ hours	3	3	1	2	4	----------	3
40 hours	82	85	94	77	67	----------	63
Over 40 hours [5]	11	8	6	19	23	----------	29
42 hours	1	1	1	1	2	----------	2
44 hours	2	1	(6)	4	5	----------	4
45 hours	2	2	2	3	3	----------	3
48 hours	4	2	1	3	7	----------	16
Over 48 hours	2	2	1	4	2	----------	1
Average hours	40.5	40.2	40.3	41.1	41.1	----------	41.5

[1] See text footnote 7.
[2] Includes transportation and communications. Railroads were excluded in a few of the areas studied.
[3] Includes insurance and real estate.
[4] Includes, among others, hotels, personal services, business services, auto-repair shops, motion pictures, nonprofit membership organizations, and engineering and architectural services.
[5] Includes weekly schedules other than those shown separately.
[6] Less than 0.5 percent.

[7] Data were obtained for one payroll period during the year (primarily in early 1961) for all nonsupervisory employees (including working supervisors or foremen) in the offices and plants of establishments in the six broad industry divisions shown in table 3. The scope of the survey excluded Government institutions and the construction and extractive industries. The establishments within the scope of the survey were those employing 50 or more workers except in the largest areas, where the minimum size was 100 employees in manufacturing, public utilities, and retail trade.

In the local trucking and transit industries, unions have achieved widespread reductions in the workweek to the standard 40 hours. In trucking, 65 percent of union members in 1940 worked schedules of 48 hours or more. By 1960, this figure had been reduced to 2 percent while the proportion working 40 hours or less had grown from 13 to 94 percent. While 1940 data for the local transit industry are not available, the trend from 1946 to 1960 is similar. In the earlier year, almost as many union members were working 48 or more hours as were working the 40-hour week. By 1960, only 4 percent had schedules as long as 48 hours, while 85 percent were on the 40-hour week.

In the fourth industry—construction—the average schedule has actually lengthened somewhat since 1940, when 29 percent of the workers were still on schedules that had been shortened below 40 hours during the depression of the 1930's. During World War II, standard hours in many areas were lengthened to the 40-hour week, and this standard has been generally maintained in the postwar years. As a result, in 1960, only 12 percent of the workers were on schedules of less than 40 hours.

In summary, recent years have witnessed a gradual increase in leisure time through reductions in the standard workweek and in hours actually worked. While such reductions have taken place throughout the economy, they have not followed a uniform pattern. In a few industries, notably printing and publishing and women's apparel, general reductions in hours to a level below 40 have taken place. In many predominantly white-collar industries, the workday has also been reduced below 8 hours. In most manufacturing industries, the 40-hour week has remained standard. In such nonmanufacturing industries as retail trade and services, where many establishments were not subject to the Fair Labor Standards Act, there has been a major movement toward the 40-hour standard.

TABLE 4.—*Union scales of weekly hours*[1] *in selected industries and trades, selected dates, 1940–60*

[Percent of workers]

Hours scale[1]	Local trucking			Building trades			Printing trades			Local transit[2]		
	June 1940	July 1950	July 1960	June 1940	July 1950	July 1960	June 1940	July 1950	July 1960	July 1946[3]	July 1950	July 1960
All scales	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Under 40 hours	0.4	0.9	3.0	29.2	13.5	12.0	35.5	85.9	97.8	------	------	------
Under 35 hours	------	------	------	9.6	.9	1.2	4.1	2.2	2.3	------	------	------
35 hours	------	------	1.4	19.6	12.6	10.7	5.0	6.4	19.1	------	------	------
Over 35 and under 37½ hours	------	------		------	------	------	3.4	33.0	32.8	------	------	------
37½ hours	------	------	1.6	------	------	------	21.7	42.6	43.1	------	------	------
Over 37½ hours and under 40 hours	------	------		------	------	------	1.3	1.7	.5	------	------	------
40 hours	12.7	72.1	91.1	66.9	86.5	88.0	63.8	13.9	2.2	31.6	31.9	84.7
Over 40 and under 48 hours	21.9	6.7	3.6	2.9	(4)	(4)	[5].7	[5].2	------	26.2	24.0	6.3
Over 40 and under 44 hours	5.3	1.3	1.1	------	------	------	------	------	------	4.0	5.4	1.7
44 hours	12.5	1.8		------	------	------	------	------	------	22.0	18.4	3.7
Over 44 and under 48 hours	4.1	3.6	2.5	------	------	------	------	------	------	.2	.2	.9
48 hours	44.4	16.7	2.0	.9	------	------	------	------	------	27.0	25.6	3.2
Over 48 hours	20.6	3.4	.1	(4)	------	------	------	------	------	3.7	3.7	.8
Not specified	------	.2	.2	------	------	------	------	------	------	11.5	14.8	5.0
Average hours	47.2	42.0	40.1	38.3	39.3	39.3	38.8	37.2	36.6	------	43.9	40.6

[1] Maximum schedules of hours at straight-time rules agreed upon through collective bargaining between trade unions and employers in cities of 100,000 or more.
[2] Operating employees only.
[3] Earliest date for which figures are available.
[4] Less than 0.05 percent.
[5] May include a very small number with longer hours.

NOTE.—Blanks indicate either no data reported or data not tabulated for specified interval

PAID VACATIONS

A more pervasive increase in leisure time since 1940 has occurred as paid vacations have been adopted or lengthened for virtually all types of workers.[8] For example, in 1940, collective bargaining agreements applying to 2 million organized wage earners, or about one-fourth of all union members, provided annual vacations with pay.[9] For most of these workers, the maximum vacation period for which they might become eligible was 1 week. A few agreements provided a 2-week vacation for all workers and about a fourth of the workers who got vacations were entitled to 2 weeks if they met specified service requirements, but only rarely was provision made for more than 2 weeks. By contrast in 1957, 91 percent of the workers covered by major collective bargaining agreements (each covering 1,000 or more workers) were eligible for paid vacations, and 84 percent of the agreements made provision for a maximum vacation of at least 3 weeks, usually for longer service employees.[10]

Practically all office and plant workers in the country's metropolitan areas are now entitled to paid vacations. In 1961 more extensive vacation benefits were generally provided for office than for plant workers. After 25 years of service, 38 percent of the office employees but only 25 percent of plant employees were eligible for 4 weeks or more of vacation (table 5). Similarly, after 10 years of service, 41 percent of the office employees but only 29 percent of the plant workers were eligible for 3 or more weeks of vacation. The most prevalent service requirements for the 2-week vacation were 1 year for office employees and 2 or 3 years for plant workers.

These figures, however, do not indicate the length of vacation actually taken by employees, and no such data are collected. But the Monthly Report on the labor force provides an estimate of the number of individuals absent from their job "on vacation" during the entire survey week. On the assumption that the survey week is representative of the months concerned, these data yield annual estimates of full weeks of vacation. (See table 6.) For 1960, over 83 million full weeks of vacation were recorded—150 percent of the 1948 level and an average of 1.3 weeks of vacation per employed person.

This figure understates total vacation time for two reasons: (1) The survey week, being the week ending nearest the 15th of the month, generally avoids all major holidays, whereas vacations tend to occur more frequently during holiday weeks. (2) The figure does not include paid vacation time of less than a full week. Including estimates for these two gaps in the calculations, a rough figure for total vacation time for 1960 would amount to 96 to 100 million vacation weeks.[11]

Almost 85 percent of nonagricultural wage and salary workers were paid while on vacation in 1960. The percentage varied somewhat by industry, from a low

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[8] One exception is employees of the Federal Government. Vacation provisions for the 1 million Government workers covered by the Federal Classification Act were reduced by the Annual and Sick Leave Act of 1951 from a uniform 26 days' annual leave to 13 days for employees with less than 3 years' service, 20 days for those with 3 but less than 15 years, and 26 days for those with 15 years or more.

[9] "Vacations With Pay in Union Agreements, 1940," Monthly Labor Review, November 1940, pp. 1070–1077.

[10] "Paid Vacation Provisions in Major Union Contracts, 1957" (BLS Bull. 1233, 1958); for summary, see Monthly Labor Review, July 1958, pp. 744–751.

[11] This figure is based on these computations:

1. To estimate the extent of the understatement because the survey week generally avoids all major holidays: The most recent survey week containing Labor Day (September 1959) showed 600,000 more persons on vacation than in the following September. The last survey week containing July 4 (July 1954) showed 1.3 million more people on vacation than in the following July. Assuming 7 holidays a year, 6 of which have the same effect as Labor Day, and adding 1.5 million for the seventh (July 4), additional vacation weeks due to the occurrence of holidays would be between 5 and 5½ million. Variations in the specific identity of the 6 paid holidays received by the average worker (footnote 16) due to differences in local customs, worker desires, employer practice, etc., account for the assumption that some workers observe holidays (and take vacations during the holiday week) on at least 7 different days during the year.

2. To estimate the extent of the understatement because no allowance was made for part-time vacations: According to household survey data, in the average week, about one-half of 1 percent of all employed persons take about one-third week part-time vacation. For 1960 this amounted to approximately 4 to 5 million vacation weeks. However, certain part-week vacations may not be fully reported in the monthly survey (for example, in weeks containing a holiday that are not survey weeks). Consequently, a judgment was made that the total understatement for part-week vacations might be somewhat higher than these statistics would indicate.

of 60 to 70 percent for construction and the service industries (including educational services) to 93 percent for workers in transportation and public utilities and 96 percent for employees in public administration.[12]

PAID HOLIDAYS

A similar development in recent years leading toward increased leisure has been the growth in the provision of time off with full pay on holidays.

Before World War II, while major holidays were frequently observed throughout industry, the practice of providing pay for hourly rated employees was quite rare. During the war, the practice of paid holidays first began to spread, partly as a result of decisions by the National War Labor Board that the granting of as many as six paid holidays would be allowed within wage stabilization regulations. But in 1943 a Bureau of Labor Statistics analysis of collective-bargaining contracts concluded:

> Although an increasing number of union agreements make provision for paying wage earners for some or all of the major holidays, the majority of agreements in manufacturing, construction, and mining merely provide time off on holidays, without pay.[13]

After the war, the practice of paid holidays spread generally throughout industry. The most recent survey of holiday provisions in major collective-bargaining agreements indicated that in 1958 only 12 percent of the workers covered were not entitled to paid holidays.[14] Nearly three-fifths of the workers under agreements calling for paid holidays were entitled to seven or more paid holidays.

Currently, the average appears to be about 7 paid holidays in major American industries. In the country's metropolitan areas, data for 1961 show that all but 1 percent of the office workers and 5 percent of the plant workers received pay for holidays not worked (table 7). The majority of both office and plant workers received 7 or more paid holidays. Some 24 percent of the office employees had 9 or more paid holidays, but only 7 percent of the plant workers received this number. The average among those receiving holiday pay was 7.8 paid holidays for office workers and 7.0 for plant workers. Thus, the traditional advantage of office workers over plant workers with regard to this benefit still applies.

The number of paid holidays varied by industry. Traditionally, banks have had a liberal holiday policy, and over half of the office workers in the finance industry received 9 or more paid holidays, and over one-third, 11 or more. Among plant workers, the industry with the most extensive paid holiday provisions was public utilities. Among both office and plant employees, retail trade provided the fewest paid holidays.

Frequently, the additional paid holidays that have been recognized have been, not the traditional holidays, but days that provide additional leisure time at certain times of the year or a longer weekend. For example, holidays immediately preceding Christmas and New Year's Day have become increasingly popular. The Friday following Thanksgiving has become a recognized holiday in a small number of bargaining agreements. Following are two agreement clauses which illustrate how the selection of holidays has been geared to the desires of employees for longer weekends.

> Washington's Birthday is designated as the holiday in February except when the observance of Lincoln's Birthday would provide a longer weekend, in which event Lincoln's Birthday shall be the observed holiday. * * *

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[12] Special Labor Force Report 14, "Labor Force and Employment in 1960" (Bureau of Labor Statistics, 1961), table E–3, p. A–36.

[13] "Vacations and Holiday Provisions in Union Agreements," Monthly Labor Review, May 1943, p. 929.

[14] "Paid Holidays in Major Contracts, 1958," Monthly Labor Review, January 1959, pp. 26–32.

TABLE 5.—*Vacation pay provisions*[1] *for office and plant workers in metropolitan areas,*[2] *by industry division, year ending June 30, 1961*

[Percent of workers]

Amount of vacation pay and length of service[1]	Office workers							Plant workers					
	All industries	Manufacturing	Public utilities[3]	Wholesale trade	Retail trade	Finance[4]	Services[5]	All industries	Manufacturing	Public utilities[3]	Wholesale trade	Retail trade	Services[5]
All provisions	100	100	100	100	100	100	100	100	100	100	100	100	100
AFTER 1 YEAR OF SERVICE													
Under 1 week	(6)	(6)	------	(6)	(6)	------	(6)	1	1	(6)	(6)	1	(6)
1 week	23	16	53	26	63	3	25	73	77	64	59	69	70
Over 1 and under 2 weeks	1	1	(6)	(6)	1	(6)	1	4	6	2	(6)	2	2
2 weeks	75	80	46	72	35	96	70	18	13	31	36	27	18
Over 2 weeks	2	2	(6)	1	(6)	(6)	3	2	2	2	1	(6)	2
AFTER 5 YEARS OF SERVICE													
Under 2 weeks	1	1	(6)	1	2	(6)	3	5	5	(6)	6	6	14
2 weeks	85	88	95	89	81	79	66	82	83	94	84	74	74
Over 2 and under 3 weeks	5	3	(6)	2	1	11	8	5	7	1	2	2	2
3 weeks	9	7	4	7	15	9	19	6	4	4	7	17	2
Over 3 weeks	(6)	(6)	(6)	(6)	(6)	(6)	3	(6)	(6)	(6)	(6)	(6)	1
AFTER 10 YEARS OF SERVICE													
Under 2 weeks	1	1	(6)	1	2	(6)	3	4	3	(6)	4	6	14
2 weeks	50	47	71	52	41	46	47	48	45	71	54	39	61
Over 2 and under 3 weeks	8	13	3	3	1	9	1	18	26	3	4	1	3
3 weeks	40	38	25	42	53	44	42	27	23	24	34	51	14
Over 3 weeks	1	1	1	1	2	(6)	6	2	2	1	1	3	1
AFTER 15 YEARS OF SERVICE													
Under 2 weeks	1	1	(6)	1	2	(6)	3	4	3	(6)	4	6	14
2 weeks	15	13	5	25	26	12	27	19	16	3	29	28	44
Over 2 and under 3 weeks	1	1	(6)	1	(6)	1	1	2	3	(6)	1	(6)	2
3 weeks	79	81	92	71	69	80	60	69	71	92	62	61	32
Over 3 weeks	5	4	2	2	3	7	9	5	5	4	2	4	3

AFTER 25 YEARS OF SERVICE													
Under 2 weeks	1	1	(6)	1	2	(6)	3	4	3	(6)	4	6	14
2 weeks	13	12	5	24	24	9	25	17	15	3	28	26	42
Over 2 and under 3 weeks	(6)	1	(6)	(6)	(6)	(6)	1	2	3	(6)	1	(6)	2
3 weeks	46	49	56	43	24	42	50	43	44	56	43	32	31
Over 3 and under 4 weeks	3	6	(6)	1	----------	1	1	7	11	1	1	(6)	1
4 weeks	37	31	38	30	50	47	19	25	22	38	22	36	5
Over 4 weeks	1	(6)	1	(6)	(6)	2	(6)	(6)	(6)	1	(6)	(6)	(6)

[1] Includes percentage or flat-sum type payments converted to equivalent weeks of pay. Periods of service were arbitrarily chosen and do not necessarily reflect the individual provisions for progression. For example, the changes in proportions indicated at 10 years' service include changes in provisions occuring between 5 and 10 years.

The distribution does not indicate the number of workers actually receiving vacations of the stipulated length, since this depends on the number meeting length-of-service and other eligibility requirements.

[2] See text footnote 7.
[3] See footnote 2, table 3.
[4] See footnote, 3, table 3.
[5] See footnote 4, table 3.
[6] Less than 0.5 percent.

If Christmas Day is on—	The eighth holiday will be—
Sunday	Preceding Friday.
Monday	Preceding Friday.
Tuesday	Preceding Monday.
Wednesday	Day after Thanksgiving.
Thursday	Following Friday.
Friday	Preceding Thursday.
Saturday	Preceding Friday.[15]

HOW MUCH MORE LEISURE?

Clearly there has been a marked increase in leisure time over the past 20 years. Admittedly, estimates of how much increase has taken place must be rough approximations, particularly since few data are available for 1940. Nevertheless, they give for the first time some indication of the magnitude of changes in paid leisure time. Essentially, the increase in leisure time in 1960 over 1940[16] consists of the following:

	Hours per year per full-time employed person
1½ hours less in the workweek	75
6 days more paid vacation	48
4 days more paid holidays	32
Total	155

For the economy as a whole, this additional leisure time amounts to over 10 billion hours (5 billion from the shorter workweek, 3.2 billion in additional vacation, and 2.1 billion in added holidays).

Many of these hours represent additional time away from work. This is obviously true, for example, of the reduction in the workweek. However, the additional paid holidays largely represent payment for time which in 1940 was spent away from the plant without compensation. The additional vacation time is a combination of these two factors.

The 155 hours represent almost 4 average weeks of employment, but they represent only a small fraction of the gain in productivity that the national economy has achieved since 1940. BLS estimates of output per man-hour would indicate that to produce the 1960 output with the 1940 productivity would have required an additional 1,447 hours of working time—or 71 percent more—for each employed member of the 1960 labor force.[17] Thus, the 155 hours that have been accounted for in terms of reduced hours of work, increased vacations, and paid holidays amount to only 11 percent of the hours that have been made available by the Nation's increased productivity since 1940.

[15] Ibid., p. 30.

[16] Estimates in the tabulation presented here were derived as follows:

Average hours of work: The drop of 1½ hours per week seems reasonable in view of the 1.3 hour drop for full-time workers between 1948 and 1960 (table 1). Comparable estimates for 1940 are not available.

Paid vacation: Figure assumes an average paid vacation per employee of 0.3 week in 1940 and 1.5 weeks in 1960. The 1940 figure would make allowance for the following paid vacation: none for farmworkers; 1 week for one-fourth of all manual and service workers (roughly the proportion of the 1940 survey for union members; see footnote 8); 2 weeks for one-half of the white-collar workers; and 1 week for one-fourth of the white-collar workers. The 1960 figure is based on 1.3 weeks of full vacation (table 6) plus an allowance for the understatements described in footnote 10.

Paid holidays: Figure represents the difference between 2 paid holidays in 1940 and 6 paid holidays in 1960. The 1940 figure allows no paid holidays for farmworkers, 1 for manual workers, and 5 for white-collar workers. The 1960 figure is based on 7–7.8 paid holidays for workers in metropolitan areas (table 7) and a smaller number for workers outside these areas.

[17] An alternative method of determining the allocation of productivity gains to income and leisure would be to compare the actual 1960 output with that resulting from applying 1960 man-hours at 1940 levels of productivity. This procedure also involves taking into account the reduced annual hours worked during this period. The results from the two methods are essentially the same.

TABLE 6.—*Estimated number of full vacation weeks of employed persons, 1948, 1952, 1956, and 1960*

Item	1948	1952	1956	1960
Number of full vacation weeks (millions)	[1] 55.5	59.9	71.5	83.5
During July and August	[1] 36.5	36.2	42.0	49.4
During other 10 months	19.0	23.7	29.5	34.1
Average number of persons employed (millions)	59.1	61.0	64.7	66.7
Average number of vacation weeks per employed person	.9	1.0	1.1	1.3

[1] Survey week in July included July 4.

TABLE 7.—*Paid holiday provisions [1] for office and plant workers in metropolitan areas,[2] by industry division, year ending June 30, 1961*

[Percent of workers]

Number of paid holidays [1]	All industries	Manufacturing	Public utilities [3]	Wholesale trade	Retail trade	Finance [4]	Services [5]
OFFICE WORKERS							
All provisions	99	99	99	99	98	99	98
Less than 6	4	2	1	7	10	5	8
6 and 6½	19	14	9	26	42	18	20
7 and 7½	33	49	47	24	32	10	20
8 and 8½	19	22	21	23	7	15	19
9 or more	24	12	22	20	7	51	21
Average number [6]	7.8	7.4	7.8	7.5	6.7	8.9	7.4
PLANT WORKERS							
All provisions	95	96	98	97	93	----------	77
Less than 6	8	5	2	13	18	----------	18
6 and 6½	21	15	12	27	40	----------	35
7 and 7½	44	52	49	23	22	----------	14
8 and 8½	16	17	18	19	10	----------	4
9 or more	7	6	16	14	4	----------	6
Average number [6]	7.0	7.1	7.6	7.1	6.1	----------	6.1

[1] All combinations of full and half days that add to the same amount are combined; or example, the proportion of workers receiving a total of 7 days includes those with 7 full days and no half days, 6 full days and 2 half days, 5 full days and 4 half days, etc.
[2] See text footnote 7.
[3] See footnote 2, table 3.
[4] See footnote 3, table 3.
[5] See footnote 4, table 3.
[6] Based on workers in establishments providing paid holidays.

While this gain in leisure time represents only a relatively small proportion of the increased productivity since 1940, this is not unexpected. Much of the limited productivity gains of the previous decade, 1930–40, were reflected in shorter hours of work, not because workers preferred greater leisure but because of the depressed conditions of the decade. The passage of the Fair Labor Standards Act to a large extent reflected changes in hours that had already taken place. In the two decades following the 1930's, the emphasis quite naturally was on income rather than leisure.

A review of the changes in paid leisure between 1940 and 1960 shows that there was no major shift in the standard workweek. Perhaps the most significant development was that more than half the total gain in paid leisure resulted from increased vacation and holiday time, rather than from a reduction in working hours. This is a definite shift from the pattern of earlier years and seems to indicate that leisure time preferences are running more to additional whole days each year rather than additional minutes each day.

Of course, the leisure time gained since 1940 does not necessarily represent time available for travel, recreation, etc. The nature of the economy and the Nation's living habits have changed in important ways since 1940, and since

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individuals now live farther from their place of employment, some of this additional "leisure" time may now be spent in commuting to and from work.

Although the average employee has more leisure time today than in 1940, many individuals continue to prefer more work to more leisure in order to maximize their income. The operation of today's economy makes it possible for those who wish to work longer hours to do so, either by accepting overtime when it is available or by obtaining a second job. The economy also makes it possible for more people, especially women, to work at part-time jobs.

It is difficult to generalize about future trends in leisure time from this record. There is no way to measure the intensity of the demand for more leisure time against the intensity of the demand for greater income to be spent on leisure time activities. Trade unions continue to present demands for a shorter workweek, although much union pressure in this direction is motivated not by the desire for more leisure but by the possibility of increasing the number of jobs. Of course, regardless of the motivation, the attainment of shorter hours of work would bring with it greater leisure time.

Changes in vacation and holiday practices continue to be negotiated in collective bargaining. A number of unions have also expressed interest in some type of extended paid leave provided periodically for longer service employees.

One new factor is the form which the demands for leisure time are likely to take. The relatively slight decline in average hours of work in recent years has been accompanied by a greater interest in more extended paid vacations and a greater number of paid holidays, providing a greater number of days off seems likely to continue to receive greater emphasis than reducing the time spent each day at work.

(Whereupon, at 12:10 p.m., the committee adjourned, to reconvene at 2:30 p.m. of the same day.)

AFTERNOON SESSION

Chairman DOUGLAS. We are very happy to welcome Senator Miller of Iowa, who has just been appointed to this committee. We hope that your service on the committee will be a pleasant one and that it will be of value to the country.

Mr. Secretary, we are delighted to have you this afternoon and appreciate your taking the time of what I am sure is a very busy life to come here. You may proceed in your own way. We have your statement.

STATEMENT OF HON. LUTHER H. HODGES, SECRETARY; ACCOMPANIED BY DR. RICHARD H. HOLTON, SPECIAL ASSISTANT FOR ECONOMIC AFFAIRS; AND DR. LOUIS J. PARADISO, ASSISTANT DIRECTOR, OFFICE OF BUSINESS ECONOMICS, U.S. DEPARTMENT OF COMMERCE

Secretary HODGES. Thank you, Senator Douglas, Senator Proxmire, Senator Miller.

I have with me Dr. Richard Holton, who is my economic adviser in the Department of Commerce, from the University of California, who has been with us for some months. We have with us also Dr. Louis J. Paradiso, an oldtimer, whom you have seen many times. These are the two experts. I will just talk about how we see this situation and try to answer your questions or get help from these gentlemen. I think I can do best, Mr. Chairman, by just going ahead and reading this, if it is all right with you, sir.

Chairman DOUGLAS. Yes.

Secretary HODGES. Mr. Chairman and members of the committee, I greatly appreciate the opportunity to appear today to comment on the state of the economy and on the proposals for improving our current situation. I need not dwell on the details of the performance of the economy in 1962 since you are already familiar with these.

Instead, I will devote most of my remarks to certain aspects of the economy which are of particular concern to the business community and to the Department of Commerce. The central theme of my presentation is that the administration's program for dealing with our current economic problems is not only designed to help the U.S. economy as a whole; it is also designed to strengthen substantially the position of the many business firms in the country.

I am happy to say that this program is basically a probusiness program and one that businessmen from coast to coast should welcome. Since our economy is a free enterprise economy, it is fitting that public policy for growth should provide an environment within which the thousands of private firms in the country find it easier to expand, to modernize their plant and equipment, and to provide consumers with a continually expanding array of goods and services.

From many points of view 1962 was a very good year indeed. The gross national product, according to the preliminary estimates prepared by the Office of Business Economics in the Department of Commerce, rose to $553.6 billion for the year, an increase of 6.7 percent over 1961.

Personal income rose by 5.8 percent to reach a new high of $440.5 billion for the year. The employed work force also stood at an alltime high of nearly 68 million persons.

This performance, however, is simply not good enough considering our overall problems and our capability. Our goals should be not merely to surpass the peaks of previous experience, but rather to exploit to the full our potential for economic expansion. We estimate that the gross national product is currently $30 to $40 billion below our full employment potential.

All during 1962 unemployment fluctuated around 5½ percent of the work force. This means 3.8 million persons out of work. It is unbecoming for the United States, the leader of the free world, so eager to demonstrate to the emerging nations the advantages of our way of life, to operate for so many years with more than 5 percent of the work force unemployed and with so much idle capacity.

But we need to achieve our full potential and a more rapid rate of growth not only to minimize unemployment, but for a number of other reasons as well. Better performance of the economy would permit us to more nearly meet the unfilled needs of the country, both private and public.

A more buoyant economy would make it easier for State and local governments to fulfill their many demanding programs, which have been expanding since the end of the war far more rapidly than for the Federal Government. Furthermore, when the economy is growing rapidly and employment is available there is less pressure for welfare grants and other public assistance.

Firms can more readily adjust to import competition if domestic markets are expanding more rapidly; and labor can adjust to automation more easily if there are alternative jobs to be had.

The United States and the 19 other members of the OECD have agreed to attempt to achieve a 50-percent increase in the combined gross national product of the member nations between 1960 and 1970. Growth at this rate would not only strengthen the member nations in our economic competition with the Soviet bloc; since the OECD countries buy such a high proportion of the exports of the underdeveloped countries, a rapidly growing OECD means more trade for the underdeveloped countries, and, hopefully, less need for economic aid from the United States and elsewhere.

Our rate of growth in 1962, though good, fell short of expectations largely because investment expenditures were considerably less than had been anticipated. Inventory investment was far less than is normal for this stage in the business cycle.

Fixed investment, although 9 percent above 1961, did not increase as much as had been anticipated in view of the availability of internal cash, the new depreciation guidelines, and the investment credit. By the fourth quarter of 1962 gross private domestic investment was at an annual rate of about $75 billion, down from the second quarter peak of $77.4 billion.

For 1962 as a whole, gross private domestic investment will be only about 5 percent above 1959, the previous peak year. Investment expenditures were not lower than anticipated because savings were too small. Personal savings were running at about 7 percent of disposable personal income, the same as in 1961.

Corporate liquidity, measured by the ratio of current assets to current liabilities, has been remarkably stable over the last several years, and corporate gross saving exceeded gross investment by about $3 billion in 1962.

It is difficult to avoid the conclusion that investment expenditures were lower than expected not because of any shortage of funds but rather because of limited profit opportunities.

In addition to the problems of underutilized productive resources and inadequate economic growth, we are still concerned about the balance of payments. As the annual report of the Council of Economic Advisers indicates, we are making progress in correcting our balance of payments problem. The deficit in the overall balance has shrunk from $3.9 billion in 1960 to $2.5 billion in 1961 and around $2.0 billion in 1962.

Exports rose in 1962 by 4.5 percent to an all-time high of $20.8 billion, but imports rose substantially so that merchandise exports exceeded imports by only $4.7 billion in 1962 compared with $5.4 billion in 1961.

If we are to have an export balance great enough to help correct our balance of payments problems and to permit us to play the role we aspire to in international affairs, we must increase our exports substantially. We have set an immediate goal of an increase of $2 billion, or about 10 percent.

The President's economic program, including mainly the tax revision and programs in civilian technology, education, and manpower development, should go far toward solving the problems I have just reviewed. This program is largely a probusiness program. This is especially borne out by the tax proposals, which are designd to improve the profit position of American business and provide healthy incentives for investment.

One major reason for the unsatisfactory performance of the economy is that taxes are too high. This is not just the simple idea that households and business would like to see a reduction in their tax burden. Taxes are too high in the sense that, on balance, they are depressing individual expenditures and business investment so much that we cannot bring all our available labor and plant capacity into use.

The present tax system was designed for the postwar and Korean conflict years when aggregate demand was high, business expectations were buoyant, and our productive capacity was strained.

The tax structure was at that time a restraining influence, necessary to minimize inflation. Such a tax structure is an excessive burden under today's conditions.

The President's tax program is designed to raise aggregate demand, to improve profit prospects, and to increase investment incentives. The major deterrent to profits and investment is simply that total demand is too small. The reduction in personal income tax rates will raise aggregate demand by increasing take-home pay, which will flow into increased consumer spending.

The larger relative reduction in rates in the lower income ranges is consistent with this need to expand total buying.

To improve investment incentives for corporations, it is proposed that the corporate tax rate be reduced to the pre-Korean level. This will round out the initiative begun last year with revision of Treasury depreciation schedules and the enactment by the 87th Congress of the tax credit proposed by the President. The proposed reduction of the top bracket of the individual rate from 91 to 65 percent is also aimed at stimulating investment and private initiative.

Quite apart from these changes, the administration is proposing a whole series of structural reforms in the tax code which will overcome distortions in resource use and the flow of investment funds that have crept into the existing tax structure and which often represent a barrier to creative investment.

One example of this is the proposal that the tax rate on the first $25,000 of corporate income be dropped from 30 to 22 percent. While business as a whole has not been seriously restricted in their access to funds during the recent period, this has not always been true for many small and rapidly growing firms.

Still another example is the proposed reduction of the capital gains tax to 30 percent of ordinary income rate for all classes of taxpayers. This reduction in the capital gains tax should free up the capital market and thereby facilitate growth particularly for small- and medium-sized firms.

However, I would like to emphasize that the heart of the President's program is the measures designed to increase aggregate demand—primarily through the reduction of the tax rate on personal income. It is important to emphasize here that the business community should benefit substantially from an improvement in the consumer demand picture.

Businessmen for some time have been acutely aware of the "profit squeeze." The ratio of corporate profits to total national income has been declining for a decade and the rate is below that enjoyed in the 1920's.

The postwar profit squeeze is largely accounted for by a marked increase in the relative importance of depreciation charges. In 1948 the corporate before-tax profits amounted to 21.3 percent of the gross product originating in the corporate sector of the economy.

By the first half of 1962 this 21.3 percent had shrunk to 15.7 percent. Meanwhile depreciation charges had increased from 5.5 to 9.5 percent of the corporate gross product or from $8 billion in 1948 to $28.9 billion in 1962.

The increase in indirect business taxes, such as property taxes, was also substantial, from 8.9 to 10.5 percent; this was an increase from $12.7 billion in 1948 to $32 billion in 1962. The share of gross product in the corporate sector accounted for by compensation of employees was stable at about 64 percent.

Even after correcting for accelerated depreciation, it is clear that the profit share of the corporate gross product has declined markedly since the end of the war, largely as a result of increased depreciation charges.

Depreciation charges have been increasing in part because these charges were abnormally low in the immediate postwar period since the plant and equipment being depreciated had mostly been purchased at much lower price levels. The modernization of capital plant during the last decade required acquisition of new plant and equipment at the higher postwar price levels, so depreciation charges rose.

Furthermore depreciation charges were low just after World War II because our capital plant relative to our needs was small since only the most essential plant construction was permitted during the war.

During the period since 1948, capital plant increased substantially more than output. One major reason for the high percentage of corporate gross product accounted for by depreciation rests on the underutilization of these fixed assets which are being depreciated.

Every businessman knows that those extra sales dollars he can generate are typically high-profit dollars, in part because his depreciation charges in dollars are the same whether he operates at a high or a low rate of output. This is illustrated by the experience since the last trough in the GNP, namely the first quarter of 1961.

Over the first six quarters of expansion since that trough, the GNP increased 11 percent, labor income increased 10 percent, while corporate profits increased 28 percent. Furthermore, it is interesting to note that from about 1955 on a 1-percentage-point increase in the rate of plant utilization has produced a 1.5- or 2-percent increase in the profit share of national income. This provides clear evidence of the stake of business in the President's tax program.

I would also like to call your attention to the fact that this tax program is a conservative program. Recognizing the need for a temporary active deficit to overcome our chronic and passive deficits, the President could have chosen two paths.

An expansion of Federal programs and Federal expenditures could achieve the same result as a tax cut and, indeed, at the cost of a somewhat smaller deficit. Taking the tax cut route, however, preserves the maximum freedom of choice of households and business .

The tax route will allow changes in tax rates and structure that will encourage incentive, reduce inequity, and accelerate the long-term rate of growth.

Investment is generated by greater profit possibilities. Greater profit possibilities are generated not only by expanding aggregate demand but also by technological change, which improve productvity and provide new products and new processes.

In the United States we are justifiably proud of the rate of technological advance which our economy has generated over the decades. Indeed, this is a primary ingredient of our economic growth. Our expenditures on research and development in this country, furthermore, have been increasing at a phenomenal rate. It is estimated that in the 5 years, 1950–55, we spend $18 billion for research and development; this is as much as had been spent during the entire previous century and a half. In 1962 alone, $15 billion went into R. & D.

But most of this research and development money is going into the military and space research programs. Only an estimated $4 billion is being spent by industry for civilian purposes. And only about $1.5 billion of the $4 billion is aimed at work which is likely to increase productivity—the new technology that increases the total productivity of our plant. This $1.5 billion is less than one-third of 1 percent of the gross national product.

The distribution of the R. & D. effort among industries is very uneven. In many industries which are important contributors to the GNP—textiles and construction, for example—there is relatively little research and development.

On the other hand, the 300 manufacturing companies spending the most on R. & D. account for 80 percent of all the industry-financed R. & D. but for only 60 percent of manufacturing sales and employment. Furthermore, the industries in which research and development are large have characteristically had the fastest growth rates. The chemical industry, the electrical equipment and communications industry, the aircraft industry, the pharmaceutical and instrumentation industries now perform half of the industrially sponsored research and development.

Thus it seems clear first that only a small portion of our massive research and development effort is in the civilian sector; second, that R. & D. is concentrated in a small number of large firms; third, that the industries which typically spend a great deal on R. & D. are generally the growth industries; and fourth, that some important industries spend relatively little on research and development.

Simply for the sake of faster economic growth, therefore, we should increase the expenditures on research and development in general and especially in those industries where such expenditures are now relatively small. But there is still another compelling argument. Our major industrialized competitor countries in the world markets are not so burdened with huge expenditures on advancing the technology in the military and space fields.

Mr. Chairman, I could not overemphasize that. They can devote almost their entire scientific and technical effort to developing the civilian economy. West Germany, for instance, spends a far larger portion of its total resources on civilian needs and product development than we do for our civilian industries.

One of the great strengths of the United States in international trade has been the technological superiority of its manufactured products. Our machinery exports alone account for roughly 20 percent of our total export trade, and technological advantage is critical in many other export commodities as well.

If we do not take steps to improve our technological advantage, we may find our margins of technological superiority shrinking. Indeed, many would argue that this has already been happening. If we are to improve our imbalance of payments we must expand and make more effective our industrial technology to enable us to better compete for world trade.

In order to increase the rate of technological advance in the civilian sector, we must break the main bottleneck, the shortage of technically educated people. Even if we were prepared to double our outlays for civilian research and development, we could not double our effort because we simply do not have enough scientists and engineers. In 1963, the supply of scientists and engineers for research and development is expected to increase by about 30,000. But space research alone will require almost the entire supply. Because of our fear that our technological superiority in many fields may be disappearing, the Department of Commerce has launched a civilian industrial technology program under the direction of the Assistant Secretary for Science and Technology in Commerce. As part of this program, Commerce is asking Congress for funds to develop such a program.

Research and development expenditures in some industries are relatively modest because the firms in the industry are so small that the probable payout from a research project paid for by an individual firm is not big enough to justify the expenditure. This no doubt helps explain the low research expenditures in, for example, the construction industry.

In this industry the technological advances have come largely from the suppliers of construction equipment and materials. Especially for these industries in which R. & D. is now limited, the Department of Commerce as part of its civilian industrial technology program wishes to stimulate industrial and local initiative in establishing industry-wide research institutions.

As a third component of the civilian industrial technology program, the Department of Commerce is recommending an industry-university extension service. Here the local university, business community and the local government would combine their resources to aid in the solution of problems affecting industry in the community. These centers would address themselves to the local technical problems such as the experiment station does in the case of agriculture. Finally, the civilian industrial technology program would improve the dissemination of technical information so that industry can be better informed about the latest technological developments.

By these various means we hope to stimulate the rate of technological advance, thus providing greater profit possibilities, and therefore greater investment and economic growth as well as greater technological advantage in world markets. In the immediate future our growth—our ability to compete in foreign markets as well as our military and space supremacy—will depend largely on the effectiveness with which we develop and use new technology.

Another specific method for accelerating the rate of economic growth and generally improving the performance of the economy is through programs designed to assist these areas of the country where the underutilization of resources is especially serious.

The Area Redevelopment Administration in the Department of Commerce, now approaching its second birthday, is beginning to make a measurable impact on the hard-core unemployment areas of the Nation. The ARA effort, based on local initiative, investment, and planning plus ARA "seed money," already involves nearly 600 approved projects in virtually every State. More than 27,000 direct new jobs have been created and nearly 19,000 additional jobs have been generated in supporting activities.

In addition, more than 15,000 jobless workers have been, or are being, retrained and equipped with new skills so they have a chance to fill existing job vacancies.

These impressive results have been accomplished with about $75 million in Federal funds, two-thirds of which is in the form of loans. This investment has been at least matched by private individuals and firms plus their State and local governments.

More than 400 additional projects are currently being evaluated in Washington. These could lead to a Federal investment of more than $200 million, creating nearly 90,000 additional direct and indirect jobs.

Yet there remains a large group of workers idle; between the ARA and labor surplus areas, they account for well over half of all the jobless in the Nation. These areas have an enormous deficit in public facilities such as roads, sewers, water systems, hospitals, and public buildings.

To help these jobless workers find useful employment and to help these communities overcome public works deficits that have hampered their long-range economic growth, the Congress last fall enacted the accelerated public works program. In the new months since, our Area Redevelopment Administration, coordinating the work of more than 20 Federal agencies whose regular programs are involved, has been able to institute public works projects which were "on the shelf"—planned, engineered, and ready to go.

With the first $400 million appropriated by the Congress and already programed, we expect to generate in the neighborhood of 500,000 man-months of employment on useful, needed projects. This program can be pressed even further if the $500 million more which was authorized is appropriated.

Thus, the regular ARA program, combined with the public works effort, should go far toward relieving local unemployment problems and bringing depressed areas into the mainstream of the country's economic growth.

I noted earlier that although our mechandise exports rose substantially in 1962, from $19.9 billion to $20.8 billion, our merchandise trade balance actually fell from $5.4 billion to $4.7 billion. If we are to continue to move toward equilibrium in our balance of payments without restricting our other international transactions unduly, we must continue to press hard for increased exports.

The Department of Commerce, with the cooperation of other agencies of the Federal Government, is giving top priority to the export expansion problem. In 1962, the President appointed a National Export Expansion Coordinator. Working from within the Department of Commerce but with all affected Federal departments, he is directing our efforts to bring to the attention of businessmen the profit opportunities in export markets and to provide businessmen with the assistance they need in the development of foreign markets. The Government can do little directly to increase exports; this can be done only by private firms, with a few minor exceptions. But the Federal Government can do much to ease export credit problems, provide market information, and alert businessmen to new export opportunities.

These export expansion efforts can succeed only if our prices remain competitive, if our technological superiority in manufactured products is maintained or enhanced, and if we can continue to press for freer trade in world markets.

Here, the negotiations with other nations, particularly those in the European Common Market, are especially important.

We must continue our attempts to eliminate nontariff barriers as well as tariffs themselves if we are to maximize our sales into the larger foreign markets. Over the long run, successful negotiations under the Trade Expansion Act should ease the export problem.

Several steps have been or are being taken to encourage export expansion. The combined programs of the Export-Import Bank and the Foreign Credit Insurance Association have been improved so that American exporters now enjoy credit facilities which are believed to be equal to those anywhere in the world. The number of export trade opportunities developed by Foreign Service commercial officers and trade missions has increased by a huge margin: nearly 17,000 in fiscal 1962 compared with less than 10,000 the previous year. We have organized the first do-it-yourself trade mission, sponsored by an industry group, in which the members of the mission pay their own expenses. Thirty-four regional—about a thousand men—export expansion councils have been organized across the country and are launching local export expansion drives. New, permanent U.S. trade centers have been opened in London, Bangkok, and Frankfurt and two more will be opened soon, in Tokyo and Milan. U.S. participation in trade fairs abroad is also being expanded.

The Department of Commerce is requesting Congress for funds to continue and expand substantially this export effort. Only through an all-out export expansion drive can we assure ourselves that we are doing our utmost to improve our balance of payments situation as rapidly as is possible. We must make this effort even though no one can promise full success.

Besides the export expansion drive, the U.S. Travel Service is also making a helpful contribution to the balance of payments problem. In 1962 the number of oversea foreign visitors to the United States increased by 17 percent over the previous year, bringing in an estimated $40 million in extra outside trade over 1961.

Nevertheless, U.S. citizens still spend about a billion dollars more abroad than foreign travelers spend in coming to the United States. Increased promotion and attention to the problems faced by foreign travelers coming to this country should permit us to make further progress in encouraging more people to come see the United States.

To sum up my views on the state of the economy in January 1963, we should not be satisfied with our level of unemployment and of unutilized capacity, nor with our rate of economic growth for the last several years. The tax program, however, if adopted should make great progress toward putting us where we need to be, to the benefit of the business community and the consuming public.

Our balance-of-payments problem is still a matter of concern. But with a more rapidly advancing technology and intensified efforts to expand exports, we should move toward an equilibrium which would permit us to meet necessary obligations abroad and give us a more productive economy at home.

Mr. Chairman, ladies and gentlemen, thank you very much.

Chairman DOUGLAS. Thank you, Mr. Secretary.

Mr. Secretary, the tax reduction program of the administration was largely based upon the assumption that this reduction in taxes ultimately will come to $8 to $10 billion and will result in an increase in consumers' demand of a greater magnitude than the reduction itself. In other words, it will be a multiplier which will be applied to the reduction.

I wondered if you or your economists have done any work on the relative magnitude of this multiplier.

Secretary HODGES. Mr. Chairman, I suppose there are differences of opinion about the multiplier. I think I would say as a layman that certainly when you put a dollar in circulation and it keeps moving and makes its contact and creates additional expenditures, that you will get something in the way of a multiplier. I have heard it estimated from 2 to 2½ times—that you would get, if you had an $8 billion tax cut, you might get back $16 or $20 billion.

Chairman DOUGLAS. Has your Department done any concrete work on this trying to get a quantitative estimate of the size of the multiplier?

Secretary HODGES. Dr. Holton may answer more specifically, but I think that is generally the figure.

Mr. HOLTON. We do not have a concrete answer on this. The range would be 2 to 2½ times. Mr. Paradiso, do you want to press this?

Mr. PARADISO. Over the years we have done a considerable amount of work, but, as you recognize, we cannot get accurate results because the multiplier is dependent on the composition of the goods which are being produced, who is spending, who is saving. But on the whole we have applied numerous methods and used various types of models.

As you know, Mr. Chairman, there is a considerable amount of literature where various models have been developed to ascertain the magnitude of the multiplier. We also have explored simpler methods such as running through the accounts, from gross national product, to personal income, to disposable income, how much is saved, then going back to see how much the consumption influences the gross national product again, running the effects down to a progression so as to see how much of a multiplier you would get under certain assumptions.

So we have done a great deal of work. On the whole, the multiplier seems to center around two, perhaps a little more than two. I don't know that we have ascertained that the differences vary as between consumption and investment. My feeling is that the multiplier is somewhat bigger for investment items and a little smaller for the consumption items.

Chairman DOUGLAS. Of course, the increased consumption will also stimulate investment.

Mr. PARADISO. Quite right.

Chairman DOUGLAS. When you join the two together, when you join what is known as the accelerator principle to the multiplier principle, do you have an estimate as to the combined effects, because I take it your figure of 2 and 2½ is the pure effect on consumption isolated on its effects on production?

Mr. PARADISO. It is a little larger. The best I can say now is 2¼.

Chairman DOUGLAS. For consumption alone?

Mr. PARADISO. For both combined.

Chairman DOUGLAS. Our economists come out with a figure of about four for the combined.

Mr. PARADISO. On the investment alone I would say it is considerably higher. After all, the consumption represents two-thirds of the gross national product.

Chairman DOUGLAS. I wonder if you would submit your figures so that we may make a comparison.

Mr. PARADISO. I will be glad to do what I can. This is a very nebulous area, as you know.

Chairman DOUGLAS. It is very important, though.

Mr. PARADISO. Very important.

(The information is as follows:)

The question has been raised regarding the multipliers presented above and whether they would be different by reason of the fact that increased output itself induces expansion in investment which in turn has income effects. What is referred to here is the familiar concept of the acceleration principle.

Since we are initially interested in the effects over the next 2 or 3 years, there is some question whether the accelerator principle in its direct form is entirely applicable. With many industries operating at less than capacity there is no apparent reason why an increase in output should call for additional investment. The Office of Business Economics has developed and analyzed various relations involving consumer expenditures and GNP and investment and GNP. Estimates of the multiplier obtained from these relations and on the basis of various models vary considerably and depend on the complexity and sophistication of the underlying assumptions in the model for the economy or on the period considered in the relationships. In fairly elaborate models, which more closely reproduce the complexity of our economy, multipliers have been derived which are in the neighborhood of 2, the actual number depending on the period covered—quarterly or annually.

The model in use at the Office of Business Economics is a short-run quarterly model and ignores the accelerator effect in its direct form as not applicable to short-run movements. Investment, however, is made partly dependent upon the ratio of current output to output at capacity and posits that economic behavior will be different depending upon whether the economy is or is not operating at near capacity. It is apparent that inducements to invest will differ depending on the rate of capacity utilization and other factors. The multiplier derived from the OBE model is somewhat around 2 but is expectedly small because of the short time period considered. It already takes the short-run investment effect into consideration in that short-run changes in output do generate some change in capacity. Values for the multiplier given above have been confirmed by various researchers in this field using models of varying complexity.

It is, of course, true that if we assume that output continues to rise, forces will be at work to bring investment in plant and equipment in line with the long-run relation with output. These are long-run effects, and it is difficult to approximate the timing of such changes. Under these conditions for a given expenditure, the combined effect of the multiplier and a version of the accelerator, which makes investment responsive to the level of output rather than to the rate of change of output, will show considerable variation, depending on the particular combination of psychological, economic, political, and international forces prevailing at the time. If we assume that the secular relationship is operative, a multiplier of 2 would be changed to about 2½, but for reasons regarding capacity utilization already referred to it is questionable whether a relatively high value such as this is appropriate in the short run.

Theoretically the multiplier effects abstract from the numerous other forces which are operating in the economy at any given time. Additional expenditure brought about by a tax cut, for example, must be superimposed upon estimates of the net effect of these forces before a realistic appraisal can be made of the future behavior of the economy subsequent to changes in the tax laws. A tax cut which is to small or which is introduced at a time when the economy is leveling off or even beginning to turn down may not lead automatically to an increase in output. This is the reason why an examination of the past relations involving tax cuts or other multiplier-inducing actions on the subsequent behavior of output is so inconclusive. We find a variety of net effects arising from an expenditure which has multiplier effects—namely, output rising, leveling, and even turning down. To fully appraise such changes in the tax laws or other actions we would have to determine the most likely behavior of the economy in the absence of such changes. This is a difficult task. In the absence of such direct experience resort must be made to some model of the economy and the individual relationships encompassed in that model must be grounded in past experience to the best of our ability. Given a sufficiently large initial impact so that the behavior of the business community in subsequent periods is affected, the long-run multipliers can become substantially larger than the initial impact factors. The Office of Business Economics has not explored this area as of now. Results elsewhere, however, with fairly complex and realistic models similar to the one at the Office of Business Economics, suggest that over a period of 5 years, for example, the long-term multiplier can be considerably more than 2 or 2.5.

If we assume that each year the economy must expand its GNP by $10 billion over the productivity rise in order to take care of the jobs needed to employ the additions to the labor force, then in 1965 it is necessary to raise GNP by an extra $20 billion (on top of productivity increases) so as to be able to absorb the new entries into the labor force from 1963 to 1965. In 1965 the tax cuts will have their full effects. These will provide $10.2 billion additional income to individuals and corporations. Assuming that in 1965 the multiplier yields an additional GNP of 2½ times the size of the total of the tax cuts, this will yield an added GNP of more than $25 billion in addition to the automatic rise in GNP stemming from the increase in productivity. Thus, in 1965 job opportunities will be more than sufficient to not only absorb the additions to the labor force of about 1 million per year, but to close some of the gap between actual GNP and the potential associated with full employment. The assumption is made that as we move into 1966, the capacity will be close to full utilization and the multiplier effect of the tax cut should be greater than that assumed above. Thus in that year the economy should reach a full employment position. It is assumed, of course, that there would be an orderly schedule of demand and no untoward disturbances which would alter drastically the various economic relations. If this picture is correct, then the tax cut proposals need not be larger than those made. To try to achieve full employment sooner than in 1966 raises many questions and problems such as the consequences on price and wage pressures, the Government deficit and problems of financing it, and repercussions on the balance of payments. Furthermore, this relatively slow progression toward full employment would provide time for the economy to adjust to the various supply, price, and demand pressures.

Chairman DOUGLAS. Now, Mr. Secretary, the Trade Expansion Act, which I supported very vigorously last year, was based on two assumptions. First, that Great Britain would be admitted to the Common Market. Second, that the Comman Market would be willing to meet us and reduce some of its tariffs if we reduced ours.

The first assumption was definitely invalidated yesterday. Great Britain is not going to be in the Common Market for some time.

The attitude of the Common Market suggests that at least as far as agricultural products are concerned, that France wishes to have the European market primarily for itself. Prospects are that the exportation of agricultural products, including grains and chickens and the rest, to the Continent of Europe will be diminished. As a result of this our balance-of-payments problem will actually become more severe.

I wondered if, in anticipation of these very untoward events of the last few days, the Department of Commerce has made any plans for meeting them and counteracting them.

Secretary HODGES. Naturally, Mr. Chairman, we have been watching this very carefully. Answering your specific question, nothing in the last few days. Let me say first of all, sir, that your reference to the act, and I remember very well your support of it, we did not say that the act, itself, was dependent upon Britain joining.

One phase of the act, namely, the reduction to zero authority section was dependent, and you had an amendment, I recall, on that. I do not feel, and I said this to Governor Herter before he went to Europe a couple of weeks ago, I said I assume with the De Gaulle pronouncement that Britain might not get in, but we felt that it was just as important, maybe more so, that we prosecute our program in connection with the Trade Expansion Act.

I have always been very much disturbed about the attitude of the Common Market, particularly on agricultural products. I didn't know France would be as intransigent as she is. I think we are going to have a tough time. I think they are going to be tough traders. That is the reason I am on record a hundred times that we have to be just as tough.

Chairman DOUGLAS. It is well to hope for the best, but one must also prepare for the worst. Let us assume that there is a possibility, and we should of course explore it and try to eliminate it, that France will say, "We are going to become the agricultural suppliers for the nations inside the Common Market. We will raise the price of wheat to $2.40 or $3 a bushel, $2.70 possibly. We will produce a large portion of the bread which Europe eats."

In this event, certainly, it will cut down the American exportation of wheat and also of feed grains. While I know this is not your primary responsibility, because you are Secretary of Commerce and not Secretary of Agriculture, it does affect the balance of payments, because it will directly diminish American exports, and consequently make our situation more difficult. I wondered if you had any plans which you would be willing or thought it proper to disclose for meeting this situation.

Secretary HODGES. I do not know the details, Mr. Chairman, ladies and gentlemen, of the agricultural exports. I know, generally speaking, on your wheats and feed grains we would have more of a problem. We would have less of a problem on the soybeans and poultry and so forth. So I think we would have a better market there.

I would hate to think that France can completely control what happens in agriculture in Europe, although she certainly has a great influence.

My answer is just this simple. I think that will call for us to redouble our efforts in the exports of other items and manufactured goods.

Chairman DOUGLAS. Manufactured goods?

Secretary HODGES. Absolutely. I think we ought to use the tariff situation in our discussion of agriculture. I think we ought to play one against the other.

Chairman DOUGLAS. You know the remark which a leading official in the Common Market made. He said that every association has to have an idealistic watchtower and a bargain basement. That the idealistic watchtower in the case of the Common Market was the Treaty of Rome. The bargain basement was not only implicit—yes, an implicit agreement—between France and Germany that France would have the agricultural market within the six nations but that Germany would have the market for manufactured goods inside the six nations.

You are perhaps aware of some of the difficulties which we had when we were negotiating with Erhardt, trying to get him to take in more American coal. We hope that the Common Market will not go protectionist. But this is the way at the moment they seem to be moving. If this is so, should we not begin to make plans as to what we will do if and when this finally develops to be the case?

Secretary HODGES. I think that is right, Mr. Chairman. It will be some months before we are ready to even start anything in that connection. I think this country has had some sober moments since Mr. de Gaulle's pronunciations.

Chairman DOUGLAS. Senator Miller?

Senator MILLER. Thank you.

Mr. Secretary, getting back to the multiplier problem, as I understand it, we have been given roughly a 2¼ multiplying factor. If this is valid, I am wondering why we would be proposing an $8 billion tax cut. Why not a $16 billion tax cut or a $24 billion tax cut?

Secretary HODGES. Senator, you could reach either absurdity or political unrealism on how much you put out. I don't think you could afford psychologically, economically, or politically a tax cut of that proportion at one time.

Senator MILLER. Where would you draw the line, though?

Secretary HODGES. I would draw the line where we have it. We are standing at the line.

Senator MILLER. I wonder if it would be feasible to have your people, when they come up with these figures that Senator Douglas asked for, test this out to try to come up to a, let us say, point of diminishing returns on this multiplier effect.

I recognize you could carry it on to absurdities. But offhand I just would like to have some basis for picking $8 billion rather than $9 or $10 or $16 billion. There ought to be some solid basis for that. If they they could come up with some kind of a factoring to show us where the point of diminishing returns would be, I think it would be very helpful to us.

Secretary HODGES. We will do whatever we can, Senator Miller. But I will have to point this out to you in all realism. You simply cannot measure in statistical form psychological reaction or political reaction or anything else. You have to make a choice somewhere along the line. The Treasury experts and the rest have picked these figures. We will do whatever we can on it.

Senator MILLER. Thank you. I would just like to follow on with this matter of agriculture and the Common Market.

Secretary of Agriculture Freeman made a pretty stiff statement over in Paris recently pointing out that if the Common Market persisted in discriminating against our agricultural exports, we would be compelled to retaliate. I would like to find out whether you and Secretary Freeman are in agreement on this matter?

Secretary HODGES. Yes, sir; we are in agreement in principle. We both are fighters.

Senator MILLER. Thank you. This is a little bit complicated. Do you have a copy of the Economic Indicators before you? I would like to lay this out as a foundation for my question, because I think it might be rather important.

On page 2 of the January 1963 edition of Economic Indicators, we have in the chart a gross national product set of statistics. In the second column, down at the bottom of the page, it shows that from the end or starting with the end of 1960, we grew from a gross national product of $503.4 billion to $555.3 billion as of the end of the third quarter of the last year.

Secretary HODGES. Yes, sir.

Senator MILLER. That is an increase of $51.9 billion in gross national product, at least from these figures.

Secretary HODGES. Yes, sir.

Senator MILLER. You have projected this forward to the end of the year, but for my purpose, I would like to use these figures here.

Secretary HODGES. Yes, sir.

Senator MILLER. In the next column, however, this gross national product is adjusted in terms of 1961 prices. Not 1960 prices. I suspect that if we use 1960 prices, the figures would be even more startling. But using 1961 prices, we find that the gross national product increase has only been $37.7 billion. The difference between the two is $14.2 billion, and that is due to inflation. Now, I would like to tie that into another figure.

On page 35, we have the public debt at the end of certain periods over in the last column on the bottom. Unfortunately we don't have the December 31, 1960, figure but we could take the average, and incidentally the difference is rather small. We can take the difference between the fiscal year 1960 and the fiscal year 1961. That comes out to about 1.4 billion, and adding it to the fiscal 1960 figure we come up with a beginning debt for this period of about $287.9 billion.

As of the end of September 1962, we find the national debt increased to $300 billion or an increase for this period of a little over $12 billion. My point is that it appears from these figures that for about every $1 billion that we go further into debt, we have a billion dollars of inflation. We have a proposed budget of about $12 billion further into debt for the fiscal year 1964.

I also note that during that same period the taxpayers are supposed to receive a net tax cut of about $4 billion. Just using a rough rule of thumb, we might, I would suggest, expect an inflation of around $10 billion on this $12 billion increased indebtedness. I am wondering how stimulating it is going to be to have a tax cut on the one hand of $4 billion and inflation on the other hand of $8 to $10 billion. I suggest that it is going to have a retarding effect rather than an encouraging or stimulating effect.

I certainly want to be openminded about this, but I would like to be persuaded to the contrary.

Secretary HODGES. Mr. Chairman, I think you have a pretty good member from the other side on the committee. He has done a little homework. He didn't present the question to me, but it was very much involved beforehand. You can prove anything with figures, as you are doing there. But I don't believe there is a relationship. I have these professional economists on either side of me to comment, if they wish. I don't believe there is any direct relationship between going in debt a billion dollars and in having inflation, because if you have guidelines which hold down your cost of living, and so forth, you won't have this. You didn't put those in until a year or more ago. I don't think there is that relationship. You can take your figures, but I don't think so.

Senator MILLER. May I say this. We do have the figures, so we do know what has happened. Whether it will happen in the future, you might not think so. I personally do. I would like to ask you this. If we do have an increase in inflation which will at least offset the tax cut increase, would you consider this to have the stimulating effect that we should have?

Secretary HODGES. No, if you cancel out your situation, it is not as good. But I point out to you that if you had the inflation of $4 billion and didn't have the tax cut of $4 billion, you would be $4 billion worse off. So you do balance out from the taxpayer, whether he be corporate or individual.

Senator MILLER. In the course of your statement on the bottom of page 6, you pointed out that the President could have chosen two paths.

Secretary HODGES. Yes, sir.

Senator MILLER. One which you label a conservative path. I must say that I have a little different concept of that word. The other is the expenditure path.

Now, Mr. Secretary, isn't it possible that there might have been a third alternative, and the third alternative I would suggest—this is, incidentally, not my idea, this is what I am receiving from many of my constituents in the mail—is a tax cut and an expenditure cut to make room for it. That would be a third choice.

I was wondering if that would not have a stimulating effect, or do you think they would tend to cancel each other out?

Secretary HODGES. Senator, I think you are saying to those of us here that the difference in point of view of conservative depends on what you are talking about. It depends on the premise.

We were talking about the question of whether or not you got this advance and this relief by tax cuts or by Federal expenditures. I say it is more conservative to get it by a tax cut than spending more Federal money, because in your next question you raised the question, don't spend any more Federal money but spend less than you are now spending.

Senator MILLER. And have a tax cut at the same time.

Secretary HODGES. And have a tax cut at the same time.

Senator MILLER. Yes.

Secretary HODGES. Nothing would please me more than to see the situation in such a way that you could have less spending. I particularly refer to the very tremendous spending we are having to do on our defense and space. Some day, pray God, we will be where we won't have to spend that kind of money. But if you tried now to start cutting down, you would have to cut primarily, to have any effect in total dollars, in those two fields.

If you add to that the national interest and the veterans' thing, I give you the four which seem to be sacrosanct in Congress as well as elsewhere, and you haven't got much left.

Representative CURTIS. I would certainly add foreign aid.

Secretary HODGES. I would not put it in the same category, although you could, Mr. Curtis, you could if you wish.

Representative CURTIS. It is a sizable amount. It is around $4 billion.

Senator MILLER. I don't want to belabor the point, but I did want to get your policy. Your position would be that if we could make room for the tax cuts with spending cuts, you would prefer this as against the first two choices?

Secretary HODGES. I will say this. I said my own conviction was that I wished we were at that point. I didn't admit we were at that point.

Senator MILLER. I realize that. I want to get your thinking on this.

Secretary HODGES. I don't think anybody would disagree with that point of view, that you would rather cut down spending than to increase spending if you could have your economy going all right.

Senator MILLER. Thank you very much, sir.

Chairman DOUGLAS. Congressman Reuss?

Representative REUSS. Mr. Chairman, thank you.

Mr. Secretary, I want to commend you on the fine job that you and your associates are doing for the business sector of the community. When you look at the action last year of faster depreciation allowances, the investment credit, the present proposal for the reduction of corporate income taxes, the action that you are taking in invigorating the private travel industry, and the private research activities of industry in general, some of which you have detailed today in your report, it seems to me that your carrying out your job as that Cabinet officer most intimately concerned with American business is outstanding, and I want to congratulate you on it.

Secretary HODGES. Thank you, sir.

Representative REUSS. To take up where Chairman Douglas left off on this vital point of how do we expand our export surplus. You pointed out that, unfortunately, our export surplus actually diminished last year due to increased imports.

In your statement I think you show how important it is that we continue to press for freer trade in world markets, mentioning specifically the European Common Market, and you say in your last sentence on that page: "Over the long run, successful negotiations under the Trade Expansion Act should ease the export problem."

I agree with that, but because I think we have an immediate problem here, I would like to ask what about the short run, and whether it is not possible to be a little more vigorous in our use of the new Trade Expansion Act which was signed into law last October. I hear it said from the State Department that we are going to get around to bargaining on that sometime late in 1964.

I have here in front of me the Trade Expansion Act and the Tariff Classification Act of 1962, and the General Agreement on Tariff and Trade. As I read those three documents, I can't see any reason under the sun why within the next few weeks the Tariff Commission could not file its list of what it proposes to bargain on in the great new tariff-cutting round ahead of us, which holds out so much promise for American business, and then promptly take the 6 months which under the act is necessary for your hearings and for people who disagree with the agenda to make known that disagreement, and then there is nothing in the GATT which says we can't, that next day, go before the signatories of the General Agreement on Tariffs and Trade and say, "All right, here is our program; we would like to start bargaining."

I don't see any reason why we can't do this in 1963 rather than 1964. If my sensing of our balance-of-payments predicament is accurate, that is precisely what we need to do. Since you are a go-getter, I would like to ask you about this.

Secretary HODGES. Thank you, Congressman Reuss. I don't agree that it has to be the end of 1964. I might point out to you that under the act you don't look to the State Department to tell you what is going to happen. You look to the President's special representative, the Honorable Governor Herter. He and his staff are working along that line.

I could answer more specifically and more surely after Governor Herter's return from Switzerland and Belgium.

When the administration presents a list of items on which it wants to bargain, it has to go to the Tariff Commission to be published and wait 6 months. I would guess, subject to this present muddle we have in Europe as a whole, that we ought to get to it toward the end of 1963 and the early part of 1964. That would be my present guess.

Representative REUSS. I hope your voice, which is a very important one in this whole matter, will be frequently exercised, because I think that a little more energy may be needed in our total governmental councils. Unless somebody can show me that I read these statutes and agreements wrong, I can't see anything but administrative lethargy and inertia which is holding us back. I would like to see us move faster on it.

I have a moment left of my time, Mr. Chairman. I would like to give a preliminary answer, Mr. Curtis, to the question you raised this morning. When I said this morning that there were those who were prepared to accept a 5 percent unemployment rate, Mr. Curtis asked me to identify and specify these gentlemen, and I would like, therefore, to call Mr. Curtis' attention to the report of the Joint Economic Committee, Document No. 140, 81st Congress, particularly to page 9 et sequitur thereof, in which people like Phillip Taft in his book "Economic Problems in Labor," Mr. Nourse who was once a member of the Council of Economic Advisers, Mr. Yntema, who is now vice president of Ford Motor Co., all are quoted as saying that they would regard an unemployment rate of on the order of 5 percent as normal.

I will have some more citations to submit. That is enough for this afternoon.

Representative CURTIS. I would say I appreciate this detail, and I am glad to note that it is 5 percent and not a 6 and 7 percent rate, which the gentleman used, and which attracted my attention.

Representative REUSS. The gentleman this morning, when his attention was attracted, talked about a 5 percent. He may have had 6 or 7 percent in his mind, but the reporter on the stenotype put you down for 5 percent.

Representative CURTIS. I have nothing to say in response, except that I question the 4 percent rate used by the Council of Economic Advisers. I was questioning your 6 or 7 percent that you said certain people were advocating, and I wanted to know who those people were.

I appreciate your identifying some people who discussed the 5 percent rate.

Representative REUSS. Anyway, the main point that I was making was simply this: That those who accept a somewhat high rate of unemployment as normal I think disregard an important social problem; namely, that if you have a 5 percent overall unemployment rate, this falls with disproportionate intensity upon the young people in our community. They come out of that average with something like 10 or 15 percent or a higher percent of unemployment. My point, therefore, was that we should not be blithe about accepting these averages, because they may conceal within themselves a very real social problem.

I am sure, Tom, that you recognize that problem and want to do something about it; don't you?

Representative CURTIS. Certainly. That is why I raised the question. You were assuming that there were people who were blithe about it. I don't know anyone who is. Even these people who make remarks after economic studies have as much humanitarianism within them as you or I do. So I don't think there is a blithe approach to it.

Chairman DOUGLAS. Congressman Curtis, you have 10 minutes.

Representative CURTIS. Thank you, Mr. Chairman.

In going through your remarks, Mr. Secretary, I am attracted to a statement where you say that the reason our 1962 growth rate fell short of expectations was largely because investment inventory and expenditures were considerably less than had been anticipated. Then you point out—and I happen to agree with this—that investment expenditures were not lower than anticipated because savings were too small. Actually personal savings rose.

You say that it is difficult to avoid the conclusion that investment expenditures were lower than expected because of limited profit opportunities, not a shortage of funds.

I think there is the key. The question is, then: Why does the Council of Economic Advisers suggest a tax cut designed to bring more money into the purchasing or investment sector? Will it help this situation? It is not money we need because there is not a lack of funds. The very fact that savings rates were high indicates that consumers were willing to save. Thus, it comes down to limited profit opportunities.

Therefore, I would say you have a different solution to our economic problems than a tax cut.

Secretary HODGES. I think the tax cut is part of the solution. Without knowing specifically what other people may recommend, I think that the profit situation is one of the main keys to a recovery to the point we are talking about. Mr. Curtis, if you have this tax cut, you immediately make available, multiplier or otherwise, more money for two groups. You make it for the individual, the householder, the consumer, who spends it.

Representative CURTIS. Wait. You went too fast. Who will spend it? The point is, as you point out very well, that personal savings were running at about 7 percent. That means they were not spending it. Why do you assume that if you give them more money they are going to spend it?

As you said, it goes two ways. One is that it goes to the investment dollar. But you have already said it is not lack of investment dollars that is causing the problem. So I again go back to the question: Why do you think that a tax cut, either to the consumer for consumer purchasing power or to the investor, is going to help if your diagnosis is accurate?

Secretary HODGES. I only gave you one-half of my answer; namely, that you have affecting the consumer who will spend it. He will spend around 7 percent or somewhere around 6 or 8 if it is traditional and will spend more if it is the same percentage. To me, when he spends, when he loses a glass or destroys a glass or wants a better glass, then he goes to a store and buys it, and he replenishes his stock and increases his inventory, and by doing that he causes the starting up of two more machines.

Representative CURTIS. I understand that multiplier theory. Let us go on to the second.

Secretary HODGES. What I am saying is that if you get this corporate tax down from 52 to 47 percent, if you reduce many of these wealthier top people from 91 to 65, you do certain things psychologically and you also do certain things which make corporations which are run by human beings who have wives, who say how much they are going to spend here and there, they decide to invest a little more. This incentive, if given to them, will make them put more into investment.

Representative CURTIS. Do you think this will increase profits?

Secretary HODGES. I know it will increase profits because I have been in a couple of kinds of businesses and I can give you specifics that when you get above a certain percentage most of the extra volume is profit.

Representative CURTIS. Now let us return to the premises. You used the term that the 6 to 8 percent saving rate is traditional. I regret to disagree with you. It is not. In the thirties the figure was 3 percent. In the twenties it was 5.5 percent. Furthermore, studies have been made that reveal that the higher the income groups, the higher the rate of savings. And we are moving our people up this income ladder constantly.

Secretary HODGES. The average.

Representative CURTIS. The premise that they will spend, Mr. Secretary, is not well-grounded, I would say.

Now again, you said it was not a shortage of funds that deterred investment expenditures, but rather profit opportunities. So I think we narrow your theory down to the fact that a tax cut will increase business profits.

Secretary HODGES. Sure it will.

Representative CURTIS. I am not arguing. I am just saying this is the extent of your argument. I am willing to look at that.

Don't you think there are other better ways of increasing profit opportunities than in this particular area? For example, I think you discuss in your next paragraph the discipline we have now on prices which relate to the foreign market because of our balance-of-payments situation.

We get into this very serious question of costs. With our costs here, can we indeed raise our prices so there can be any profits? Income tax is only on profits. You have to make the profits before you pay the tax. If the costs keep rising and we can't increase the prices to get the profit. We are in a bind. That is what I would like to hear you discuss.

Secretary HODGES. Mr. Curtis, you don't necessarily raise prices in order to make greater profits.

Representative CURTIS. You don't? What do you do?

Secretary HODGES. I can tell you. If you have lower taxes, the costs are immediately lowered, and if you get greater consumer demand for goods and services, you get a greater volume, and that is the greatest thing I know for raising profits. It is just natural.

Representative CURTIS. So you are talking about increasing the volume?

Secretary HODGES. That is exactly what we are talking about.

Representative CURTIS. Fine. I am perfectly willing to go along. But I want to follow this in an orderly fashion. Let us examine our sectors. If we were to increase consumer purchasing power, for instance in your own field of textiles——

Secretary HODGES. My former.

Representative CURTIS (continuing). Would we increase the demand in our society for textiles?

Secretary HODGES. If you did what?

Representative CURTIS. Increase consumer purchasing power.

Secretary HODGES. Sure you would.

Representative CURTIS. How do you figure that?

Secretary HODGES. Gracious alive, my wife bought three dresses yesterday.

Representative CURTIS. This is no joke.

Secretary HODGES. This is not a joke. I am talking as seriously as I can.

Representative CURTIS. Let us take the agriculture sector which will be even more apparent. Here we have had great and fast technological advancement, and yet we have great unemployment.

Secretary HODGES. Yes, sir.

Representative CURTIS. We have a great underutilization of plant. Do you think that increasing consumer purchasing power will do anything in regard to the amount of food that people eat.

Secretary HODGES. Mr. Curtis, you put your finger on the one exception in all the world. You can only eat so much.

Representative CURTIS. You can only eat so much. That is really why I mentioned this other area. I think we have not used up all our demand in other sectors and in the clothing field. But there is a point where we will stop buying more clothes just as we do food.

Secretary HODGES. I don't agree with that at all, sir.

Representative CURTIS. You think we can have 10 suits apiece?

Secretary HODGES. Absolutely. If we had goods selling in this country, lots of courtesy and new ideas, I would go out and buy two more suits tomorrow.

Representative CURTIS. I see my time is just about up. Along this same line, let us examine the steel industry. We point out very frequently that it is operating at only 60 percent of capacity, or less; is that right?

Secretary HODGES. I don't know what it is at the moment; it is roughly that.

Representative CURTIS. My question is, capacity to do what? To produce what? It seems to me that whatever sector we examine, whether it is textiles, agriculture, or steel, we have to find out what this capacity is. I suggest that the bulk of it is obsolete. For example, the steel industry, which is operating below 60 percent capacity, spent about $1 billion last year to increase capacity. This was needed to produce a new thin steel sheet to compete with plastics and other materials. Again it appears that the base of economic growth is not consumer demand, but rather technological advancement. As the consumer demand shifts, there is a demand for new goods and services.

I think McGraw-Hill pointed out that 30 percent of the goods and services available to our consumers today were unknown 5 years ago. This is rapid economic growth. Yet, the very thesis upon which this administration has presented its recommendations to Congress stresses that we have a tired and sluggish economy. They say "tired blood." To me, our problems are those of growing pains. That is why I related it to these questions.

I think you made a very fine case for my point of view.

Secretary HODGES. Thank you, sir.

Chairman DOUGLAS. Senator Proxmire?

Senator PROXMIRE. I appreciated the statement very, very much as I told you just before we began. I think it is awfully good. I think the emphasis that you put on the assistance for small business through investing the corporation income tax so 80 percent of our corporations would get a 25-percent tax cut is mighty welcome. The revenue loss from that particular change would be small.

Secretary HODGES. That is basically correct; yes, sir.

Senator PROXMIRE. Then, also, the emphasis on civilian industry research. Your Dr. Holloman has done a lot of work on this.

Secretary HODGES. Yes, a very great deal. I think he has put his finger on one of the most significant truths in America that practically nobody has paid any attention to, namely, that we are spending ourselves, in defense and space, out of the competition with the rest of the world.

Senator PROXMIRE. Exactly. The only answer you get is the side effects. The side effects may be there, eventually, in some areas by happenstance, but, as he points out, there is no case really that has been documented that by engaging in extensive research in space and defense, which we agree is necessary, you are going to get much help for industry. You have to do the direct industrial research, too. We are not doing it.

Secretary HODGES. We are doing a very small percent compared to what you do if you do it directly.

Senator PROXMIRE. We may likely lose our markets in competition with other countries because they are doing much more.

Secretary HODGES. That is right, sir.

Senator PROXMIRE. Believe me, Mr. Secretary, this is not meant to embarrass you at all, but simply for purposes of getting an answer, which I am sure you are very capable of giving.

I notice that the Department of Commerce, which represents our business people, and is very conscious of their desires and their feelings, has greatly increased its personnel in the coming year. The budget in 1963 provides for 32,800 employees. I am talking from page 48 of this budget document. In 1964 it will be 36,299. That is an increase of 11 percent. The only agency that is anywhere near the size of the Department of Commerce that is expanding by the same amount is space.

This seems to me to be a very big increase in governmental spending in a nondefense sector. From my association with business people, I think this is one thing that they would disapprove and would hope that in the future we could prevent. It seems like a very rapid bureaucratic growth in 1 year.

Secretary HODGES. I will be very glad to go over that with you and defend it completely before the Appropriations Committee because we knew what these various programs are. They are primarily new programs and primarily devoted to either this local development of the ARA or to the civilian technology and export expansion. Much of it is along those lines.

Senator PROXMIRE. Are there any older programs that could be cut back?

Secretary HODGES. You put your finger on one of my favorite subjects that I probably won't need to discuss today. I think that is a problem with all governments, and this included. You never cut back old ones. That includes the Congress. But you always add new ones.

Senator PROXMIRE. Parkinson's law.

Chairman DOUGLAS. Mr. Secretary, there is a sort of an impish desire which takes hold of me at this moment. I have a vague memory that once you declared that you felt that the Department of Commerce could operate more effectively with 10 percent fewer employees. Is my memory at fault?

Secretary HODGES. No; you have the basic idea right. The exact quotation is not correct. I made the statement before an Appropriations Committee. I have done it on several occasions. If the Congress will say, which they will not do, after asking them time and time again, will allow flexibility of appropriations where you could take old programs, tired blood, Mr. Curtis, and cut them down or eliminate them or what not, and take that money and put it into things that are more modern and up to date such as civilian technology, the whole science of technology, that you could save 10 percent. I said that.

Chairman DOUGLAS. I congratulate you on being an honest man and an honest administrator.

Senator PROXMIRE. You are told, for example, to cut 5 or 10 percent of your employees. You feel that would not be a terrible disaster for the Department of Commerce provided you had the discretion in making the cut where you want it?

Secretary HODGES. I have learned a lot in the last couple of years, and if the President of the United States and the Congress should say, "We will cut 5 or 10 percent," I will be very happy to join. I would have no difficulty.

Senator PROXMIRE. Very good.

Secretary HODGES. On the overall, I am not going to go it alone any more. I have tried it.

Senator PROXMIRE. I take it that the reaction to Senator Douglas' question and the question by Senator Miller on the multiplier is that there is a feeling on the part of both you and your experts that this is a pretty nebulous concept. It is a very shaky one to work with. If you come up with any specific figures, they are subject to all kinds of assumptions. You can't really rely on it very much. While there may be—there is undoubtedly—some kind of multiplier effect, that you can't be at all precise, and the whole thing may be upset by certain psychological factors that just wash it out.

Mr. HOLTON. This is certainly the case. After all, what we would really like to have here is a multiplier and accelerator for the future. We are looking at the historical material only as a basis for a projection. When you look especially at the accelerator and think of the many factors which influence the level of investment expenditures, it is difficult to come up with a precise figure that you can be really comfortable with.

One thing that clearly was influential in determining the level of expenditures in the immediate postwar years was the backlog of technological advances that had accumulated during the war. Now there is some question as to whether we have anything like that backlog of technological advances which will or can operate to stimulate investment. So this is just an illustration of the kind of uncertainty these estimates involve.

This particular case underscores the importance of the science and technology program, the civilian technology program, because we do know that with any given amount of funds available for investment, more will be invested if you have some recent technological advances which are around to be implemented.

Senator PROXMIRE. The second is enormously important. You can have the extra funds and as the Secretary said in his statement, they may not be utilized.

Secretary HODGES. That is right.

Senator PROXMIRE. The argument was made by the President in one of his statements, I believe, and very briefly made by Dr. Heller, and I don't find you making it today, but I would like to ask you about it because you are an expert in this field, that the tax cut will somehow benefit us in our adverse balance of payments.

I can understand how that might help us reduce our costs, the corporate tax cut especially. On the other hand, the main thrust of this tax cut is in the consumer-spending area and if it works at all it will increase our demand. The old classical theory was that you get your trade equilibrium because as income increases in a country and as wages increase, as exports increase, costs tend to increase, and prices tend to increase. As demand increases, prices increase. Gradually you price yourself ahead of the competitor who is suffering from recession or depression. His prices drop. Therefore, he is able to sell in your market and you are not able to sell in his. This ten dency, it seems to me, would flow from this kind of a tax cut.

We increase the demand of our people for goods. They buy goods that are produced abroad and goods that are produced here. Therefore imports would be inclined to go up. I would think the pressure possibly, eventually moderate on our own prices would tend to drive our prices up a little bit. Therefore, it would seem to me that the tax cut, itself, as distinguished from other phases of the President's recommendation, would tend somewhat to diminish or rather to worsen our adverse balance of payments rather than to help it.

Secretary HODGES. I don't think that is entirely true, Senator Proxmire. I think if we keep in mind—using these round figures—that if you have an 82-percent utilization of capacity now, and you have 10 percentage points spread to get it up to what ought to be optimum, you are not going to have much danger of inflation or higher prices. I think that is pretty correct.

Senator PROXMIRE. Let me say at that point you recognize that this is very uneven. The operation of 82 percent in industry. This is the average. Steel is far below that. Other industries are below it. Others are crowding that optimum figure and might increase their prices if they sell a little more.

Secretary HODGES. That is right. You are dealing with averages and would have to pick out every individual industry if you were to analyze it. I think basically what we want is two things: We want lower costs and more funds from this tax reduction to get greater capital investment and greater incentive to use the money they get.

Senator PROXMIRE. I think we want all of these things. I think there is a great benefit in the tax cut. I can't see it helping our adverse balance of payments. It seems to me that the main thrust will be to make our balance of payments a litle more adverse.

Secretary HODGES. I can't quite follow why it would be adverse.

Senator PROXMIRE. Because our demand increases.

Secretary HODGES. That is right.

Senator PROXMIRE. We are buying.

Secretary HODGES. Your demand for imports is not extraordinarily high from that point of view. You have abroad now as these industrialized nations, taking any of them in the Common Market or Japan, the competition is getting keener by the day. Their rates of wage increases are running two to three times of our rate of increase. It is getting more competitive all along. If we do these things I am talking about, I think we can hold our own and increase our exports which is the one answer to the balance of payments in my book.

Senator PROXMIRE. I think this is as good an answer as I can have but I still think this is a tendency. Let me ask in another field. In your statement, I think on page 5, you say businessmen for some time have been acutely aware of the profit squeeze. You indicated that the corporate income tax cut may help somewhat in this regard. I call attention to a document that was prepared by our staff after our extensive hearings last August in which we say on page 843 of the "State of the Economy and Policies for Full Employment" that, "the so-called profit squeeze is not found to exist. In the first place, the significant measure of profitability is not profits alone but total after tax income including depreciation. In other words, the significant income measure is not profits but the total income to capital. Second, as has been previously pointed out income to capital is a function of the rate at which capital is used. At lower rates of utilization, corporate incomes are lower. At high rates of utilization, corporate incomes are higher. Furthermore the volume varies much more widely than the volume of production." The attached memorandum finds that capital has not been squeezed in recent years but rather the converse. Since 1956 the total ratio of cash earnings to invested capital has been substantially higher than ever before and has been climbing at a very rapid rate. The analysis does not take into account the shortened depreciation guidelines announced by the Treasury last month.

Dr. Langam presented a very significant paper last August in which he showed that between 1946 and 1961 we had an increase in cash earnings from $17 billion to $48 billion. This was a much more rapid increase than the increase in plant and equipment outlays. As a matter of fact, the relationship now is about 75 percent more in cash earnings than investment in plant and equipment whereas it was only 30 percent more in 1946. It has been rising all the time.

My point is that one effect of this tax cut which some people seem to have implied, and perhaps you do in your statement, that corporations will have more funds available to invest and therefore will invest more after the corporation income tax does not seem to be a valid point in view of the fact that corporations seem to have had more than they need for some time now.

I know corporations always want a tax cut.

Secretary HODGES. No; they didn't have enough money for plant investment. That is what he said. That is the reason they wanted to raise prices. That was the basis of the reason they were using. I will say this: I think this will do more good to these hundreds of thousands of small business firms.

Senator PROXMIRE. I agree with that.

Secretary HODGES. Who need $2,000, $20,000. It will do more good there than anywhere else.

Senator PROXMIRE. I agree with that.

My time is up.

Chairman DOUGLAS. Congresswoman Griffiths.

Representative GRIFFITHS. Thank you, very much, Mr. Chairman.

I always enjoy hearing you, Mr. Secretary. It is a real pleasure. I would say I have some sympathy with Senator Proxmire's statement that a tax cut may worsen the balance-of-payments problem but for a different reason. In my judgment anything that makes the American market better, and I think a tax cut would make it better, decreases the tendency of American firms to compete abroad. I think this is the main problem. I would like to congratulate you on the effort you have made. How much money did you spend last year in your department promoting American sales abroad?

Secretary HODGES. A limited amount. We hardly got started. I can't give you the exact figure. We have been carrying on, for a long time, studies and so-called reports. But we have spent a very modest amount to do this. It was mainly trying to get volunteers together, about a thousand men, to go out and see their counterparts and get them to sell goods.

Representative GRIFFITHS. How many firms were represented abroad in these do-it-yourself programs?

Secretary HODGES. We had about 10 or 15 trade missions where we sent 6 to 8 specialists abroad. They would take with them 400 to 500 trade opportunities for sales from the United States to that country and in turn so many from there. We only sent the one do-it-yourself trade mission abroad where they went on their own expense.

Representative GRIFFITHS. How many people went in that mission?

Secretary HODGES. About eight, I think.

Representative GRIFFITHS. How many of them had ever sold goods abroad before?

Secretary HODGES. Practically none. I talked with them in a briefing session in Paris the first week in December, and these are top names in that particular industry. They said we are absolutely and positively ashamed of ourselves for what we have not done in the last decade or so in selling goods. We have not scratched the surface and have not tried, but we are going to do something about it.

Representative GRIFFITHS. I think that is the real answer.

Secretary HODGES. I do, too.

Representative GRIFFITHS. I was in Thailand and I found that a concern there had sent an order to an American company some 6 months before for $17 million worth of goods. They had the money in the bank in New York City. Six months passed and they never received an answer. The order was finally placed in Europe. I was told by the consulates in Asia that one of the problems was that American firms really didn't seek the business. That they had no knowledge of packaging for those areas. That the difficulty in Asia was air conditioning in which we are first, but we are not sufficiently pushing the sales. I would like to ask you, if you will, if you will develop the actual amount of money that you have spent out of your department or any other department that pushes the sales of American goods abroad, and if you will consider that as costs and the increase last year of sales as sales. What is the relation of cost to sales?

Secretary HODGES. Yes.

(The following was later received for the record:)

In fiscal year 1962, the Department of Commerce received direct appropriations of $5,775,000 to assist U.S. industry and business to expand its exports. In addition, the Department received an allocation in accordance with the provisions of the "Mutual Education and Cultural Exchange Act of 1961" (Public Law 87-256), amounting to $553,700 to send trade missions abroad.

Within the $5,775,000 direct appropriations, the amount of $4,900,000 was appropriated to the Bureau of International Commerce, $675,000 was included in the appropriation for the Office of Field Services, and $200,000 was included in the appropriation for the Business and Defense Services Administration.

Total U.S. exports (excluding military grants-in-aid) in fiscal year 1962 totaled $20.7 billion as compared with $19.9 billion in fiscal year 1961.

While exports increased $800 million during the year, a determination of the increase directly attributable to the funds utilized by the Department in encouraging and assisting industry to expand its trade horizons is not possible as industry and business do not report accordingly.

Representative GRIFFITHS. I would also like to ask you, the theory of the tax cut at the lower levels is to develop consumers, isn't it?

Secretary HODGES. Yes.

Representative GRIFFITHS. To push consumers?

Secretary HODGES Yes.

Representative GRIFFITHS. If in place of cutting it there as much as that, or in cutting it anywhere as much as that, if more billions were put into pushing American sales abroad, couldn't you actually achieve a better result?

Secretary HODGES. You would on the short term, Mrs. Griffiths, if you put enough money. It doesn't take billions. It takes a very few million to do this export promotion. You would get a quicker result that way. Long term I think you have to have the other in order to accent the investment to get newer ideas and newer processes.

Representative GRIFFITHS. But money spent on developing customers abroad, on teaching American business how to sell abroad?

Secretary HODGES. You come nearer getting an answer to help your balance of payments that Senator Proxmire was talking about, just as we did this on this little travel bureau. With an expenditure of less than $3 million we brought in $40 million in new money. That is just the beginning. We would pay for that 10 times over every year. It is that kind of thing that you promote and get people interested as this group that I talked to in Paris. I had the same experience you did. It makes you feel badly. I was in Italy and I talked to two very prominent people there in manufacturing. They said we wouldn't think of ordering anything from you over there because if you got the order you would answer it. If you answered it, you would not answer it in our language. Secondly, you would not ship it if you found a domestic customer that found it first. If you wanted to ship it, you couldn't do it because of the longshoremen strike.

Representative GRIFFITHS. That is right. That is really the answer. So if you had money in your department which actually sent small American businessmen abroad with a little American ingenuity they might make a few sales.

Secretary HODGES. I think they would make a lot of sales.

Representative GRIFFITHS. I think they would, too. Then if you had somebody in your department who could help them to package, we might do quite well?

Secretary HODGES. I couldn't agree with you more.

Representative GRIFFITHS. I am for putting the money in that department and reconsidering some of the other programs.

Secretary HODGES. You are going to have a chance to vote on it, Mrs. Griffiths.

Representative GRIFFITHS. Thank you very much.

Representative PROXMIRE (presiding). Senator Pell.

Senator PELL. Mr. Secretary, I want to congratulate you, too, on your presentation. Looking back a couple of years ago when some of us were getting elected, the area redevelopment program was regarded as a panacea at that time. It has done a very good job in specific locations but I notice from your report that only 27,000 new jobs have been created by it. Do you have any thoughts as to how the agency can achieve results matching our earlier expectations?

Secretary HODGES. I don't recall, Mr. Pell, that we forecasted exactly so many jobs.

Senator PELL. It was never specific?

Secretary HODGES. There are more potential jobs under these additional 400 projects that are now under consideration.

As you probably know, if you are working on the economic planning of a community, the communities that need these things the most have the least ability to get them ready for you. That is a natural situation. I think that we are going to accelerate in a very high progression in the next 6 or 8 months.

Senator PELL. You are optimistic.

Secretary HODGES. Very much so.

Senator PELL. Another area of concern to me, as you may be aware, is that in the Northeast we have a serious transportation problem. The President, I believe, is requesting you to make a study with particular regard to megalopolies and the problem of rail and various other forms of transportation. Do you have any idea how long it would be before we can hope for the results of that study?

Secretary HODGES. We are doing some preliminary work that we have now. We have an item in the budget which would set up a real staff on that. I couldn't tell you whether it is 3 months or 9 months. I really couldn't at the moment.

Senator PELL. It would be less than a year?

Secretary HODGES. I hope so.

Senator PELL. You mentioned earlier the problem of tariff reductions and the Common Market, and said that now that we cannot expect Great Britain to enter it for some time, it meant we would not take advantage of the zero authority section of the act. By that I presume you meant only with respect to certain goods. We would still be able to get down to zero in the goods that the Common Market is producing, would we not?

Secretary HODGES. Without Britain there is not a thing we can get to that, except aircraft. That is the only item in which you have more than 80 percent between the Common Market and ours.

Senator PELL. In connection with our exports abroad, it has often struck me that there is quite a market behind the Iron Curtain for some of our soft goods that have no relationship to defense or strategic materials. Has the idea developed at all of exchanging soft goods for hard dollars?

Secretary HODGES. Yes, sir. I said a year ago through the State Department to the President that I thought we ought to take a good long, hard look at that rather than selling to the Soviet behind the Iron Curtain choice prototype things they can copy. If we are going to do any business we ought to sell them things that would not hurt us any but will help us a lot. I don't know what the problems are. You still have things unsettled from the standpoint of lend-lease and so forth. But I would like to do it that way.

Senator PELL. In your statement, there are some figures in the second paragraph that I would like to ask you about. I was wondering if you could explain them to me. I don't really understand them. In the first six quarters of expansion since the 1961 first quarter trough in the GNP the GNP has increased 11 percent, labor income has increased 10 percent, while corporate profits increased 28 percent. That is a very interesting figure from the viewpoint of business. I am wondering if you can show how those figures were arrived at and if I am correct in understanding the implications.

Secretary HODGES. They are actual figures that illustrate very simply, Senator Pell, that as you get this higher volume, even though you have just so much more, that you get in your last 2 or 3 percentage points of sales a very high profit.

Senator PELL. So it would go in a geometric ratio?

Secretary HODGES. That is right. You will go from 82 to 92 percent. Instead of making $50 billion before taxes, I think the figure would go like that. [Gesturing upward.]

Senator PELL. I would be interested to know, in answer to Senator Miller's question, instead of $8 billion, why could we not substitute another larger figure and look for a similar multiplier effect? Could one follow the same economic theory there or not?

Secretary HODGES. You are asking specifically about this two times multiplier and so forth?

Senator PELL. Yes.

Secretary HODGES. That, as I said, is the best figure I have seen or read from the professional economists. That you usually run around two times, plus. Dr. Paradiso answered the question about the accelerator. There is a very definite difference of opinion when you run into what acceleration that brings out in the way of further investments and borrowing of money in order to make the dollar go much faster. I can't answer that myself but we will be glad to look at it and give you the answer as best we can.

Senator PELL. My final question: Do you have any views as to how the investment situation will project itself in the next couple of years with the passage of the President's tax bill?

Mr. PARADISO. On total investment?

Senator PELL. Yes.

Mr. PARADISO. For this year probably a rather moderate rise because even with the passage of the tax bill, as you know, it takes 6 months to 1 year before business actually undertakes an expansion. They probably will have to wait until demand really rises to bump against capacity. So we do have a rather modest rise for this year.

For the next year, going that far ahead is always very risky, but we expect the rise to be substantially more. I can't tell you how much because we don't know what is going to happen to the tax bill, once we have an idea there we can develop some pattern subject to all the limitations of the forecasts of the economists.

Senator PELL. Thank you very much.

Senator PROXMIRE. Senator Miller.

Senator MILLER. Mr. Secretary, getting back to the improvement of our competitive position for exports, it is my understanding that the Soviets are providing the free world petroleum companies and particularly our own with very severe competition in the petroleum world market. Is that understanding correct?

Secretary HODGES. Senator, in total I would not be able to answer. I think they have done enough dumping and of breaking the prices to create some concern in certain parts of the world; yes, sir.

Senator MILLER. I was wondering what the proposed tax alteration revolving around the percentage depletion of oil companies might do to their competitive position vis-a-vis the Soviets.

Secretary HODGES. You have asked one I can't answer.

Senator MILLER. Would it be feasible for you to have some one in your Department give us an evaluation of that?

Secretary HODGES. I would rather pass that question, which is both difficult and political, on to the Treasury Department, if you don't mind. I will be glad to take it.

Senator MILLER. I propose to ask Mr. Dillon that question also. But it seems to me that the economic impact or the commercial impact, the foreign trade impact, might lie within your jurisdiction.

Secretary HODGES. It does from that point of view. At least we have an interagency part in that and we are deeply concerned about it. From the standpoint of what you do, and I don't even know what is proposed if anything on the 27½ percent.

Senator MILLER. I was just wondering if you would check to see whether or not anybody in your Department might have made a survey of this. I think it would be helpful to us to get the commercial or the trade impact on the present state of affairs as far as this Soviet competition is concerned.

Secretary HODGES. We can do that for you. We can find out what the Soviet actions have done to the market and we can take what has been proposed in the legislation as to what effect, if any, that would have.

Senator MILLER. I would appreciate it.

(The following was later received for the record:)

The proposed change in the tax treatment of oil-production costs would have a negligible effect on our comparative position in the world market for crude petroleum. In each of the 3 years 1960–62, the United States produced between 2,575 and 2,670 million barrels of crude oil, but we exported only 2 or 3 million barrels each year or about 0.1 percent of our production. The value of these crude oil exports is about $8 million annually. Therefore, our crude exports are very small indeed, and our balance of payments would be affected very little even if our crude exports were to drop to zero.

In 1961 the Soviet Union quoted prices (f.o.b. Black Sea loading points) at $1.25 to $1.65 per barrel for Western Europe, Egypt, Japan, Brazil, and Cuba, and $2.97 for the East European satellites. Western oil companies quoted prices of about $2.21 at pipeline terminals in eastern Mediterranean ports this same year.

It is doubtful that any change in U.S. taxes would have any direct effect on Soviet oil exports to the free world. If the problem were that simple or that directly related, our difficulties with the Soviet oil offensive could be soon solved. Basically the Russians export oil because they have more than they need and because it provides them with needed foreign exchange. Unlike free world oil suppliers, the Russians can ignore operating costs and arbitrarily establish the price of oil at levels which will produce the sales dictated by political considerations. Their price structure can therefore be far below free world prices as indicated above. The willingness of certain free world governments to barter or buy Soviet oil in order to promote the sale of goods embodying advanced Western technology further complicates the problem of U.S. or other free world oil companies attempting to meet Soviet oil penetration.

Senator MILLER. Tied in with that, and you can tell me if this does lie outside of your jurisdiction, I was wondering whether or not any studies have been made on the impact of the prices of gasoline and home fuel and industrial fuel that would arise from any change in this tax treatment.

Secretary HODGES. I am sure no study has been made on that in our Department.

Senator MILLER. Would it be feasible for that to be done?

Secretary HODGES. We can look at it. I won't make a definite promise on it.

(The following was later received for the record:)

Questions relating to fuels policy and prices are largely in the domain of the Department of Interior and so the Department of Commerce has no studies on this matter. It would seem, however, that in the short run the supply of gasoline and fuel oil on the U.S. market would be little affected by the proposed tax change since the latter affects only the accounting treatment of drilling and development costs. Texas wells are currently pumping only about one-third of capacity and consequently production from existing U.S. wells could be greatly expanded over the next few years and hence supply could be increased markedly even if no new wells at all were developed.

Senator MILLER. Thank you. I had a question regarding the balance of payments.

Secretary HODGES. Yes, sir.

Senator MILLER. I am deeply concerned about this, as I believe everybody else is. I had been led to believe that the figures were a little bit different than those that you have given in your report regarding the amount of the deficit for 1961 and for 1962. I am wondering if the difference might arise from the fact that the figures I have seen included were adjusted to reflect an accelerated payment on foreign loans or foreign debts to us. Can you tell me whether or not the 2.5 billion in 1961 and 2 billion in 1962 is after an accelerated payment by a foreign debtor?

Secretary HODGES. I can't answer that. I would presume that it reflected the actual situation. I would presume that the next year would reflect the actual situation because you might have another development along the same line.

Senator MILLER. I wonder if you could have your people furnish the committee with a picture of how much of that includes, if any, an accelerated or prepayment of foreign debts.

Secretary HODGES. That has been published. We will be glad to get it for you.

Senator MILLER. Thank you.

(The following was later received for the record:)

The accelerated debt repayment in both 1961 and 1962 was about $670 million; the deficits in the balance of payments for both years were calculated after adding these accelerated debt repayments to the receipts.

Senator MILLER. Now I would like to clear up your comments regarding the area redevelopment program on page 10. At the bottom of the page you state that more than 27,000 direct new jobs have been created. Are those jobs filled, or are these merely job positions?

Secretary HODGES. These are people who were not working before who will be working when the approved projects become fully operable.

Senator MILLER. In other words, 27,000 more people are working than were working?

Secretary HODGES. Yes sir; after the projects become operable, although the figure does not include temporary construction workers.

Senator MILLER. Then we have 15,000 jobless workers who have been or are being retrained, equipped, and so on. How many of those are back on the payroll? Would you have the figure on that?

Secretary HODGES. No; but I can get it for you as to what our experience has been.

Senator MILLER. I would like to try to get a picture of how many of our unemployed people have actually gone back on the payroll since we went into this program.

Secretary HODGES. Out of the 15,000 that are getting the retraining, I can bring that up to date for you and see how many of the 15,000 have jobs.

Senator MILLER. That would be fine.

(The following was later received for the record:)

We are informed by the Department of Labor, which administers the training and retraining features of the Area Redevelopment Act, that approximately 15,000 jobless workers have been approved for retraining to date. Of this number, some 10,000 or 11,000 have entered training or have completed training. To make a completely accurate accounting of the status and progress of the program at a specific date requires a canvass of the various State employment security agencies which directly administer the program. The Labor Department is conducting such an overall canvass. The results of it, however, will not be available in time to incorporate into this testimony. However, we are informed the average experience with trainees who have completed their training period under this program and have had an opportunity to seek jobs has been that 60 to 66 percent have actually secured jobs. Ultimately on the basis of this experience, it can be reasonably expected that 9,000 to 10,000 of the 15,000 approved trainees will be actually at work shortly following completion of their training.

Senator MILLER. Now the last question. Because of my time I didn't have a chance to get into a fourth alternative. You remember I suggested there might be a third.

Secretary HODGES. Yes.

Senator MILLER. As I understand it, you indicated that if it were possible you would prefer this third one?

Secretary HODGES. I said if you can get the thing we needed in the economy I thought everybody would prefer the third.

Senator MILLER. I am wondering if we might pursue a fourth alternative, and that is to not have any tax cuts for a taxpayer, say a business, except as to their growth income. Take a business or a small corporation that makes a hundred thousand dollars a year. We want them to grow and provide for job opportunities. So let us say they grow $50,000 more net income in the next year. Why not give them the tax cut on that? The reason I suggest that—and it would be a substantial one, maybe just half the tax rate instead of 52 percent corporation rate—26 percent on that $50,000 growth income—the idea behind that being to provide a real incentive to growth. Because under the present proposed tax cut everyone gets it whether he really earns it or not. This would be calculated to provide an incentive to grow and the benefit would be only to the person or the business that grew. Another benefit would be that the tax cut would come in the growth area so you would not end up going deeper into debt as a result of it. I was wondering if you have given any thought to that as a possible fourth alternative.

Secretary HODGES. No, sir; I have not. That is an intriguing idea.

Senator MILLER. Would you care to have that kicked around in your shop?

Secretary HODGES. I am afraid it would be kicked around. I will say that I think we need the tax cut for all the people because I think they have been paying too much taxes. But I think we need some of the other kind of things. I would agree with you immediately if you wanted to put it on export growth where it would do the most good. I would make an incentive for a man who added another $50,000 to his exports.

Senator MILLER. I am trying to satisfy you because you say you can't cut expenditures. I am trying to satisfy the taxpayer by giving him a cut. So we end up having our cake and eating it both. We don't have any deficit as a result of the tax cut and we don't cut expenditures. Leave the expenditures where they are. But we give them the tax cut, and a big one, in their growth area. If you could kick it around and kick it favorably I would appreciate it.

Secretary HODGES. Thank you.

(The following was later received for the record:)

One of the basic difficulties in this proposal is to set forth a proper definition of growth income. In periods of strong economic upswing, a large proportion of companies will experience an increase in income. However, even under such favorable conditions, there will always be companies which will show no increase in income due to forces beyond their control such as strong competition, changes and shifts in demand, and higher costs. The question is how to define the growth income—should all companies showing increases over the previous year's income be included? Or should the tax apply only to the so-called "true growth" companies—those which have had a reasonably long period of continuous gains?

In any case, the growth companies will enjoy a marked advantage over those which failed to show an increase in income in a particular year. Over time, this would lead to higher taxes for those corporations least able to pay. These latter companies will be placed at an even greater competitive disadvantage since the additional after-tax income of the growth companies would enable them to increase their efficiency and develop and market new products at the expense of companies not receiving the tax advantage. And how should the partnership be treated? If it is competing with a growing corporation, it would find its own taxes increasing more rapidly, as it grows, than do the taxes of the corporation. This would seem unduly onerous for the partnerships. The net effect of this proposal might well result in large increases in bankruptcies and in widespread mergers.

Senator PROXMIRE. Mr. Curtis.

Representative CURTIS. Mr. Secretary, do you have any of the study papers or charts that were used in computing the multiplier?

Secretary HODGES. No, sir.

Representative CURTIS. I thought you might have some of that material which would be available to the committee.

Secretary HODGES. I don't think we would have anything that would help you more than this general estimate.

Representative CURTIS. Just your estimates and your narrative.

Secretary HODGES. Yes, sir.

Representative CURTIS. I had a hard time keeping from biting my tongue in the exchange you had with Mrs. Griffiths on "The Ugly American."

Secretary HODGES. We were not talking about an ugly American, we were talking about a fat American.

Representative CURTIS. All right, the fat American—whatever you want to call him.

Incidentally, I am very much in favor of our improving our exports abroad, but I think you presented an unfortunate picture.

Let me give some statistics to show how improper a picture that was. In 1950, our merchandise exports abroad were $10 billion. That doesn't sound like Americans were ignoring foreign markets. By 1960, these exports were almost $20 billion. Services amounted to $2 billion in 1950 and approximately $4 billion in 1960. The total, I might say, in 1950, $13.8 billion, and in 1960, $27 billion. I happen to think that our private sector and American businessmen are doing a good job. It is time we gave them a little lift, instead of the kicks that I have been listening to here. I want to criticize this in context. I know we can improve it. The work the private sector has done in South America is so superior to that I have seen done by the governmental sector that I want to clear the record on that point. I might say, Mr. Secretary, I don't want to see the Government entering this area too strongly. I like your spirit and desire to encourage our people to look at investment and exports abroad. But, I must say, that the Government's policy in the tax bill of 1962 was just the reverse of encouraging foreign investment. I might also add that our use of cartel agreements in foreign trade, specifically in textiles, is neither going to free trade nor increase it.

Secretary HODGES. Before you leave that, I would like to put something in the record, too.

Representative CURTIS. Certainly.

Secretary HODGES. I don't want you to even intimate to the public and to the country or your party or my party that we have anything against the businessman. I had 30 years as a businessman. I still am as much interested as you could possibly be. What Mrs. Griffiths and I were talking about was a situation that is true in too many cases. It is not a reflection on the average businessman. He is a great person. He is doing a good job. But he is not doing anything like what he ought to do in our exports. Let me give you a figure.

Representative CURTIS. All I can say is that the increase in merchandise exports from $10 billion to $20 billion in 10 years is very good. All I am asking is that we have our criticism in context. This is why I wanted to correct the record. If it had been left as it was, the colloquy between you and Mrs. Griffiths, would certainly not have given the picture of the fine average American businessmen you are now talking about. We can improve and we must point to specific inadequacies. I want to do that. But I made a mental note to check into this incident in Laos. So often I find these horrible and dramatic examples are caused by other reasons. People are not as foolish as these extreme cases indicate. Sometimes they are. But until I cleared up the record, it presented a case that is all too common in America today. We tend to whip the private sector in order to build up the Government.

Mrs. Griffiths' remarks were very clear. She wanted to expand the Government's effort in encouraging exports. I frankly don't want Government in that business. I want Government to leave our private enterprise system alone. They are doing enough damage now and have been for years. The main job of the Federal Government is to encourage growth, instead of figuring out new ways of impeding it.

Secretary HODGES. I think that is true. Federal Government from time immemorial, including both administrations.

Representative CURTIS. This has nothing to do with the administrations.

Secretary HODGES. Let me put in the record because you put in the 10 billion and 20 billion, Mr. Curtis, we are the lowest industrialized nation in the entire world in the percentage of goods we sell abroad.

Representative CURTIS. Because our own domestic market is so large.

Secretary HODGES. Exactly.

Representative CURTIS. In absolute figures, our percentage of gross national product in foreign trade is meager. Incidentally, I ought to identify where I read my figures: 1962 Supplement to Economic Indicators on page 82, U.S. export and imports of goods and services.

Surely, you prepared it.

Secretary HODGES. Therefore, it is good.

Representative CURTIS. Of course it is good. That is the very reason I don't like you to downgrade it. I don't think it was done intentionally.

Secretary HODGES. No; it was not, Mr. Curtis.

Representative CURTIS. I would like to examine corporate liquidity. You say that in terms of current assets and current liabilities it has been remarkably stable over past years. Do you have these figures broken down by companies? I think in certain areas this liquidity is very worrisome. But I suspect that the reverse is true in areas of growth. This accounts for the increased interest rates.

Do you have studies that break it down into component parts so we could identify the tightness?

Secretary HODGES. Mr. Paradiso may answer.

Mr. PARADISO. We may have some information by industries. By companies we would have to look into that.

(The following was later received for the record:)

As indicated above the liquidity ratio for all industries has been fairly constant over the the past several years. However, examination of the ratios by industries clearly indicates that the ratios show a very substantial degree of variability—some industries being in a rather easy position while others are in a more difficult situation. The two tables which follow show liquidity ratios for manufacturing industries by quarters on two bases for the 2 years 1961 and 1962. These data show that while the total liquidity ratio for all manufacturing companies has been quite constant over the past 2 years, the ratios vary substantially by industries. For example, in the third quarter of 1962 the liquidity ratio as measured by current assets to current liabilities in the third quarter of 1962 varied from the high of 3.95 for tobacco manufacturing to the low of 1.48 for the aircraft and parts industry. Undoubtedly, this type of wide dispersion exists among companies as well as among industries.

Liquidity ratios of U.S. manufacturing corporations

[A] CURRENT ASSETS TO CURRENT LIABILITIES

	1961				1962		
	I	II	III	IV	I	II	III
All manufacturing corporations, except newspapers	2.54	2.55	2.53	2.48	2.48	2.47	2.45
Transportation equipment	1.99	1.99	2.00	1.92	1.94	1.93	1.93
Motor vehicles and equipment	2.47	2.43	2.50	2.26	2.29	2.22	2.25
Aircraft and parts	1.45	1.47	1.46	1.47	1.47	1.49	1.48
Electrical and machinery equipment and supplies	2.37	2.42	2.43	2.35	2.31	2.35	2.36
Other machinery	2.75	2.73	2.86	2.85	2.79	2.76	2.80
Metalworking machinery and equipment	2.84	2.93	2.91	2.83	2.73	2.80	2.92
Other fabricated metal products	2.76	2.64	2.65	2.68	2.68	2.57	2.58
Primary metal industries	2.89	2.97	2.96	2.94	2.89	2.96	3.01
Primary iron and steel	2.70	2.84	2.77	2.77	2.71	2.80	2.84
Primary nonferrous metals	3.36	3.28	3.41	3.34	3.34	3.33	3.41
Stone, clay, and glass products	2.85	2.83	2.81	2.81	2.84	2.69	2.75
Furniture and fixtures	2.57	2.54	2.46	2.53	2.53	2.43	2.43
Lumber and wood products, except furniture	2.50	2.44	2.42	2.41	2.42	2.35	2.17
Instruments and related products	2.95	3.05	2.99	2.86	3.03	2.96	2.83
Miscellaneous manufacturing and ordnance	2.53	2.36	2.44	2.43	2.48	2.36	2.35
Food and kindred products	2.47	2.55	2.42	2.34	2.43	2.5	2.37
Bakery products	([1])	([1])	2.14	2.22	2.24	2.20	2.20
Alcohol beverages	3.87	3.68	3.57	3.47	3.96	3.80	3.44
Tobacco manufactures	3.78	4.65	4.19	3.36	3.53	4.00	3.95
Textile mill products	2.74	2.64	2.69	2.93	2.76	2.66	2.65
Apparel and other finished products	1.91	1.82	1.79	1.91	1.91	1.86	1.81
Paper and allied products	2.79	2.73	2.65	2.67	2.64	2.62	2.52
Printing and publishing except newspapers	2.35	2.35	2.26	2.17	2.29	2.19	2.22
Chemical and allied products	2.82	2.79	2.77	2.69	2.78	2.77	2.76
Basic chemicals	2.88	2.86	2.78	2.66	2.70	2.70	2.70
Drugs	2.92	2.88	2.75	2.64	2.79	2.89	2.75
Petroleum refining and related industries	2.65	2.71	2.61	2.54	2.45	2.42	2.37
Petroleum refining	2.66	2.73	2.62	2.54	2.45	2.42	2.37
Rubber and miscellaneous plastic products	2.90	2.93	2.97	2.89	2.78	2.71	2.79
Leather and leather products	2.48	2.49	2.37	2.43	2.37	2.46	2.36

[1] Not given.

[B] TOTAL CASH AND U.S. GOVERNMENT SECURITIES TO TOTAL CURRENT LIABILITIES

	1961				1962		
	I	II	III	IV	I	II	III
All manufacturing corporations, except newspapers	0.48	0.48	0.47	0.49	0.45	0.44	0.42
Transportation equipment	.44	.49	.40	.41	.39	.44	.39
Motor vehicles and equipment	.78	.84	.70	.66	.64	.70	.62
Aircraft and parts	.10	.11	.11	.12	.10	.10	.09
Electrical machinery, equipment, and supplies	.33	.33	.32	.33	.29	.29	.27
Other machinery	.45	.44	.49	.49	.44	.42	.44
Metalworking machinery and equipment	.55	.54	.54	.54	.48	.49	.54
Other fabricated metal products	.46	.42	.45	.49	.42	.39	.41
Primary metal industries	.70	.76	.75	.73	.68	.72	.74
Primary iron and steel	.74	.83	.79	.77	.71	.77	.80
Primary nonferrous metals	.60	.59	.63	.62	.61	.62	.62
Stone, clay, and glass products	.69	.67	.70	.76	.66	.61	.62
Furniture and fixtures	.42	.42	.40	.43	.38	.34	.35
Lumber and wood products, except furniture	.43	.42	.40	.41	.40	.38	.34
Instruments and related products	.63	.60	.62	.63	.64	.58	.58
Miscellaneous manufacturing and ordnance	.36	.32	.33	.38	.36	.32	.28
Food and kindred products	.39	.40	.38	.38	.37	.39	.37
Bakery products	(1)	(1)	.80	.86	.83	.79	.69
Alcohol beverages	.52	.46	.55	.50	.48	.45	.45
Tobacco manufactures	.15	.16	.13	.13	.12	.16	.12
Textile mill products	.36	.32	.33	.39	.31	.30	.30
Apparel and other finished products	.19	.18	.16	.23	.19	.17	.16
Paper and allied products	.58	.55	.54	.60	.50	.49	.45
Printing and publishing, except newspapers	.53	.49	.44	.48	.47	.43	.42
Chemicals and allied products	.61	.58	.58	.62	.56	.56	.56
Basic chemicals	.62	.57	.52	.56	.49	.50	.52
Drugs	.79	.76	.71	.77	.76	.78	.71
Petroleum refining and related industries	.82	.78	.71	.78	.71	.65	.58
Petroleum refining	.82	.79	.72	.78	.71	.66	.58
Rubber and miscellaneous plastic products	.32	.34	.38	.41	.27	.26	.27
Leather and leather products	.28	.27	.27	.31	.24	.27	.25

[1] Not given.

Source: Federal Trade Commission, Securities and Exchange Commission, Quarterly Financial Report for Manufacturing Corporations.

Representative CURTIS. Do you know whether my premise is correct?

Mr. PARADISO. It sounds correct. I think you find an average like this always this kind of picture where some are often better off and some worse off.

Representative CURTIS. I think it is particularly true when you have an economy such as ours that is growing so fast. These shifts from manufacturing into service areas create bottlenecks of shifting capital. This becomes important as Senator Proxmire was pointing out while discusing the interest rate. We have a relatively high interest rate for our society, although not compared to those abroad. It would seem that if there were an excess of investment funds, and you say there is not a shortage, the rate would come down. I think the bottlenecks within these aggregates produce this confused picture. This is why these components are very important.

Mr. PARADISO. May I make a comment on this excess amount of funds?

Representative CURTIS. Yes.

Mr. PARADISO. You are quite right there was an excess amount of funds in the period 1961 to 1962. In other words, there was a rise in retained earnings plus the depreciation allowances. This is not commensurate with what we would like to see on plant and equipment spending.

Now, why? It was not because business didn't want to spend on plant equipment. I think basically the demand for goods and services did not increase enough so as to narrow the very large excess capacity which existed here and there. This in my judgment was the basic reason why business did not utilize the amount of funds which it had on hand for plant and equipment spending.

Now if we can move the demand for goods and services up toward a position where businessmen feel a pressure on their capacity, and at the same time they have these funds plus some more, it seems to me that this would be the motivation for going ahead and spending the funds that they have available. What is an example of this? I think the period 1955–57 is a good illustration, where there was a large expansion in the cash flow, the same time a large expansion in the demand for goods and services, and this was accompanied by a very sizable expansion in the plant and equipment spending.

Representative CURTIS. Now you are getting back to the theme of the administration which is different from this paper. In his statement, the Secretary said that it was not a shortage of funds but rather limited profit opportunities, which hindered investment. I happen to think this is the key. That is the reason I want to conclude with this one point. The Secretary said that cutting taxes would encourage investment. Mr. Secretary, suppose you had $1 million invested and you had a return of 2 percent, $20,000. With a 50 percent tax, you net $10,000. You cut your tax from 52 to 47 percent corporate rate, or 5-percent cut in the rate.

Secretary HODGES. A 5-percentage-point cut—10-percent cut.

Representative CURTIS. It gives you $1,000, or a tenth of a percent additional, so you have a 2.1-percent profit. I suggest this is not the answer to our problem. That type of incentive means very little compared with the prospects of selling more. If you were more efficient, you might increase your profit to 3 percent. If you go up 1 percentage point, from 2 to 3 percent, you gain $10,000. This is the area of profit. The proposed tax cut is not going to improve profit opportunities if this analysis is correct. It clearly demonstrates that where business profit opportunities exist, as they did in thin sheet steel, they can be multiplied a hundred times over. This so-called idle plant capacity, which is essentially obsolete must be handled with, as I often say, a rifle and not a shotgun.

We must improve these areas of obsolescence. We are experiencing rapid economic growth, not tired blood.

Senator PROXMIRE. I have just a couple of more questions, Mr. Secretary, and I apologize for detaining you. I notice in 1957 our merchandise exports were $19 billion. In the third quarter of 1962 on an annual rate they were $20 billion. In other words, in the last 5 years, it fluctuated but it seems we made very little progress in our exports. This would seem to confirm your notion that we can do a great deal better, we must do better and various steps were suggested to increase exports. I would ask a little bit more about the stimulation of this tax cut. I have gotten the impression from Mr. Paradiso—maybe I am wrong—that in this particular case, at least to begin with, the accelerator effect of this tax cut might be quite modest and maybe negligible for a while at least in view of the fact that we now operate at 82 percent of the capacity in general. Therefore, before business buys more plant, or expands plant, at least, it could proceed profitably to utilize more fully the plant it already has. The whole impact of the accelerator, as I take it, is the effect of increased demand, making it necessary for manufacturers to buy more capacity so that they can meet that demand, and that buying of capacity stimulating more consumer spending.

Mr. PARADISO. There would be in addition to that, of course, the kind of situations which Representative Curtis has mentioned; namely, in a period of expansion there will be need for certain types of capacity additions to even out existing capacity. In the steel industry you don't have a situation where the capacity rate of operations are the same all through the structure.

Senator PROXMIRE. Seasonal differences and so on.

Mr. PARADISO. Seasonable differences or differential impact of demand. For example, if the automobile industry should expand terrifically you might need more steel sheets and that might put somewhat earlier the pressure on the steel industry to expand this type of capacity. When I was talking about a general lag, it is a lag considering the economy as a whole. In specific cases, if a new product is developed you will get some additional capacity there. I think you will have a mixed picture. But as far as the total investment is concerned I really believe there will be some considerable lag until these demands catch up with the bulk of the existing capacity.

Senator PROXMIRE. At any rate, if we assume that the funds are readily or relatively available now, if we assume, and I tend to disagree with Mr. Curtis and you may disagree, that the incentive is not very great in the corporate income tax cut we suggested particularly in the first 2 or 3 years corporations will actually be paying more taxes—it will be 1965 and 1966, before they get the full effect of the cut, because of the speedup—then we are left only with the demand increases.

Is it not true that the multiplier effect depends strictly on the propensity to save? That is, if there is a tendency for this tax cut to be translated into increased savings very largely, and even if that tendency is to increase only from 6 percent savings to 8 percent savings the whole effect of the tax cut could be washed out.

Mr. PARADISO. I don't agree with that.

Senator PROXMIRE. Why not?

Mr. PARADISO. I don't agree with that because past experience has shown that while there is this variation in the rate of saving or consumption, varying from 92 percent to 94 percent or 6 to 8, as you described it, the variation is to some degree correlated with the amount of durable goods which consumers buy. In other words, when incomes rise consumers and jobs are created, more people are employed, consumers tend to buy automobiles, furniture, and housing. Under these conditions they have to borrow. In the process of borrowing this tends to reduce the rate of savings. What I'm saying is—I can supply you a table if you wish—there are periods where you can demonstrate that in an expansionary condition the durable goods sector favors from that situation and this results not in a 92-percent rate of consumption but in a 94-percent rate of consumption.

Senator PROXMIRE. You recognize that this kind of tax cut for most people is a tax cut of $4, $5, $6 a pay check. It seems to me very few people are likely to buy a home or car with that.

Secretary HODGES. That is right.

Senator PROXMIRE. On the other hand, if you do these two things: No. 1, cut out the 10 percent excise tax on automobiles, the taxes of that kind that directly increase the cost, and at the same time you have monetary policy that will reduce interest rates moderately, then the tendency to buy a house because interest is the biggest element in cost, buy a car, it would seem to me would be increased. If you follow the policy of simple monetary stimulation you don't have the deficit. You don't have the burden in the future. As a matter of fact, the reduced interest rate would mean the burden of servicing the national debt would be decreased.

Secretary HODGES. I don't disagree with you but I don't think you should minimize the effect of an additional $6 or $8 per week in the hands of a particular family.

Senator PROXMIRE. Do you agree with Dr. Heller that they will buy an extra pair of shoes?

Mr. PARADISO. No. We have aggregates in buying. This creates some additional equipment which the shoe company people will have to have. These people then feel they have a job which is secure. They are the ones who go ahead and buy the car. It is not necessarily the initial beneficiary of the tax, the $6-a-week family that does it, but it is the new people who become employed and who feel they have more security in a job which they probably didn't have before.

Senator PROXMIRE. I am inclined to think the main beneficiary and I suppose I should support the tax cut for this reason, is the beer industry in Milwaukee because the boys will buy an extra couple of beers on the way home because they have that kind of extra money and that is all they have.

I understand from this committee staff particularly, that the work you have done on capital stock, the statistics you have or are working up on capital stocks, plant and equipment has been very helpful to them, and I appreciate this work. Telling us about an inventory of American industry. We like this. It is very helpful. We hope it will continue.

The other thing is that I am happy to see on page 204 of the budget the reference herein, science and technology to a program of support of industrial research in which you say a variety of techniques will be used to support and facilitate industrial research and development through grants and contracts primarily with universities and nonprofit institutions for basic innovation. I might say the University of Wisconsin can do a great job for you and we would be delighted to have you entertain us as a source.

Secretary HODGES. Thank you very much.

Senator PROXMIRE. Are there any other questions?

Senator MILLER. Just to add that Iowa State University at Ames can also help you.

Representative CURTIS. In the discussion of demand, one point has not been emphasized sufficiently. Disposable personal income continues to rise throughout most of the postwar recessions. This was true even during the recent one, although it lasted only one quarter. As Senator Proxmire was interrogating, I was examining consumer and real estate credit in the January Economic Indicators. Going back to 1952, there is a constant rise of consumer credit.

There is no problem here as to consumer purchasing power, which is the combination of actual money plus availability of credit. Demand is not the problem in this area. The thesis, as I understand the Government's case, is on the demand sector. They examine the aggregate instead of the components. I just wanted to point that out.

Secretary HODGES. Thank you, sir.

Senator PROXMIRE. Thank you very much, Mr. Secretary.

(Whereupon, at 4:45 p.m., the hearing was recessed.)

JANUARY 1963 ECONOMIC REPORT OF THE PRESIDENT

THURSDAY, JANUARY 31, 1963

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

The committee met at 10:05 a.m., pursuant to recess, in room AE-1, the Capitol, Senator Paul H. Douglas (chairman of the Joint Economic Committee) presiding.

Present: Senators Douglas, Sparkman, Fulbright, Proxmire, Pell, Javits, and Miller.

Representatives Reuss and Curtis.

Also present: Henry H. Fowler, Under Secretary of the Treasury.

William Summers Johnson, executive director; John R. Stark, clerk; James W. Knowles, senior economist; Roy E. Moor and Donald A. Webster, economists.

Chairman DOUGLAS. Our meeting time having arrived, the committee will come to order.

We are very happy to have as our witness today the distinguished Secretary of the Treasury, Mr. Douglas Dillon.

Before you begin, Mr. Dillon, I want to personally congratulate you on the many fine things you have done as Secretary, and especially commend you for putting long-time bonds up for competitive bidding for the first time in recent history, and I believe you have effected a saving by doing this.

Some of us in Congress has been advocating this for some years. We want to congratulate the executive department for being willing to take advice, even from such lowly persons as Senators and Congressmen.

You may proceed.

STATEMENT OF HON. C. DOUGLAS DILLON, SECRETARY OF THE TREASURY

Secretary DILLON. Thank you very much, Mr. Chairman.

I think you are quite right in your description. We were quite pleased with the results of that operation.

Mr. Chairman and members of the Joint Economic Committee:

The recent performance of the American economy has already been reviewed in the economic message of the President and in the report and testimony of the Council of Economic Advisers. The compelling and overriding theme of their remarks can be simply stated.

THE NEED FOR FASTER GROWTH

Nineteen hundred and sixty-two was, against the background of recent experience, a good year. Employment, output, and incomes all reached new records. Almost 2 years after the last recession, the economy appears free of those excesses and imbalances that in the past have signaled a new downturn. Virtual price stability has been maintained throughout the expansion period. And, despite the substantially higher level of imports generated by rising business activity, the pattern of increasingly large deficits in our balance of payments that characterized the years 1958–60 has been reversed.

Nevertheless, our recovery since early 1961, reassuring as it has been, has not achieved the kind of decisive transition to dynamic, self-reinforcing growth that is well within our means. The past 5 years have left us with a residue of unemployment that a recovery of only normal proportions cannot eliminate. Excess productive capacity and pressures on profits continue to chill the incentives to invest and expand upon which our economic vitality depends. Not only has our progress at home been limited, but also our ability to provide expanded markets for other nations struggling to find the means for a better life within a framework of individual freedom. At the same time, the deficit in our international payments has remained uncomfortably large.

We want to increase our rate of economic growth and improve our living standards because it is basic to our way of life. We are concerned that too many of our citizens are unemployed, that others do not have a fair share of the national prosperity, that there are depressed economic areas, that our economy is not growing as fast as others. We are not willing to accept these as inevitable and we believe a combination of appropriate Government policies and private initiative, consistent with our political and economic traditions, can help to ease these problems.

Our difficulties are not those of crisis—a sharp domestic recession—an unmanageable drain of international reserves—an early relapse into inflation. Rather, the problem lies in a gradual accumulation of deficiencies over a period of years, each interacting with the other to retard our progress. Slow growth and less-than-capacity operations inevitably dull incentives to invest, encourage inefficient make work practices, and lead to pressures on unit costs and profit margins. In this setting, investment opportunities abroad, within the borders of our rapidly growing foreign competitors, become magnets to American capital, burdening our balance of payments today and diverting potential new jobs and efficient productive facilities from our shores. And, in terms of the Federal budget, our underemployed economy is not able to generate the revenues needed to cover the costs of Government—even though increases in spending for fiscal year 1964 are being held to the essentials of national security, space, and interest payments.

THE LINK BETWEEN OUR DOMESTIC AND BALANCE-OF-PAYMENTS GOALS

One lesson of the past 5 years is that our goals of domestic growth and external balance cannot safely be separated. We live in an open economy—an economy whose performance powerfully influences our trading partners, rich and poor alike, and which is itself subject to strong competitive pressures from abroad. Our growth—or failure to grow, the efficiency with which we produce, the climate for domestic investment, and our success in achieving price stability all affect the flows of goods and capital between nations. And the strength and stability of our currency concern every nation with a stake in freely flowing trade and a durable international payments system, for side by side with gold itself, the dollar serves the free world as its chief reserve and trading currency.

The continuing need to reconcile our domestic and international objectives sometimes limits the kind and scope of specific actions that we can take in pursuit of one goal or the other. But fundamentally these goals need not be incompatible; indeed, they can reinforce each other. Faster growth at home and an efficient industry, able to pour out the new products eagerly sought in world markets, both depend upon a higher level of domestic investment, incorporating the latest technology and exploiting the fruits of new research. A dynamic domestic economy, alive with new and profitable investment opportunities, is ultimately the only way—consistent with our free market system—by which we can discourage excessive outflows of capital and attract funds from abroad. Price stability is essential both to broaden our export markets and to achieve balanced growth at home.

The continuing challenge before us is to seek out and apply that blend of practical policies that, taken together, promise to support both our domestic and international objectives. This requires, first of all, a clear appraisal of existing trends—not just for recent months or the past year, but for a long enough period to appreciate the underlying forces at work in the economy. It is in this longer perspective that the performance of the past year, while gratifying in many respects, has demonstrated the need for new approaches.

THE KEY ROLE OF INVESTMENT

One fact that stands out in our recent experience has been the sluggishness of business investment—the kind of spending that both generates current income and enlarges our productive potential. This is true in relation to both our earlier postwar record and that of our aggressive foreign competitors. To be sure, business spending for plant and equipment rose by 9 percent in 1962. But the gains slowed appreciably after the early months of recovery and, in dollar volume, outlays barely surpassed levels reached as long ago as 1957. In real terms, spending is actually below earlier peaks. We have been adding to our capital stock at a rate of little more than 1.5 percent per year since 1957—well below the amounts that are needed to support a vigorously growing economy. Moreover, businessmen, once the threat of a steel strike was eliminated early last year, have followed increasingly cautious inventory policies, adding to stocks only where clearly needed to support their current level of sales.

The explanation for these conservative business policies is not hard to find. With many industries faced for some time with more capacity than they could effectively use, and with profit margins under pressure over a period of years, businessmen understandably have confined their investment spending largely to those replacement and modernization projects offering clear and prompt cost advantages. With fast deliveries assured, and with constantly improving methods of inventory control allowing smaller inventories to serve a given level of demand, incentives for adding to their volume have been weak.

These investment and inventory practices, rooted in the experience of the past 5 years, are one reason why the danger of serious recession in the months ahead appears remote. But, in an economy with a growing labor force and steady increases in worker productivity, we cannot be satisfied with stability or creeping advance. And the fact of the matter is that we need, and could effectively utilize at a high level of employment, much more investment than has been forthcoming.

Much of the difficulty lies in an absence of sufficiently strong and assured markets—markets more in line with our potential capacity to produce. After 5 years of inadequate progress we cannot confidently sit back in the hopes that such markets will appear spontaneously, without the encouragement of fresh incentives and the release of new purchasing power.

Residential housing, for instance, had a good year in 1962—helped by the prevailing ease of mortgage credit. But it would be unrealistic to expect, within the limits set by family formation and current income levels, that that sector can supply the further expansionary drive that is needed. Government expenditures, at all levels, are also rising, but not appreciably faster than current tax rates are draining income from other sectors of the economy. To permit expenditures to rise further, in areas of less than compelling need, merely as a means of expanding demand would clearly violate important considerations of public policy. Finally, consumers—accounting for two-thirds of our whole gross national product—have regularly been spending a normal share of their after-tax incomes. Further increases in their outlays can be expected, but only as we generate a rise in income and employment from other sources.

THE TAX PROGRAM AND DEBT MANAGEMENT

We have at our command an instrument that will permit us to cut through this impasse. A broad consensus has developed among leaders from all sectors of our economy that fresh incentives for investment, for risk taking, and for personal effort—supported by the release of additional purchasing power through tax reduction—offers a practicable means for breaking through the sluggish performance of recent years to achieve the difficult transition to sustained and self-reinforcing prosperity. This consensus is embodied in the program of tax reduction and reform that the President presented to the Congress last week, and that lies at the core of our economic and financial policy. I shall be testifying on that program in detail before the House Ways and Means Committee next week, and am not in a position to treat the specifics at any great length here today. Rather, I would like to consider the program in the perspective of the overall financial policy of this administration, for tax reduction, however, vital, can be only a part of a well-conceived financial program for the mid-1960's.

Ultimately, one result of our proposed tax program will be a higher level of Federal revenues than can reasonably be expected if we continue to hold back our productive power with a tax structure that saps initiative and drains off such a large fraction of income that reasonably full employment becomes an ever-receding mirage. The reason is very simple—revenues reflect not only the level of tax rates, but also the level of incomes to which they are applied. Our own experience—most recently following the 1954 tax reduction—shows that this kind of stimulus to an idling economy can be the surest path to vigorous expansion and budgetary balance. And the record of the past 5 years also demonstrates the futility of deferring action in the hope that some other stimulus—always just beyond the visible horizon—can do the job.

None of us can be happy with the temporary increase in the deficit that our tax program implies for fiscal 1964—although I should point out that the estimated net revenue loss of $2.7 billion is small when compared to the $9.2 billion deficit that we face in any event as a consequence of the failure of our economy to achieve reasonably full capacity operation. The phasing of the full program over 3 years, but with enactment in a single package, is designed to minimize the transitional deficit, before balance can be restored, without delaying the impact on business incentives. And I am confident that we will be able to manage a deficit of the magnitude we foresee without endangering either our record of price stability or our balance of payments position, just as we have successfully financed our deficits of the past 2 years.

We have been aided in that task by a rising flow of savings that individuals and businesses have been willing to commit to investment for a substantial period of time. Almost all the deficit in 1962 was financed outside the banking system. Moreover, the increase in outstanding Government securities maturing in more than 5 years was substantially greater than the total rise in the public debt. Under the circumstances, it was possible to achieve this progress toward restructuring and funding the marketable debt—symbolized by a 7½-percent increase in its average maturity—without diverting funds from productive use elsewhere in the economy. In fact, most long-term interest rates drifted down below their recession lows over the course of the year.

As we move ahead in financing the deficit, we will remain alert to the need to maintain a debt structure that will not contribute to inflationary pressures as full employment is restored. This will require distribution of the debt among the various maturity areas and investor groups in a manner that avoids excessive liquidity, either in the form of new money creation or short-term Treasury securities.

Of course, at a time of unemployment and excess capacity like the present, the use of short-term securities or commercial bank financing is fully justified in appropriate amounts. A growing economy needs more money and other liquid assets, and short-term Government issues may help to fill these needs. The compelling policy requirement—and the guide that we have consistently observed—is to insure that the growth of liquidity instruments of all kinds does not run ahead of the ability of the economy to absorb them without inflation.

While hard and fast mechanical rules cannot be set down in advance, this guide implies a continuing need to tap longer term savings—either directly, or through the complex of savings institutions—for a portion of the funds required to finance our forthcoming deficit. We are fortunate, in approaching this task, that techniques have been developed that permit us to raise funds in the intermediate and longer term sectors of the market with a minimum of disturbance to

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other borrowers. I am thinking partly of our advance refundings, which have now been tested and found useful in six instances over the course of two administrations. I am also thinking of our recent experience in auctioning long-term bonds through competing syndicates of security dealers—an experiment that owes much to the continuing interest and support of Senator Douglas. I am happy to report that our initial venture in selling $250 million of long-term bonds by that means was highly successful in achieving a wide distribution of the new securities, in this instance at an interest cost virtually equivalent to the prevailing yield for comparable outstanding securities. While it is still too soon to permit a judgment concerning the ultimate role of this new technique within our total debt management program, the initial success provides every reason for further testing from time to time as market conditions and our own objectives make that desirable.

Chairman Douglas. Mr. Secretary, have you made an estimate as to the probable interest savings which you effected by competitive bidding for these $250 million of long-term securities?

Secretary Dillon. We have not made one, but I have seen one made independently which I do not think was far off the mark.

Chairman Douglas. Well, I made an estimate.

Secretary Dillon. I think that is the one I am referring to.

Chairman Douglas. I made an estimate that the yield, I believe, on the present securities is 4.01 percent.

Secretary Dillon. That is right.

Chairman Douglas. I made an estimate that if you had disposed of them under the former method, that you would have been compelled to have a yield of 4⅛ percent, or 4.125, is that true?

Secretary Dillon. I said I thought that was roughly right. It might have been a 4.10 yield. It is close.

Chairman Douglas. And, therefore, the savings have been in the nature of one-tenth of 1 percent a year, somewhere around that?

Secretary Dillon. Something like that, yes.

Chairman Douglas. That would be $250,000 a year. For 30 years, that would be $7,250,000. I congratulate you.

Secretary Dillon. Thank you.

FINANCING THE TRADITIONAL DEFICIT

It is sometimes argued that, to the extent we tap savings in financing the deficit, the desired stimulus from our tax program will be offset—that we will, in effect, take back with one hand the money that we provide with the other. This oversimplified account of the financing process overlooks several important considerations. First of all, however the deficit is financed, it will leave untouched the spur to the economy from the greater incentives for productive effort and new investment brought on by tax rate reduction. Equally important, there is every reason to believe that, until we return closer to full employment, the flow of longer term investment funds generated by rising levels of business activity will continue to exceed the combined borrowing requirements of individuals, businesses, and State and local governments—just as has been the case over the last 2 years.

An increased volume of savings will not require decisions to reduce spending by business or consumers, but rather will flow from higher incomes. The act of saving may itself be the end product of a long sequence of prior spending decisions, each of which will tend to add to the level of business activity and the incomes of workers. The taxpayer himself, when he devotes part of his tax saving to purchases of goods or services, will be only the first link in this chain of spending, income generation, and saving that lies at the heart of the expansionary process. Under these circumstances, it is quite possible and practicable for the Government to absorb some of the new savings for its own use, without bringing undesirable upward pressures on interest rates or diverting funds from use in other investment channels.

As the economy reaches full employment, and potential savings can be fully and productively employed in financing our expanding private economy, the situation becomes quite different. Then, it is quite true that wedging Government bonds into an already taut capital market will raise interest rates and curtail private spending. And, in a potentially inflationary situation, that could be appropriate. Even more to the point, that would clearly be a situation in which Government policies should be directed toward budgetary balance and surplus, thereby restraining demand and (through debt retirement) releasing funds for productive use by other sectors of the economy. I am confident that, as the economy does reach its full potential, the tax rates we are proposing will in fact generate revenues adequate to cover the essential expenditures of Government.

The course of interest rates in the months ahead will be affected less by Treasury debt management decisions than by the course of the economy itself, and by the policies of the Federal Reserve in response to emerging developments both domestically and in our balance of payments.

Whatever the future may bring in this respect, it is clear that easy money and ample availability of credit has been a major factor supporting the economy throughout this period of expansion, and remains so today. Seldom in our history—certainly not since World War II—have most long-term interest rates actually declined during a recovery period. I was interested to see recently a report that the larger New York banks charged an average of one-eighth to one-fourth percent less per annum for new term loans in 1962 than was the case a year earlier—a striking reflection of the downward pressures on the rate structure and aggressiveness of banks in seeking out new borrowers, even while the so-called prime rate remained unchanged. The record volume of mortgage financing in 1962—coming at a time in the expansion period when tight money has often sharply curtailed homebuilding—is another sign of the really unique character of this period.

TAX POLICY AND THE BALANCE OF PAYMENTS

The continuing need for striking an appropriate balance between domestic and external considerations in the execution of debt management and monetary policies will not be fundamentally changed by our tax proposals. However, we have developed the tax program so as to reduce the possibility of serious conflicts arising. For one thing, it will take on a good part of the burden for encouraging expansion that is being borne by monetary policy, thereby easing the problems of the monetary authorities should they one day find themselves compelled to deal more vigorously with the balance of payments.

Equally important, the stimulus to domestic investment, the new incentives for cost cutting and modernization, the encouragement for industrial research, and the higher profits implicit in the tax program will support and reinforce our more specific efforts to deal with the balance-of-payments problem. Some capital that is now inclined to seek employment abroad will find new opportunities opening up in this country. The productivity of our industry should be reinforced, bettering our competitive posture in markets at home and abroad. Our leadership in research and its application to industrial products—products that account for a large portion of our total exports—will also be further bolstered.

To realize these potential benefits for our balance of payments, it remains critically important that we maintain price stability. The wage and price guideposts reiterated in the report of the Council of Economic Advisers clearly set forth the general standards by which price and wage decisions may appropriately be evaluated from the standpoint of the public interest. The increases in take-home pay and profits implicit in our tax program should make it easier for both sides to accept wage settlements and to make pricing decisions that lie well within these guideposts, effectively supporting our goal of price stability.

BALANCE-OF-PAYMENTS RESULTS

One of the disappointments of the past year has been the relatively slow improvement in our balance of payments. The preliminary figures presently available, indicating that our overall deficit remained somewhat over $2 billion, demonstrate conclusively that we must seek out and apply even more vigorously measures specifically aimed at restoring lasting equilibrium in our international accounts.

With merchandise imports rising by $1.6 billion last year, the moderate progress recorded in reducing our deficit from the $2.5 billion of 1961 was possible only because the concerted efforts to stem the dollar drains directly associated with Government activities have begun to bear fruit. Most importantly, net military spending overseas declined by almost $600 million (on the basis of incomplete data), reflecting offsetting purchases of military goods and services by our allies. The vigorous efforts to economize on our own military spending overseas merely served to hold the overall total level while absorbing the costs of larger forces and higher foreign price levels. Prepayments of loans by France, Italy, and Sweden amounted to over $650 million, approximately comparable to our 1961 receipts from this source. A larger proportion of our aid to the less developed countries was directly reflected in purchases in this country, and fully three-quarters of this fiscal year's new AID commitments will result in American exports in coming years.

Further savings in Government spending overseas are clearly necessary. I am confident that they will emerge as the new Government-wide control system for international transactions, established within the Bureau of the Budget, becomes fully effective as an administrative device for budgeting our foreign exchange outlays.

Improvement developed in other directions as well. Commercial exports rose moderately, despite slower growth in Europe—our most rapidly expanding export market. The steady increase in earnings on our oversea investment provided a factor of long-term strength. Short-term capital outflows, which had reached exceptionally high levels in 1960 and 1961, declined, although they still remain a major factor in our payments difficulties. These outflows, including items not specifically recorded in our balance-of-payments statistics, accounted for approximately 70 percent of our total defict as compared to about 80 percent in 1961.

Last year's deficit resulted in a gold loss of $890 million as compared to $857 million in 1961. Toward the end of last year, and continuing into early 1963, 10 weeks passed in which there was no net decline in our gold stock. This situation could not be expected to continue in the face of our payments deficit, and the gold outflow resumed in January. Further moderate outflows can be expected in the coming weeks and months.

The improvement in our balance of payments thus far is simply not good enough if we are to maintain a strong dollar and fulfill our basic commitments for aid and defense. The hard job of searching out and penetrating new foreign markets has only begun, and the President has therefore proposed a sharp step-up in our export expansion program. Our long-term capital exports continue to reflect the absence of effective alternatives abroad to our own well developed capital markets, as well as the inadequate investment opportunities at home. And the burdens of aid and defense must be more equitably shared.

STRENGTHENING THE INTERNATIONAL PAYMENTS SYSTEM

We cannot take comfort in the thought that an "easy" solution can be found in some new monetary arrangement that will shield us from the necessity for taking corrective action. Any effective monetary arrangement necessarily presupposes, not balance every year, but an ability and willingness to avoid large and continuing deficits, as well as the full confidence of a group of willing lenders.

We need a stable monetary system, resistant to the strains and shocks that can quickly develop as a result of sudden and massive flows of funds between countries, and capable of meeting the needs of a growing world economy for international liquidity and access to credit. During the past year, we have made great strides toward strengthening the existing system. The prompt ratification and implementation of the special IMF borrowing arrangement—making available in time of demonstrated need a pool of up to $6 billion of convertible currencies—was a source of special gratification. Moreover, we have now tested in a wide variety of situations the usefulness of operations for our own account in both the spot and forward foreign exchange markets, of reciprocal currency agreements by the Federal Reserve with the monetary authorities of other industrialized countries, and of Treasury direct borrowing at short and medium term from other countries in a strong payments position. The effectiveness of these arrangements, supplementing the resources of the IMF itself, in meeting incipient strains of various kinds—whether directed against the dollar or other currencies—was demonstrated at the time of the stock market disturbances last spring, and again during the Canadian exchange crisis and the Cuban situation. Similarly, the new cooperative arrangements in the London gold market have been helpful in dispelling a potentially speculative atmosphere, and the price of gold in that market declined toward the end of last year. For much of January, the price has been below $35.06, touching the lowest level since 1959.

No doubt there is room for further innovation and improvement in these areas. We are continuing to study these questions in cooperation with other interested countries. But no monetary mechanism can effectively substitute for the hard and continuing task of steadily improving our own balance of payments. The "easy," obvious savings have already been made—the hard core of the deficit that remains will require the conscious effort and understanding of all groups in the economy, as well as the cooperation of our friends abroad who now find themselves in a strong position.

In this connection, I was much interested in reading the report of your own subcommittee, chaired by Congressman Reuss, that recently made available a mass of valuable and provocative material on the balance of payments and related monetary arrangements. The emphasis in your own conclusions on the fundamental necessity for working with our allies to achieve a more equitable sharing of the burdens of defense and aid, with full recognition of the increased capacity and economic strength of other industrialized nations in recent years, seems to me entirely appropriate. And I also share your view that we can find no solution to our problems by simply multiplying guarantees for dollars in the hands of foreigners.

THE NEED FOR PRICE STABILITY

But there is one sort of "guarantee" that is vitally necessary if we are to maintain the confidence of our friends abroad and successfully achieve our twin goals of domestic expansion and balance in our international accounts—that is a pledge that we will conduct our affairs in a manner that will maintain our recent record of price stability. That is why it is essential that we finance our deficit in a prudent way, with an eye toward the future as well as the present. That is why we need to maintain a flexible monetary policy, alert to developments as they emerge. And, above all, that is why it is so important that labor and business alike, as the stimulus from our tax program takes hold, continue to seek out more efficient methods of production and display restraint in their wage bargaining and pricing decisions.

This process should be greatly facilitated by the new incentives and the increases in after-tax incomes of individuals and business enterprises alike which will be provided by our tax program. It is in this context of responsible citizen action within a framework of effective public policy that tax reduction will be a boon to us all.

Thank you, Mr. Chairman.

Chairman DOUGLAS. Thank you, Mr. Secretary, for your very able statement.

Am I correct in inferring that there are these two general purposes behind the administration's tax proposals:

First, an effort to stimulate the economy so that we may more fully reach our potential and bring a closer approach to full employment; and, Second, to make our tax laws as just as possible? Am I correct in that?

Secretary DILLON. I think that is correct, yes, sir.

Chairman DOUGLAS. And you think the stimulation will result from releasing additional monetary purchasing power that otherwise would not be spent or invested, thus stimulating total demand?

Secretary DILLON. It will come in two ways. I think it will come from that, and it will also come from the effect of rate reductions which will increase incentives for effort and for investment opportunities for profit.

Chairman DOUGLAS. Even though there is already a large supply of savings which are not invested?

Secretary DILLON. Yes.

I think that the advantage will be that if investment looks more profitable—for two reasons, first, because demand is higher and the economy is moving more rapidly, and, second, because of lower tax rates—when this begins to take hold, this supply of uninvested savings, or liquid savings, will begin to be going down.

Chairman DOUGLAS. May I ask if it is not true that without the tax reform proposals, the proposed tax cut would reduce the tax liabilities for the lowest income bracket by approximately 28 percent, those with less than 3,000 of taxable income; and to about 22 percent for those in the $50,000 bracket and over?

I get these figures from page 24 of the President's message printed in House Document 43, and on page 25 in the mimeographed release which was issued prior to printing. It is the third column.

Secretary DILLON. Yes; I see that column. That is correct.

Chairman DOUGLAS. From 28 percent for the lowest income group to 22 percent for the highest income group? In other words, divorced from tax reform, the people in the upper income brackets, or upmost income brackets get almost the same tax reduction, proportionately, as those in the lower brackets?

Secretary DILLON. Yes. It is only modestly different.

Chairman DOUGLAS. And in absolute terms, which is shown in the first subdivision of table 3 at the head of the page, of the total tax reductions of $11 billion, only $410 million would go to the lowest group, or 4 percent; about $1.1 billion would go to those $3,000 to $5,000, or 10 percent; or the two lowest groups, those with taxable incomes of less than $5,000, would get only roughly 15 percent of the total tax reductions even though they comprise about 40 percent of the taxpayers, is that not true?

Secretary DILLON. That is correct.

Chairman DOUGLAS. On the other hand, those with incomes over $20,000, the two higher brackets, would get total reductions of $2.3 billion, or one and a half times as great in absolute amount as the low income groups, and they would receive about 20 percent of the dollar amount of the tax cut.

Secretary DILLON. That is roughly correct, yes.

Chairman DOUGLAS. Yet, they form only 2 percent of the total number of taxpayers.

Secretary DILLON. 2.5 percent.

Chairman DOUGLAS. Now, the degree of progression which is contained within the total program of the administration depends primarily, does it not, upon the tax reform proposals, rather than upon the tax reduction proposals?

Secretary DILLON. Yes.

I think the tax reduction proposals were generally of the same order of magnitude. They were 30 percent in the very lowest bracket and 29 percent——

Chairman DOUGLAS. 28 percent. I mean the tax reform.

Secretary DILLON. I said the reductions were just about the same.

Chairman DOUGLAS. Yes.

Secretary DILLON. Because the reduction from 20 percent to 14 percent is a 30-percent reduction. The reduction from 91 to 65 is 29 percent, and the bulk of rates in between were reduced about 20 percent.

Chairman DOUGLAS. Yes.

Secretary DILLON. So that was——

Chairman DOUGLAS. On the other hand, the so-called tax reforms as indicated in the fourth column at the bottom of pages 24 and 25, respectively, would add a further benefit of 10 percent to the lowest income group and a loss of 13 percent to the upper income group, and that provides for a differential cut of 39 percent for the lowest group below $3,000, 28 percent for those from $3,000 to $5,000, and of 9 percent for those $50,000 and over.

Now, we all went through the experience last year, Mr. Secretary, of the way Congress treated the tax reform proposals of the administration, and, while some people in the administration regarded that as a victory for tax reform, I certainly did not regard it as any appreciable victory for tax reform. Quite the contrary, I think most of the tax reforms were thrown out of the window by Congress.

Now, suppose Congress in its lack of wisdom refuses to put the tax reform proposals into effect. Would you be willing to accept the results of Congress, or would you battle for a reduction in the tax benefits given to those in the upper income groups, since they are the ones who, as a class, not necessarily individually, benefit from the so-called loopholes or truck holes in the tax system?

Secretary DILLON. Well, I think it depends, to some extent, on what individual reforms we are talking about. One of them which undoubtedly will require considerable discussion is the recommendation that was repeated from 1961, the repeal of the dividend credit and exclusion. I think the record shows the way that particular provision applies. By far the greater benefit of it goes to those in the higher income brackets, so that the President specifically pointed out in his message that, if that one was left out, the revenue should be recovered from those in that particular bracket.

Some of the other reforms affect taxpayers more across the board.

Chairman DOUGLAS. What about the depletion allowances on gas and oil which benefit primarily those in the upper income groups?

Secretary DILLON. I think that is true, too. It is our feeling, that most of the benefit there is in the corporate area, and might have some impact on what we could do with the corporate tax generally.

Chairman DOUGLAS. Now, may I ask this question.

Is it not true that a tax cut will have a greater stimulative effect if it goes to those who will spend the cut on consumption items rather than putting it in savings?

Secretary DILLON. I think, from the point of view of the immediate stimulus given to consumer demand, there is no doubt that that is correct. There is this other aspect which we consider equally important, which is the effect of the reduction in rates on incentives.

Chairman DOUGLAS. Is it not true that the upper income groups spend a smaller fraction of their total income and a still smaller fraction of their incremental income on consumption items than the lower income groups, and that, as you go up the scale the propensity to save increases?

Secretary DILLON. That is generally correct.

Chairman DOUGLAS. Therefore, to have the greatest stimulus, a tax cut should go, should it not, in the largest part, to those in the lowest income brackets, who will spend it on consumption items?

Secretary DILLON. Yes, certainly, from the point of view of increasing demand, which is vitally important, that is right.

I keep saying there is this other incentive aspect to the program which we consider highly important also.

Chairman DOUGLAS. Is it not true, then, that if you take the President's program as a whole, it will have this effect, but if you strip it of its reform features, that it will not have this effect?

Secretary DILLON. It will have this effect much more, taken as a whole, than it would otherwise. The larger part of any tax reduction goes to those who are in the lower middle ranges—who would, presumably, be likely to spend—just because they happen to be the biggest taxpayers. That is where we get most of our money from. So any change in that area, naturally, is important.

Chairman DOUGLAS. Mr. Secretary, you know the practical situation which you are likely to face. Everyone will be for the reductions in taxes and want even more, but they will be opposed to those specific features which may hit them.

Now, is it not true that if you take each class as a unit, that they will benefit more by the cuts than they will lose by the reforms?

Secretary DILLON. Oh, very much so, that is correct.

Chairman DOUGLAS. And should this not be constantly brought home in the discussion?

Secretary DILLON. I think I have seen some erroneous reports that certain income groups or certain areas of our social structure—the middle classes and the upper middle classes and those in the upper brackets—might actually be paying more under this program than they do now. It might be possible, and probably would be possible, to construct a few individual cases where that would be true, where taxpayers were receiving all their funds from the oil business or something of that nature. But, taking a class as a whole, and taking a very great majority of taxpayers within a class, it is not true at all.

Chairman DOUGLAS. Thank you very much.

Are there questions, Congressman Curtis?

I wish to announce, with the courtesy of Congressman Curtis, I was permitted to overrun my time by a minute and a half.

Representative CURTIS. Thank you, Mr. Chairman.

Mr. Secretary, in reading your statement, I find no reference to expenditure policy. Is that an accident or doesn't expenditure policy concern the Treasury Department?

Secretary DILLON. No, it concerns it very much, and I think expenditure policy has to be tied in with tax policy.

Representative CURTIS. Would you comment then on what your expenditure policy is and whether or not you feel there is room for expenditure reform? Would expenditure reform be necessary in order to have the tax cut be as stimulative as possible?

Secretary DILLON. I think that that is the case. I am looking here for the words which indicate this. This is the statement in the President's budget message, which is found on page 11, the second paragraph, which indicates that as the tax cut becomes fully effective and the economy climbs toward full employment, a substantial part of the revenue increases must go toward eliminating transitional deficits.

It says:

> Although it will be necessary to increase certain expenditures, we shall continue, and, indeed, intensify, the effort to include in our fiscal program only those expenditures which meet strict criteria of fulfilling important national needs.

The basic point there is that we must not take all the increased revenues which would result from a better state of the economy which in turn would flow from the tax program and turn around and spend them. We must not do that, but instead use part of the increased revenue every year to reduce this very, and unacceptably, large deficit we are running now.

Representative CURTIS. Yes. Attention should be directed by all of the administration officials, including the President, toward expenditure reform or a justification of expenditures. They make no comment at all. In fact, the one comment you make on spending is rather ironical.

On page 18 you say:

> Further savings in Government spending overseas are clearly necessary.

By reading it that way, I would be taking it out of context. I do not believe you are talking about cutting back the foreign aid requests in the President's budget, or am I wrong? I hope you are talking about cutting back some expenditure levels.

Secretary DILLON. Most certainly. I did not know—nothing should be drawn from the fact that I did not devote a substantial portion of my statement to that. The reason I did not was that there is a division of labor here. The Budget Director testified for a whole session before this committee, and I felt that it was appropriate for him to talk about expenditure policy and not for me to repeat it.

But I certainly do believe very strongly that there is a connection and that we do have to be far more careful and prudent in expenditures than we would be if we had surplus revenue.

Representative CURTIS. You will recall I made my comment not because you devoted a substantial portion of your testimony to expenditure reform, but rather because you devoted no attention to it at all.

I might add this is the exact approach the administration has taken in its press releases and the Presidential messages. I might add that if one reviews the testimony of the Director of the Bureau of the Budget, the subject of expenditure reform was avoided as if it were a plague.

Many of us have been saying for a long time that expenditure reform is necessary. We also feel that if the tax cut is to be really effective, it must be combined with a cut in expenditures or at least a holding, of expenditures to previous levels.

Let me go on to another point. You point out that sluggishness of business investment lies at the base of our economic situation. Basically, this is what Secretary Hodges said yesterday, and I agree. But, this is in light of the fact that we have very good liquidity in our private sector, in terms of possible funds for investment. Is that not true, Mr. Secretary? What is your appraisal of that analysis?

Secretary DILLON. Well, I would like, first, to comment on some of the earlier statements about there being no thought about expenditures.

Representatives CURTIS. Mr. Secretary, let me say this. I have only a few minutes to make my points. The administration has been getting its points across constantly so I will be happy to have your remarks in the record. I will be happy to reply to it. But now I was directing my questions to your statement and my observations.

Secretary DILLON. You also mentioned the President's statements.

Representative CURTIS. I certainly did, and I have every time.

Secretary DILLON. Yes.

Representative CURTIS. I am not here, at this time, to discusss administration statements. I have many other questions, but a very limited time. The administration has plenty of time.

Secretary DILLON. I will not have to take any more time, except enough to say I do not agree with statements that have been made, and I think the record should show that. I would be glad to fill in the details later.

Representative CURTIS. That is perfectly proper.

Secretary DILLON. Fine.

Representative CURTIS. I know you take that position. I referred to the record myself, Mr. Secretary, not to be presumptuous. Yesterday I said let people look at the record.

Secretary DILLON. Sure.

Representative CURTIS. My point is that you identify sluggishness of business investment as the base of our problems. So I ask, Is this because of tight investment money?

Secretary Hodges agrees with me and pointed out that we had quite a good liquidity position. In his judgment, it was not a lack of investment funds.

Secretary DILLON. I think I pointed that out in some detail in my statement.

Representative CURTIS. If we break down the liquidity of corporations into components, is there a tightness of funds in areas where there is real growth? Is there liquidity in areas where the market choices have shifted? I know this is true in the aggregate.

Would you say that——

Secretary DILLON. I think it is an accepted fact that small businesses, newly starting businesses, do have greater difficulty in raising the funds that they want and need. We have tried to meet that with certain provisions in this tax program, and any other proposals that would bear on that I think should be given serious consideration, because it is true that financial institutions are less inclined, even when they have funds available, to make them available freely to the newer and smaller businesses than to big, established ones.

Representative CURTIS. Here is another interesting thing. We do have a high interest rate in relation to liquidity. This suggests that we need to look into the components, and it becomes of material importance on the question of whether or not we would increase inflationary pressures through a tax cut. If we actually have these bottlenecks, we should approach them from a specific rather than an aggregate point of view.

Secretary DILLON. I think it has to be approached in both ways, and that is, for instance, why we suggested the reversal in corporate and normal surtax to see if we can provide specific help for small businesses and, as I said, if there are any other specific measures they should be considered. We had some special provisions in the investment credit last year for small business. I think that is very important.

Representative CURTIS. It is my view that taxes are really a very small part of this problem. You point out the real problem. You feel that profit margins under pressure for a period of years is the key here. So did Secretary Hodges.

What are the causes of these pressures?

Secretary DILLON. One of the pressures is lack of adequate demand in relation to the supply that was available.

Representative CURTIS. That is not a pressure for a profit margin, is it?

Secretary DILLON. Oh, yes, it is.

If the companies have a lot of excess capacity that they have to carry, and they are not operating at full capacity, their unit costs are higher and profits are less.

Representative CURTIS. Do you think there is more of a shift in the agriculture sector, for example, where we have the greatest amount of unused capacity? Certainly, it is not consumer demand, or rather, purchasing power that is the base here. It is consumer choice that determines most of this unused capacity. It is a misinterpretation, Mr. Secretary, of what is happening.

Instead of a sluggish, tired economy, we have one that is growing so rapidly that we are creating bottlenecks. We must realize that the market demand for products and services has shifted. The aggregate approach presented by the administration is going to do more harm than good.

Representative REUSS. Mr. Secretary, I would like to talk about gold and the balance of payments.

I thought your analysis of these international problems was very helpful. It seemed to me you were dividing the problem into about three piles, which I find helpful for my own understanding of it.

First, you talk about the balance of payments, and there you say that we simply must bring our so-called basic deficit into balance immediately, if not sooner.

By the "basic deficit," we mean the net balance from exports and imports of goods and services, capital investment both ways, foreign aid, defense, and quite generally, everything except short-term capital movements.

Secretary DILLON. That is right.

Representative REUSS. Then your second category has to do with flows of short-term capital, and there you say, quite properly, that the solution must be some sort of a monetary mechanism, and you tell what you have done in that regard. And then the third problem is that of international liquidity—of having enough reserves—and there, although you do not explicitly say so, I think from our past discussions you probably would agree that this is a somewhat less pressing problem. Up to the present time, dollar and sterling reserves have provided adequate supplements to gold in monetary reserves so that we have not suffered unduly from the relatively small additions to reserves in the form of gold.

Let me talk about that second category, short-term capital flows, the category that, as I view it, really raises difficulties with a full-employment-without-inflation policy at home.

You and other witnesses before us have spoken about the fact that we may need to raise interest rates in order to prevent short-term outflows. This is always tactfully put. You refer to this need on page 16 when you talk about "easing the problems of the monetary authorities should they one day find themselves compelled to deal more vigorously with the balance of payments." But I guess that is what you mean.

Secretary DILLON. That is exactly what I mean.

Representative REUSS. This disturbs me, as, no doubt, it disturbs you, because, no matter how tactfully we put it, raising interest rates will hinder our reaching the goal of domestic full employment and maximum growth without inflation.

There is no doubt tbout that, is there?

Secretary DILLON. Well, it depends on overall interest rates. Certainly, in the short-term area last year our rates were somewhat higher on short-term Government paper, and that did not have any effect on the overall interest-rate structure. The longer term rate structure actually was somewhat lower. Of course, that cannot continue indefinitely. It is a function of the demand for capital, the supply and the amount of movement in the short-term rate.

Now, certainly, if you have a very modest change in short rates, I could conceive of that not having any effect on the economy. On the other hand, if there is a very sharp change in the whole structure of interest rates, you are absolutely right, it would have a very, very severe effect.

Representative REUSS. I was talking not so much about the recent past, where—I agree with you and not with others—this economy has not basically suffered from a shortage of money or from grossly high interest rates. I am talking, however, about the future. It is repeatedly said by some among the monetary authorities, when asked whether they are ready to defend the dollar by higher interest rates, "Yes, they are ready to go." This worries me, because it seems to me that we ought to have a better system than defending the dollar by high interest rates and a restrictive money supply at a time when we are a long way from full employment.

I, therefore, would like to ask a question, without seeming to be ungrateful for what the Treasury has done recently through currency swaps, debt prepayment, holding down speculation in the London gold market, and so forth. The fact is that we still do not have a monetary mechanism which allows this country to pursue at home the best methods of reaching full employment without inflation. We have not attained that, and you, yourself, in your testimony, have indicated that.

Secretary DILLON. Yes, I think there is some possibility that one can say that. The fact is, however, I think we now feel that we probably have not been using the best methods for attaining reasonably full employment and faster growth; that the tax weapons probably should have been used sooner; and that it is impossible to achieve faster growth—the record of the last year seems to show that it is impossible to achieve further growth—just with adequate supplies of money, with easy money. You have to supplement that with something else. Maybe, if we had done that sooner, the strains on the balance of payments from the monetary point of view would not have continued so long, and the monetary system might be considered fully adequate.

I do not think that you can get other countries to agree to a monetary system that will leave us completely free to pursue a policy which they would feel was totally wrong—that is, say, to try to use only monetary means of domestic expansion and not any other means—for a period of a long time, without very good results; they would not want to underwrite your policy.

Representative REUSS. Of course, Mr. Secretary.

What I am asking is the following:

Why do we not propose to our friends and allies, the leading industrial countries of the world, that they do for us what we helped them to do in the 1950's, when they formed the highly successful European Payments Union? At the very least, such a payments plan would offset short-term capital flows, whether due to speculation, the needs of trade, or differential interest rates, by credits with some degree of automaticity.

I cannot see any reason why they should not do for us what we were willing to do for them. If it be said that certain countries, perhaps France, may not be willing to go along, then I think we would, nevertheless, be well advised to try to get the maximum number of countries to participate in such a plan.

Anything we can do in this regard will provide, it seems to me, necessary elbow room to go forward with domestic policies for full employment without inflation. Certainly, these domestic policies include, in addition to expansionary fiscal measures, a policy of adequate money and reasonable interest rates.

I hate to think that we are going into the years ahead of us with one arm strapped behind our back, when I do not think it is necessary that it be so strapped.

What about that?

Secretary DILLON. I would say on that, Mr. Reuss, we think we have made considerable progress with this—I mentioned this new IMF borrowing arrangement. While it is not fully automatic, we think we have very good assurance that, if need arose, it could be used in just this particular area.

Now, we obviously would, from our point of view, be pleased if that agreement had been fully automatic, but it was the feeling of the other countries who were putting up twice as much as we were—and this was really helpful to us—that that was something that they were not yet prepared to do. They want to have this chance to sit down and talk about the situation and understand what our policies are.

So, to say that we could have gotten a fully automatic thing at that time, we know from experience and our effort that that was not possible.

One other thing is that the international monetary mechanisms are so closely related that these countries look very carefully at each other, and there is a very strong feeling that none of them will differentiate themselves very sharply from each other. So if one country that is in a very strong position says they will not make an agreement to help, the result has been that the others are not ready to, either.

So what has to be done, at least among the strong countries, is to obtain a consensus, and that consensus is necessarily somewhat limited by those who are the least ready to go all the way.

One thing about this short-term flow I think we should bear in mind—it is a technical thing, but I think it ought to be in the record—is that there is pretty much of a certainty that a portion—no one can measure the exact portion, but it may be a relatively substantial portion—is connected with direct investment abroad. It is just going through this short-term channel first for a period of months or a year, a period of time, from which it will then flow on over and be used by the corporations who send their money abroad for direct investment.

So I do not think that the short-term problem, in the sense of sensitivity to interest rates or things of that nature, is as big as the short-term figures that we show, because I think some of these errors and omissions are of that type.

Representative REUSS. Thank you. My time is up. I would just leave with you the final thought that, while it is true that a year and a half ago you were valiantly getting the best agreement you could following the Vienna negotiations, the European countries did act in concert and they chose the least common denominator among alternatives for a supplemental credit agreement.

I suggest that maybe the events at Brussels of the last few days may have changed this situation. We might now do a little better if we did not try to include every country, or at least if we said we want to include only those who are willing. If people like our French friends do not want to be included, then we should get the other 95 percent on our side.

Chairman DOUGLAS. Unless the members of the committee disapprove, I would like to make a slight change in procedure. The rules of the Senate provide not only for a limitation of 10 minutes in the questioning by each member of the committee, but also that the questions move in order of seniority on the committee.

This would normally mean I would call on Senator Javits of New York, but, with his full cooperation and in view of the fact that Senator Miller has been here since the beginning, I am going to call on Senator Miller.

Senator MILLER. Thank you, Mr. Chairman.

Mr. Secretary, the keynote of most of your statement regarding the tax-cut program seems to be maintaining price stability and maintaining purchasing power or boosting purchasing power. If that is so, I am concerned because of some of the figures I find in Economic Indicators published by Dr. Heller's committee.

In your statement you point out that you estimate a net revenue lost of $2.7 billion for fiscal 1964. I want to ask you first is that what we are talking about, that figure, when we talk about a tax cut for fiscal 1964?

Secretary DILLON. That would be the net effect in fiscal 1964 if the program is adopted as recommended, allowing for the additional revenues generated by the stimulus to the economy from the tax cut.

Senator MILLER. This, I assume, is premised on $2.7 billion of purchasing power being transferred out of the tax area into the pockets of consumers and businesses, is that correct?

Secretary DILLON. Partly that, but I would just like to make one point. I don't agree that our theory and my statement are limited to increasing purchasing power and to price stability, although those are in it. Actually, I think the key is the statement where I said that, "A broad concensus has developed among leaders of all sectors of our economy that fresh incentives for investment, for risk-taking and personal effort, supported by release of purchasing power through tax reduction are needed." So I think this is the practical means for moving ahead, and that we have embodied that consensus in our program of tax reduction and reform. We believe there is equal importance in both the incentive effect of rate cuts—both on individual initiative, on risk-taking, on individual effort—and the direct effects on demand. I just want to get that clear.

Senator MILLER. But that incentive is premised on maintaining increased purchasing power, is it not?

Secretary DILLON. Certainly, I think an increase in purchasing power is an important element in it.

Senator MILLER. Now we have that point cleared up.

In the Economic Indicators for January, on page 2, if you will compare the increase in gross national product for 1960 up to the third quarter of 1962, you will find we have an increase in gross national product of $51.9 billion.

But over in the first column Dr. Heller's committee has reflected this in terms of 1961 prices. I wish they had done it in terms of January 1, 1961, prices but they took the average for the whole year, and that shows a net increase in gross national product of only $37.7 billion. The inevitable conclusion is that during this 21-month period, inflation or loss in purchasing power, has cost the American people over $14 billion.

If you project this on through eight quarters you come up to about $16 billion, and that is about $8 billion a year of what many people call inflation tax, which is about 12 percent of the annual revenue collections in your department.

Now this concerns me because if we go into fiscal 1964, and have another $8 billion loss in purchasing power, that will so far offset the $2.7 billion in net tax cut that you refer to in your statement that I am afraid we are going to be going backward rather than moving forward, unless we do something about checking this inflation.

Do you have any comments on this?

Secretary DILLON. Well, the question of inflation is a very difficult thing to get a sharp answer on. Certainly the stability of the last 5 years in wholesale prices, which relates primarily to manufactured products and relates to our exports, has been remarkable. The index has been completely stable.

On the other hand, the consumer index, which reflects prices of services, has shown a steady increase. There is also some question as to whether all of this increase is real, or whether some of it may not also reflect improvements in quality.

The basic thing that you are talking about is the price deflator for total GNP which is the last column across there, the increase was about 1½ percent in the third quarter of 1962 as compared to the whole of 1961, on the average.

This, of course, does reflect the prices of services. It also reflects Government payrolls and Government wage rates. I would think that as a result of that, and in view of the Government wage increase that was passed last year, and is now going into effect, to bring Government pay into line with civilian pay, there will be a further increase in that index in the next year or two. We seem to have been going along at about a 1 or 1½ percent clip for some time. I don't think it causes us a loss in revenue, and it doesn't seem to be translated into the basics of wholesale food prices or wholesale prices generally.

So, how much it really has affected individuals and how seriously is hard to say, but certainly we would like to see it totally eliminated. All I can say is our record is probably the best record of any major country in the world in the last few years, save only Canada which is moving right along with us at about the same level.

Other countries are having much bigger inflation, and that is one reason why we hope that our export situation will improve, because our price relationship with other countries is better now than it was 3 or 4 years ago.

Senator MILLER. Let me say that I am interested in wholesale price indexes but I am infinitely more interested in the retail price index because that is what the average taxpayer gets hit with.

Do you think that we can have a properly managed deficit without keeping the implicit price deflator stable?

Secretary DILLON. Well, I think we have been able to do it in the past year with the increase of 1½ percent. But certainly this index is a measure of inflation, and if you do have inflation it will go up rather rapidly.

Also, I am pointing out that a 1½ percent use in this particular deflator is a far better record than is generally available in the world, although I would be much happier if it were zero, as you say. I think every effort should be made to keep it there. But, because of the fact that service industries do not respond—the relationships between wages there and productivity increases—in quite the same way as in manufacturing, I think it is likely that there will be continued upcreeps in the GNP deflator. Manufacturing wage increases can be offset by new machinery, by automation, by better productivity. And, while that is true to some extent also in the service industries, it is much less true for a doctor or something of that nature. So, if their income is going to keep parallel with the rest of the economy, there is bound to be a certain amount of increase regularly in the GNP deflator, unless prices in the manufacturing area are actually going down slightly to compensate for this other increase. You could arrive at that point, but it is not very likely.

Senator MILLER. Then you think we could maintain a balance of zero on this deflator?

Secretary DILLON. I think it is conceivable but not likely. I think it would be reasonably satisfactory if we could maintain the present record, which is about 1½ percent in that particular index.

Senator MILLER. Thank you, sir.

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Chairman DOUGLAS. At the suggestion of Senator Sparkman, I am going to make another variation and ask Senator Fulbright to continue the questioning.

Senator FULBRIGHT. Thank you, Mr. Chairman.

Mr. Secretary, first, I would like to congratulate you on this reform in the corporate tax rate. I think it is a very progressive step and a very useful one. I hope it is adopted.

I wonder if I might ask whether your statement was prepared prior to the rejection of the United Kingdom by General De Gaulle of entry into the Common Market?

Secretary DILLON. It was prepared, I think, originally prior to the definitive results and I don't think we saw any reason to change it as a result of that, because time is too short to be able to assess just what the results of that far-reaching decision may be.

Senator FULBRIGHT. The effect, however, upon our exports could be very serious, couldn't they, if the Common Market as now constituted turns more inward as apparently this action indicates? Actions which they have already taken with regard to some of our exports confirm the possible harm of such inward thinking. They have already taken some very drastic action restricting, for example, our poultry market, and if the present regulations are retained or strengthened they would with one stroke have destroyed a rather substantial export of ours, wouldn't they?

Secretary DILLON. Yes, I would certainly say if we assumed that this means that the Common Market is going to turn to a more inward-looking trade policy, it would be difficult. It would have repercussions all over the world, because there is such a great trading group there that we would presumably have to do something similar ourselves and the type of policy we have been pursuing all these years would be gravely affected. I quite agree with you that in the agricultural field there have been actions taken that are distressing as far as we are concerned.

I am not entirely sure though, that this break over the British application to join the Common Market will necessarily push the rest of the members, over the coming years, into a more restrictive policy than they would have taken otherwise.

Senator FULBRIGHT. The action I referred to was taken before the break.

Secretary DILLON. That is right.

Senator FULBRIGHT. And we have done our best—George Ball, Under Secretary Ball, and others—to persuade them to change it. This break only fortifies their apparent determination to continue this policy. My only point is that it may be that your estimate of the probabilities in export markets might be overly optimistic which would, of course, bring into play some of the other matters which you mentioned with regard to the control and influencing of our exports. Isn't that true?

Secretary DILLON. I think that is true. If the Common Market becomes more restrictive to exports from the United States, it could have very serious effect which would require a new look at our whole trade policy.

Senator FULBRIGHT. Since you have been an Under Secretary of State you have sort of a dual capacity here. I don't wish to press you, but my committee will be confronted with foreign aid in the very near future, and it strikes me that some of your suggestions would give tentative approval to reconsideration of such expenditures of foreign aid as well as military expenditures abroad.

Secretary DILLON. Well, I think we have got to look at foreign aid basically, with a very careful eye as to what is in the direct interests or security interests of the United States, and to make those expenditures that clearly meet that criterion and be very careful about other ones.

Senator FULBRIGHT. Which leads me to just one other point: As Secretary of the Treasury, do you feel that it is your responsibility to evaluate the nature of the expenditures in the budget with regard to their impact upon the future development of our economy?

In other words, your proposal in the tax program is a long-term one. As I understand it, you don't foresee a balanced budget, even if all of this is accepted, prior to 1966 or 1967. That is a long time.

Secretary DILLON. That is correct.

Senator FULBRIGHT. It occurs to me that 62 percent of our budget will go to military and space activities which are not generally considered the most productive ways to invest public moneys; are they?

Secretary DILLON. Certainly not as far as the long-term economy is concerned.

Senator FULBRIGHT. Is it proper for the Secretary of the Treasury to evidence an interest in expending these moneys in a little more productive manner, such as urban renewal, or education or roads or resource development?

Secretary DILLON. Well, from my point of view, I think I would obviously like to see something of that nature, and I would also like to see some expenditures reduced and the money used for reducing the deficit we presently have. But I think it is obvious that the basic question of what is needed to meet our national security in the present-day world is a question that probably transcends all others because the existence of the country is at stake. Those decisions have been made and are made by the President, in consultation with the State Department and the Defense Department, although he does take into account, certainly, the basic economic needs of the country. He is really giving priority to those this year because of the feeling that a strong economy here will make us stronger in meeting our world needs.

Senator FULBRIGHT. Well, does this kind of expenditure really strengthen the economy?

Secretary DILLON. I don't think it does in the long run.

Senator FULBRIGHT. That is one of our troubles.

Secretary DILLON. This kind of expenditure.

Senator FULBRIGHT. It doesn't really contribute to the strengthening of the economy in the long run. It gives a short-term shot in the arm to a particular community but it does not increase the long term.

Secretary DILLON. And as our military and space spending projects go on, I think they probably give less general employment than other types of expenditures, because they are now in such highly sophisticated weapons that projects don't require as many people. They do not involve so broad a range of the economy as military expenditures used to. So I think even the immediate stimulus is not as much as it might otherwise be.

Senator FULBRIGHT. It would seem that way to me. I was amazed at the extent of the increase in space expenditures which is percentage-wise far greater than any other single item, and the very meager increase in expenditures for such things as education or resource development. I believe space goes up to an authorization of $5.7 billion which amazes me.

Secretary DILLON. The space program——

Senator FULBRIGHT. I find it very difficult to accept it.

Senator DILLON. The space program is one that has been accepted heretofore unanimously, as far as I know, by Congress, and pretty much so by the people.

However, maybe they didn't realize how rapidly these expenditures were going to increase to achieve the goals that they were ready to agree were right.

Senator FULBRIGHT. I certainly didn't realize it. This came as a great shock to me, the way this had burgeoned.

Secretary DILLON. Well, the earlier talk of it costing so many billion dollars to——

Senator FULBRIGHT. Go to the moon.

Secretary DILLON. Go to the moon involved something like this. Maybe they found it slightly more expensive than they thought originally, but it certainly is a matter that should be the subject of a national consensus. It is a tremendous expenditure and a tremendous weight on our budget.

Senator FULBRIGHT. I have one more minute, I think. I wonder if you would comment briefly about the Government-wide control systems for international transactions and so on within the Budget Bureau. Your interest rates have already been discussed. What other Government-wide controls do you have in mind? Are there any more at all or should there be?

Secretary DILLON. What we were doing there, what I referred to, is an accounting procedure and a forecasting procedure that was newly instituted last year and getting underway now. The Bureau of the Budget requires quarterly reports from the departments and quarterly projections over the coming year of the amount of expenditures they make which enter into the balance of payments. Having gotten those, they then sit down and determine whether there are feasible administrative ceilings, and the Budget Bureau will give these ceilings back to the departments. The departments would try to meet these ceilings just the same way they have to meet budgetary ceilings. But these are ceilings based on foreign exchange payments.

Senator FULBRIGHT. Thank you, Mr. Chairman.

Chairman DOUGLAS. Senator Javits.

Senator JAVITS. Mr. Secretary, glad to welcome you here again at your annual pilgrimage.

I, too, would like to inquire about General de Gaulle's action which, it seems to me, shatters the hopes of a great deal of mankind, at least for the moment, and engenders new fears, quite justifiable ones. I notice you speak on page 19 of your statement of "Further moderate outflows can be expected in the coming weeks and months, relating to gold and our balance of payments."

Do you feel you have any reason to revise that now in the light of the shock to the world which General de Gaulle has administered?

Secretary DILLON. Well, the immediate effect—I don't know, one can't tell what the long-term effect will be—I think the immediate situation, has had a side effect that is generally helpful to our balance of payments. This is the time of year when sterling is usually strong, and usually when that happens, and there are substantial gains in London, the British follow their policy of converting foreign exchange into gold. Sterling has not been strong as a result of this new development, and so the British face, at least temporarily, quite a different situation.

There also is a broader aspect of this which has been immediately noticed by many of the monetary people—the European ones—who have reported their feelings to us as this situation developed. In this situation, the longer term prospects of investment in the United States look much better compared to Europe than they did in the picture they were looking at before, with a unified Europe moving ahead.

Here you have a split in Europe and you have a potential split even within the Six, and their busines also has not been moving ahead as rapidly. There have been pressures on prices in Europe and on profits in the last year or two, which has reduced the attractiveness of investment there. This new situation, compounded on top of that, may well lead to quite a reduction in capital outflow from this country for investment there, and might lead to an inflow of European capital, thinking it is more attractive here.

So it could be helpful to our balance of payments, at least initially, and also in the capital area.

Senator JAVITS. I have seen the speculation that General de Gaulle would engender a call upon us by the European central banks which would rudely shock our system, which is very heavily subject to such call, is it not? This is a very serious question we face.

Secretary DILLON. Certainly, if all of the European central banks wanted at the same time to transfer all their dollar assets into gold, it would be very serious, but it would be not only serious for us, it would be serious for them, because the dollar is the basis of world trade. Their monetary systems are closely intertwined in that way with the dollar. Anything that hurts the dollar would deal a very severe blow to international trade as a whole and would hurt them also. It would be problematical who would be hurt the most.

Senator JAVITS. Mr. Secretary, do you contemplate or does the administration contemplate, seeking assurances from the other members of the European economic community that they will not follow a French lead, and draw on us heavily?

Secretary DILLON. Well, we haven't felt that that was necessary because we have seen no sign in anything that we have heard from the French that they have any such intention.

Obviously, you mentioned it as a possibility, but our financial relations with the French have been of the best right along, and there is no indication of any change.

We do talk with all these European financial authorities constantly, and naturally if there was any indication of something like that coming up, we would all know about it at the same time and it would be a subject of discussion.

Senator JAVITS. Now, Mr. Secretary, turning to another phase of the same subject, the Trade Expansion Act of 1962, your statement makes it very clear that one of our major objectives is a sharp, as you put it, step up in our export expansion program.

The Trade Expansion Act would inhibit now rather free trade negotiations with the European Economic Community on many items in the absence of Britain. Indeed, Senator Douglas and I fought a losing fight to anticipate exactly such an eventuality and we are now reduced to the unhappy alternative of reintroducing our amendments, and I pay a special tribute to Senator Douglas, my colleague for his foresight in the committee even before it got to the floor, where I had a chance to get at it.

Do you contemplate or do you think we should contemplate some revision or request to the Congress for a revision of the Trade Expansion Act so that we may offer the sorely pressed British and the Commonwealth, which is critically important—Canada, Australia, New Zealand, and the other members of the Commonwealth—some alternative to the fact that they have been set adrift, as it were, in a very important sense and, also, I think suffered a very, very serious blow to their prestige in the world.

Secretary DILLON. I think from the point of view of trade policy, Senator Javits, this is a highly complex matter which is directly, of course, in the hands of the State Department and the Commerce Department.

The State Department, I know, is in conversations regularly, every day now, with these different countries to find out what their policies are likely to be. My own feeling is that it is premature to know what would be in the best interests of the United States, whether it would be in the best interests to evolve some new, totally new approach, or whether there are possibilities of proceeding along the lines of our present program.

Of course, Governor Herter, as you know, is abroad now and he has not yet come back. He has this particular assignment which is to talk, not only with the continental countries, but also with the British, as to what they see the possibilities are under the Trade Expansion Act. Certainly if it looks like something additional is needed, I am sure he will recommend it when he gets back, after discussion with the State Department.

But I think it is just too early to offer an opinion.

Senator JAVITS. If I may get the attention of the Chair, would the Chair consider it appropriate to have a request made—I am glad to make it on the record now—of State, Commerce, and the Treasury as to their policy upon this matter which I have just referred to when, as, and if they are ready to give us some conclusions as to their policy, because I cannot conceive of our not reacting, which is the thrust of my question.

How are we going to react to this, aside from the unhappy statements that the President and so many of my colleagues, including myself, have made upon this subject? How are we practically going to react? I think that has a great bearing on the economic report, and on how we are going to carry out the intent of the Employment Act, which we are especially designated to consider.

So, I hope the Chair would allow me to make that request, and to include Mr. Herter, if that is permissible.

Chairman DOUGLAS. Personally, I think it is a very sensible suggestion. Unless there is objection——

Senator MILLER. Mr. Chairman, I was wondering if it would be feasible to include the Secretary of Defense in that, too, because of the very definite relationship between the NATO situation and this whole problem.

Chairman DOUGLAS. I may be conservative in these matters but I thought this was so sensitive a field that I would not like to have that put on paper.

Senator JAVITS. Mr. Chairman, I have made the request. I think if Senator Miller wishes to add the Defense Department, perhaps we ought to consider that separately.

Chairman DOUGLAS. Would you like to move that as an amendment?

Senator MILLER. I am not going to press this. But it seems to me that there is a definite relationship between military assistance programs in the NATO countries and the whole problem.

Chairman DOUGLAS. We have the No. 1 and No. 2 men of the Foreign Relations Committee.

Senator SPARKMAN. Why not just ask through the Secretary of Treasury that the administration give us a report on that.

They can pull together——

Senator JAVITS. I agree; I think that is excellent.

Senator SPARKMAN. They can pull together such people as are necessary.

Chairman DOUGLAS. Will you raise the question?

Senator JAVITS. I think what we want is administration policies as they affect the Trade Expansion Act of 1962 and other aspects of our relationships with the European Economic Community, the United Kingdom, and the British Commonwealth and the European Free Trade Association. To follow Senator Douglas' lead; how are they affected by the rejection of Britain's application for membership and—when, as, and if ready—what are our intentions in those respects in order to meet this new situation ? (See p. 324.)

Secretary DILLON. I will be glad to see what we can get.

Senator PELL. May I interrupt here?

Chairman DOUGLAS. Senator Pell.

Senator PELL. I wonder if that question could also cover a consideration of Majority Leader Mansfield's record submitted to the chairman of the Foreign Relations Committee on Monday of this week which had some ideas on what should be done if the action we feared happened.

Senator JAVITS. May I say to Senator Pell that is so uniquely in Senator Fulbright's province, unless he wished to add it——

Senator FULBRIGHT. We already have that report. It is available for everyone and I think the Administration necessarily would take that into consideration.

Senator JAVITS. Thank you, Mr. Chairman.

Chairman DOUGLAS. Without objection, the request will be made.

Senator JAVITS. If I have 30 seconds, I just wanted to say to you, Mr. Secretary, that one of the subjects I have been developing with the witnesses insofar as I have been able to be here, with other commitments, is the question, much as I favor a tax cut, as to what you have to add to it to do the job which the President and all of us, without regard to party, want done and I urge for your consideration the need for legislation dealing with strikes, the need for legislation dealing with the transition to prevent hardship on workers in respect of automation, the need for reconsideration of the antitrust laws, and the need for labor management cooperation, incidentally recommended by a committee on stimulating exports headed by Messrs. Wirtz and Hodges.

I just leave those thoughts with you.

Thank you, Mr. Chairman.

Chairman DOUGLAS. Senator Sparkman.

Senator SPARKMAN. Mr. Secretary, I want to ask you about one thing in your statement. This has to do with our loss of gold.

You say last year's deficit resulted in gold loss of $890 million as compared to $857 million in 1962.

Secretary DILLON. That was a misprint.

Senator SPARKMAN. Does that mean 1961?

Secretary DILLON. 1961. It is a misprint, it should be 1961.

Senator SPARKMAN. I thought it must, but I was a little puzzled by it.

Secretary DILLON. I wanted to get my statement corrected for the record; it is 1961.

Senator SPARKMAN. Mr. Secretary, you have been comparing with 1961 but it is a considerable decrease from years preceding that, isn't it?

Secretary DILLON. Yes; it is. A few years before that it ranged as high as a billion and a half dollars. Actually it was——

Senator SPARKMAN. I believe the highest year it approached $3 billion, wasn't it?

Secretary DILLON. That is about right.

Senator SPARKMAN. 1958, 1959.

Secretary DILLON. It got over $3 billion. I can give you the exact figure.

Senator SPARKMAN. I think it would be helpful if you would supply for the record a statement, a table, that shows the loss of gold over the past several years and also a statement regarding the deficit in the balance of payments. The reason is that I hear repeatedly the statement about the gold reserves being at an all-time low. Of course, every month we lose gold, it goes down to a new record, doesn't it?

(The following was later received for the record:)

U.S. overall balance-of-payments deficits and reductions in U.S. gold stock, 1958–62

[In millions]

Year	Payments deficits	Reductions in U.S. gold stock
1958	3,529	2,275
1959	3,743	[1] 1,075
1960	3,925	1,703
1961	2,461	857
1962	[2] 2,000	890

[1] Includes gold subscription of $344,000,000 to the International Monetary Fund.
[2] Preliminary.

Secretary DILLON. It goes down to a lower figure than we have had for some time.

Senator SPARKMAN. A new low?

Secretary DILLON. Not an alltime low, but since the late thirties when we had this tremendous increase.

Senator SPARKMAN. Yes. The point I have in mind is that starting back in 1958, 1959, there has been a steady improvement in that situation; is that not true? Starting with that high year, I have forgotten what year it was.

Secretary DILLON. The high year was 1958, and there was a sharp improvement in 1959, and then a sharp——

Senator SPARKMAN. Very slight increase the next year?

Secretary DILLON. Quite a substantial increase.

Senator SPARKMAN. Was it?

Secretary DILLON. In 1960. It wasn't back more than halfway. The figures are $2,275 million for 1958, $1,075 million for 1959, $1,700 million for 1960.

And then $857 and $890 million, so it is cut in half in 1961, and maintained roughly there in 1962 from the 1960 level.

Senator SPARKMAN. Yes.

Now, in recent months it was stated that, the economists, both of this country and, I think, the Executive Director, Per Jacobsson, of the International Bank——

Senator FULBRIGHT. No, IMF.

Senator SPARKMAN. IMF, in fact, I heard him make the statement that he believed that by the end of 1963 we would bring that outflow into balance.

Could you tell us what change, if any, has been made since that time as to the outflow or could you give us a prediction at this time?

Secretary DILLON. No, I think it is very hard to predict a time period for these things.

I think it is our view, and I think this view is shared by all serious students of the problem—we have consulted a great many of them ourselves, including Mr. Jacobsson—that the broad trends in our balance of payments are operating, are tending to operate, in our favor. When you try to set a time limit, whether it is the end of 1963 or the end of 1964 or even the end of 1965, as the moment that you will pass the point of balance, that is a very difficult thing, and I don't know whether it is actually a very fruitful thing. We have got to make every effort to get there as fast as we can, taking advantage of these broad trends in investment flows, and in prices abroad and here. I think that there is a study made in quite some depth of this problem by the Brookings Institution, and they are apparently coming to essentially the same conclusion. I think they set the date a little later than some of the figures we have done—they said 1965 or 1966.

Dr. Bernstein, one of the greatest and most competent individual expert in this field, sets it at about some time during the year 1965. Mr. Jacobsson set it in 1964, when he said at the end of 1963.

I would say that looking at the situation that we are in today, we have still quite a way to go, and that it looks like it would be difficult to meet the goal that has sometimes been expressed, of reaching complete equilibrium by the end of this year. But I certainly would expect that we will continue our improvement, and we hope balance will come in 1964 some time, or not later than 1965.

I think the prospects are very good for it.

Senator SPARKMAN. Yes.

Mr. Secretary, I want to say just a word about the corporate tax structure that you propose, and particularly the reversal of the basic and surtax rates. I want to join Senator Fulbright in commending you for making that proposal. I believe you know it is a proposal that many of us in Congress have advocated for a long time.

The Senate Small Business Committee has advocated it; I have introduced bills on it; and one year Senator Fulbright almost got it written into a bill in the Senate.

I think, and I wonder if this is your opinion also, that this change will be of tremendous benefit to the smaller companies and the newer companies that are trying to get a start?

Secretary DILLON. Most certainly, because the great bulk of our corporations, some 475,000 of them, out of a total of maybe 580-odd thousand, are in the category that have earnings of $25,000 and under. Their earnings would fall entirely in this category so it would be very helpful to them.

Senator SPARKMAN. What was that percentage again?

Secretary DILLON. Well, it is over 80 percent, or about 80 percent.

Senator SPARKMAN. It seems to me I have seen the figure 81.4 percent, is that right?

Secretary DILLON. I certainly would defer to you, Senator, because you are the expert in this field. That is right.

Senator SPARKMAN. I raised this question the other day with the Director of the Budget when he was here. That had to do with the sale of home mortgages held by FNMA.

I believe FNMA holds between $2 and $3 billion worth of mortgages.

Now, experts in this field have suggested to me that this would be a very good time to carry on, and I don't mean to dump those mortgages, but to have an aggressive selling campaign of those mortgages and it might bring into the Treasury some very badly needed funds.

You are a member ex officio of the FNMA Board, are you not?

Secretary DILLON. That is right. Actually the Under Secretary for Monetary Affairs, Mr. Roosa, generally follows that and attends those meetings.

Senator SPARKMAN. Senator Fulbright suggests I had better use a different name than FNMA. Of course, I am referring to the Federal National Mortgage Association.

Secretary DILLON. That is correct.

Senator SPARKMAN. I will not question you further on it but I would suggest to you that serious consideration be given to that because I think it might be helpful. This policy was suggested to me also a few days ago by an official of the Veterans' Administration who told me that the VA-guaranteed mortgages have been selling quite well recently.

Secretary DILLON. That is correct.

Senator SPARKMAN. Apparently, they have been selling a great many of them.

Secretary DILLON. As you know, in the current budget document there is reflected an intention to try to move in that general direction more aggressively than has been the case in the past so we agree with your suggestion.

Senator SPARKMAN. There was another question I raised with him, I am not sure that we came to any satisfactory conclusion, but it had to do with the possibility of changing certain operations from the public to private sector. One item that I specifically asked him about was the sale of the handling of farm home mortgages.

There is a program today. In the President's message it calls for an authorization of $400 million for farm home loans, mortgages, and it recommends that $50 million be direct loans by the Farmers Home Administration, and that the other $350 million be covered with an insurance plan.

Now, I raised the point that we have had an insurance plan on farm home mortgages for a good many years, but I don't think it has worked, and I personally would like, if we could, to have a statement for the record from somebody giving us an account of just how this is planned so it will work when the other has not been working so well.

Secretary DILLON. We would be glad to furnish that in detail. I know generally that there is a third matter involved there of making these mortgages discountable or purchaseable by FNMA, which hasn't been the case in the past. They felt that that would give the insured mortgage a market they didn't have in the past but I will be glad to furnish a detailed description of what the proposal is and why it is expected to work.

(The following was later received for the record:)

The Secretary of Agriculture has transmitted to the Congress a draft of a bill, to amend title V of the Housing Act of 1949 and the Federal National Mortgage Association Charter Act, in order to provide for insuring rural housing loans and market assistance thereof, and for other purposes. This proposed legislation has been referred to the Senate and House Committees on Banking and Currency (Congressional Record, Senate, Jan. 22, 1963, p. 704; House, Jan. 24, 1963, p. 992).

The National Housing Act as amended (sec. 203i) presently authorizes the Federal Housing Commissioner to relax some of the normal Federal Housing Administration requirements in insuring certain rural housing loans. However, the larger private lenders have been unwilling to make any significant volume of such loans primarily because of the relatively high expenses for mortgage origination and servicing in rural areas. In addition, the liquidity requirements of rural lending institutions and their lack of familiarity with the Federal Housing Administration programs have limited their participation. The draft bill, however, provides that Farmers Home Administration may originate and service insured rural housing loans as it has done under its direct loan program. Originations would be financed through a revolving fund to be known as the rural housing insurance fund. Other provisions of the proposed legislation include a more realistic interest rate, authorization for sales at market prices, and provision for use of the secondary market facilities of the Federal National Mortgage Association. These provisions are expected to improve the marketability of rural housing mortgages and to permit the substitution of private credit for direct Federal loans to avoid substantially increased budget expenditures which would otherwise be required to meet demands.

The proposed bill leaves intact the present provisions of title V relating to direct rural housing loans under section 502. This authority will continue to be used during the transition to the insured loan program to assure that rural housing mortgage money will continue to be available in adequate quantities. As the insured loan program becomes operative, however, the section 502 direct loan authority would revert to a standby status.

Senator SPARKMAN. Thank you very much. My time is up. Thank you, Mr. Chairman.

Chairman DOUGLAS. Senator Proxmire.

Senator PROXMIRE. I want to pursue another line of questioning, but I want to say I concur fully with what has been said about reversing the basic corporation income tax and the surtax income tax. Even if we did nothing else, if we did that, (*a*) it would not substantially reduce revenues, and (*b*) it would provide a great advantage for small business.

Secretary DILLON. It is about $450 million in cost.

Senator PROXMIRE. It would be a cut but it wouldn't be in the nature——

Secretary DILLON. It wouldn't be in the nature of a big program at all.

Senator PROXMIRE. On the FNMA sales, I do hope if there is an aggressive selling job, if there is such a selling job of half a billion dollars to a billion dollars of FNMA, that the full economic effect will be considered and analyzed, because it seems to me——

Secretary DILLON. Yes.

Senator PROXMIRE (continuing). If the Government sells this large number of mortgages it certainly tends to drive the price down and interest rates up in the mortgage area, which can have a most unfortunate economic effect.

Secretary DILLON. I think you can only sell them when the demand is there, and any aggressive action that would bring about results such as you talk about would be undesirable. But I think the question is whether there isn't a demand for this paper in the present circumstances, when there seems to be a relative lack of demand for new corporate financing, for instance, and money is seeking outlets. There may be money that just has not been able to find an adequate outlet, and would buy some more of these than in the case in the past.

Senator PROXMIRE. Of course, home construction is so enormously important in the field of employment.

Secretary DILLON. That is correct. We shouldn't affect that.

Senator PROXMIRE. We should do everything we can to encourage a downward drift in interest rates, not a rise.

Secretary DILLON. That, of course, has happened to our home mortgage rates in the past year, and we think that is one of the real reasons why home construction was so good last year.

Senator SPARKMAN. Would the Senator yield for me to say—long enough for me to say I am in complete agreement. Of course, it would have to be an orderly disposal and only as the demand would justify.

Secretary DILLON. Yes.

Senator PROXMIRE. Mr. Secretary, you and Mr. Martin are the two most powerful men in deciding the manner in which this deficit is going to be financed, and I think the manner in which it is going to be financed is critically important in terms of any stimulating effect we might get from the tax cut.

I feel that if it is financed in such a way as to increase the propensity to save significantly there would be no multiplier, and the multiplier as has been brought out many times in these hearings is absolutely crucial.

I have a letter from Mr. Martin which I received yesterday and I would like to read one short paragraph from his quotation of a speech he made on January 16 in which he said:

> I believe that it is important, and I think it is vitally important, that regardless of what comes out of any deficit that may come about from a short fall of the economy or from additional Government expenditures or from a tax cut it be financed in large measure through bona fide savings and not feed the printing presses.

Now, it seems to me if this philosophy means that as John Q. Public gets a $200 tax cut, on the average, we see that John Q. Public ends up with $200 in savings bonds or $200 in bonds, the effect of the tax cut is going to be, if not nil, enormously diminished.

The propensity to save may increase by 2 percent or so, which would completely wash out any multiplier effect or any significant economic effect of a tax cut. I would like to ask for your reaction to this.

Secretary DILLON. Certainly as far as stimulation of demand is concerned, if a tax cut was immediately transferred into savings bonds and nobody used it at all to spend, there wouldn't be much of any stimulation, except from the very real incentive, which is the other half of our program, from the lowering of rates, which makes for greater incentives to effort for individuals.

Senator PROXMIRE. On that particular point, I wonder if you have seen a study by George Break. Mr. Break made a sutdy of taxes which was published in the American Economic Review and he found that as taxes went up the people involved worked harder, because they had to work harder in order to get more money, they had certain goals as a standard of living, say $18,000 a year.

As taxes go up and more of their income is taken by taxes, they just have to put out more effort. They have to exert more energy.

At the same time as taxes go down it is perfectly possible instead of an incentive for working harder, people can relax, make less effort and achieve their goal, their standard of living, of perhaps $18,000 a year with less effort or less ingenuity on their part. Isn't there some possibility that this is true in view of the diminishing marginal utility of that dollar, which is one of the basic concepts of economics?

Secretary DILLON. Yes, I think it works both ways.

Obviously, at a certain point in the range from zero to 100 an increase in taxes could do as this study indicates, make people work harder to stay even and keep their standard of living.

On the other hand, carrying the other thing to a reductio ad absurdum, just to illustrate the point, if taxes reached up to 100 percent there wouldn't be any point in working at all because you wouldn't keep anything.

So there is a point where they are too high and it works in the opposite direction. I don't think it is possible—I don't think anyone has been able to get an economic model that would prove exactly what the level is where this breaking point comes.

It is our feeling, and I think it is the general feeling—as a result of past results here in the economy, and taking a look at tax rates in other countries and what has happened there, which is the only comparison we have—that a rate structure topping out at about 65 percent and then going down from there would be about the optimum rate structure that you could have to get the maximum effort out of the people and at the same time not discourage them.

If you went further down, or well below that I think the result would probably fall over into the side that you were talking about.

Senator PROXMIRE. Yes. I bring this into consideration because I think the incentive is important but I think it is awfully——

Secretary DILLON. Hard to measure.

Senator PROXMIRE (continuing). Vague and indefinite and we can't be so sure about it.

Secretary DILLON. It's hard to measure it.

Senator PROXMIRE. On this other aspect of increasing purchasing power, last night's Star had a fascinating article. I quote from it:

> The Kennedy administration plans to raise the interest rate of savings bonds from 3¾ to 4 percent late next year or early in 1965 authoritative sources said today. By that time, the sources said, interest rates throughout the economy will be rising and it will be necessary to boost the rate for savings bonds to keep them competitive. Some experts predict the general level of interest rates will start climbing significantly during 1963. If that happens the administration probably will raise the savings bond rate this year or early in 1964. Interest rates generally are expected to rise as an indirect result of the administration's tax program and big budget deficits.

Now, if this is the case, it seems to me, No. 1, this action will persuade people to buy more savings bonds and save more and, No. 2, it will have an even more discouraging effect on business generally as interest rates rise and discourage people from buying homes, buying cars, small business from borrowing, and so forth.

This, I think, is a matter of the deepest concern because I can see the bind we are getting into, if we have an enormous deficit, not too much stimulation in the economy, rising interest rates which makes service on that national debt heavier than ever. I would like to get your reaction because your opinion and your attitude is so important in determining whether or not this sorry prediction of the Star's last night becomes a fact.

Secretary DILLON. Well, I think there are two things: It is difficult to predict 2 years ahead, and secondly, I look at that prospect in a different way, which is the way I would prefer to look at it. I don't think it is necessarily a sorry prediction. The difference arises because when you were summing up a situation, you pointed to a deficit and higher interest rates and not much stimulation in the economy. That is where I would part ways abruptly.

I would think that the only reason for interest rates to rise would be because of a very substantial stimulation of the economy, and a very substantial increase in the demand for money as we move to and reach full employment. As a result of the stimulation of the economy, industry starts to want to expand more, and finds it profitable to do so, and then there will be a greater demand for money, which traditionally would lead to some increase in interest rates. But that wouldn't come about just because of the deficit. It would come about because if this tax program had been successful in stimulating the economy to full employment.

So, therefore, higher rates wouldn't be repressing the economy. They would be merely moving with it.

Senator PROXMIRE. Let me just say at this point nobody can certainly argue when we reach a level of near full employment interest rates should rise. It is desirable they rise and I think that is correct.

Secretary DILLON. Yes, I think that was the point behind that story.

Senator PROXMIRE. But this article quotes authoritative administration source as saying that interest rates will start climbing significantly during 1963.

Secretary DILLON. They say some people believe that.

Senator PROXMIRE. And interest on savings bonds in 1964, and the proposals I have seen suggest that we won't be close to a 4 percent unemployment rate until 1965 or maybe 1966.

Secretary DILLON. I read that story, too. If you read through it further, toward the end it indicates that other people believe that this effect on interest rates won't occur until around the time you are talking about, when we come nearer full employment.

I happen to be one of those who have that belief, and do not believe that there will be any substantial early change because I don't think there will be a tremendous demand for money.

The first results of an increase in business willl be to absorb the presently available capacity rather than to build new capacity. Until such time as business, as a whole, moves into another expansion phase as a result of reaching full employment, I dont' think that demand for credit will be such as to cause much higher interest rates.

Senator PROXMIRE. Well, my time is up, Mr. Chairman. But I just don't believe in laissez faire in monetary supply. I believe this is something well within the control of the Treasury and the Federal Reserve Board and I would hope that the Secretary of the Treasury and the Chairman of the Federal Reserve Board would adopt a policy as long as we have unemployment exceeding 4 percent of striving to keep the money supply in such shape that interest rates don't rise at all. Not a bit.

Thank you, Mr. Chairman. My time is up.

Chairman DOUGLAS. Senator Pell?

Senator PELL. Mr. Secretary, I noticed in your statement that business spending for plant and equipment rose by 9 percent in 1962. That is indeed a good figure, somewhat belying the reports that have been circulated that there has been no great improvement.

Can you foresee in what direction this will go. Do you think the trends will be upward and how do you account for it.

Secretary DILLON. Well, actually the increase has slowed down very sharply in the latter part of 1962. The major part of the increase over rather depressed levels of 1961 was in the earlier part of the year, and this applies both to inventory and to business spending for expansion, or for new plant.

The estimates that came out last fall were somewhat puzzling on this aspect, because they showed the actual amounts being spent in the fourth quarter were larger than had been predicted a few months before, and then they predicted ahead that there would be stability, a slowdown in this expansion, even probably some decrease in expenditures in the first months of 1963.

Well, if this actually takes place it would be quite an unusual situation, because usually when the trend is for more expeditures than expectations that means that expenditures will continue to grow at least modestly.

I don't think we are planning or expecting that there will be any dramatic increase over the rates that were achieved in 1962. I think the general business estimates of business economists, McGraw-Hill, and so forth, are for reasonable stability, a 2 or 3 percent increase this year.

Senator PELL. Thank you.

Taking a general approach to tax structure, I know I have been struck with the simplicity of some of the tax structures of other nations where they have virtually no deduction and a very low tax rate, maybe ranging from 10 to 40 percent. Do you see, as a long-term objective for our own tax policy, for the sake of simplicity so that people know they are, and at the same time assuring practically the same revenue, a policy that will go in that direction, lowering the rates steadily, and knocking out the deductions?

Secretary DILLON. Of course, this program we are suggesting makes a modest step in that direction, and it will be very interesting to see as debate and consideration of it develop over that particular aspect over the coming months, just what the trend of the reaction is.

I think up to a point that is a very good objective. But I don't think you can carry it to the point of taking actions that would disrupt our basic economy, particularly when we are trying to make it operate more effectively and faster, and there are certain actions that, certain policies that, just have become built into our present system, one of which is the tax exemption of State and municipal bonds, which is the basis on which all municipalities and States are able to finance themselves and raise their money.

Under this other theory, if we are starting new you might not have that exemption, but it is in our system, and to change it might disrupt the financing plans of States and municipalities all over across the country. It is a very complex problem.

Senator PELL. Thank you.

We receive from our home areas a great deal of mail concerning this tax program. People are worried about the deficit. They think there should be a reduction in the expenditures. But one point that I was wondering about is why one should not push harder for more tax reforms because that would have the effect of keeping the budget more in balance. In this connection, as you may recall, I suggested earlier that the dividend and interest withholding tax be referred to as the anticheat tax because basically it is going after money that belongs to the Government and which the Government is currently being cheated out of.

I now understand you have agreed to see how this automatic data processing machine system works out for a couple of years; however, I would like to have your estimate of the total number of dollars that will be wilfully withheld or inadvertently withheld from the Federal Government, say, in fiscal 1963?

Secretary DILLON. Well, I don't have that figure any more at my fingertips, but it approaches a billion dollars in taxes on dividends and interest, something in that area.

We still feel, in agreement with you, that the best answer to this problem would have been an effective withholding system, and as a result of the various discussions that we had with banks and others as the year progressed last year, I think that we did finally develop a system that would have been feasible and would not have been difficult to operate.

However, the Congress, following what was apparently the desires of their constituents, decided otherwise, and while they recognized the fact that there was this leakage, they felt that it could possibly be met by a stiff reporting requirement and ADP, and all we are doing. We feel in view of the fact this was debated fully and that decision was reached, it is not appropriate to reopen it until we have more information so we can challenge that basic assumption, and that is why we are ready to wait 2 or 3 or 4 years, whatever is necessary.

Chairman DOUGLAS. Will the Senator yield?

As one who struggled vigorously to have the withholding of the basic tax on dividends and interest required, but was only able to muster 20 votes on the rollcall, I would like to say that I think that our motto should be that of the old Scottish song, "I lie me down and bleed awhile and then rise and fight again." [Laughter.]

Senator PELL. Finally, there has been much discussion throughout the Nation as to what this tax program actually means to the taxpayer. I hope you will put out some simple tables of figures showing what it would mean in terms of decreased taxes and increased spending dollars to families in different brackets with two children, three children, and four children, and so on because our constituents always want to know what it will affect them personally and these figures we find rather difficult to secure.

Now, could you give me or give us a general idea as to the relative impact on the upper bracket groups versus the lower bracket groups. There have been complaints that those in the middle and upper brackets are too hard hit. I, myself, as I read the figures, have the feeling that this group is getting more of a break than those in the lower brackets.

What would your views be on this?

Secretary DILLON. Since the higher-bracket taxpayers pay more taxes, even a small percentage reduction gives them a greater dollar reduction than a small low-bracket individual who pays very little in taxes.

Percentagewise, which is I think the fairest measure, this table that the chairman read from that was attached to the President's tax message, indicates that the tax liability of those under $3,000 is being reduced by 39 percent. That doesn't amount to much money because they don't even now pay very much taxes in that area, but that is an area where if you have to live on that much money, it is not an easy task. We felt additional reductions were desirable in that area, and were fair.

Between three and five thousand dollars, these considerations apply also to a lesser extent, but still apply. There the reduction is 28 percent and there also it is not a very heavy taxpaying group, although it is much larger than the first. The total taxes under present law paid by those between three and five thousand dollars are about equal to those paid by those over $50,000.

Then you come to the great mass of taxpayers, the biggest number in any one area, those between five and ten thousand dollars. Their reduction is 21 percent on the average, and when you get between 10 and 20, the average is about 15 percent; 20 and 50, 12 percent, and 50 and over 9 percent.

This is the net result after taking into account all of the various revisions in the rate structure and in the basic structure, which is sometimes referred to as base broadening or closing of loopholes. And I think that is a clear indication that everybody profits. Certainly in the higher brackets, those over $50,000, this 9 percent figure is considerably lower than the average of 18 percent that is the across the board average. But I think they will actually do a little better than this because they will share disproportionately in benefits of any corporate tax reduction because they generally are holders of the common stock of corporations whose earnings will be increased by corporate reduction.

It was too difficult a computation to try to carry that through in individual classes. But I think generally the higher income brackets will be somewhat better treated than the figures here indicate.

Also they will benefit more, I think, from the incentive of the lower rates for anything additional they may want to do. So I think they are treated very fairly and I think it is fair that this thing progresses in about the way we have suggested.

Senator PELL. In essence then while the upper and middle brackets will be more hit by the reforms, they will still benefit more by the reductions?

Secretary DILLON. They will still benefit very substantially by the net results because their benefits from the reductions are infinitely greater, in most cases two and three times as great, than any loss they might sustain from base broadening.

Senator PELL. Thank you, sir.

Chairman DOUGLAS. I hope it will be possible for us to avoid an afternoon session because of the pressure upon the Secretary and also because of the fact that we have some very important issues on the floor of the Senate and possibly on the floor of the House.

So, personally, I am not going to ask any more questions, and while people are entitled to operate under the 10-minute rule, if convenient, if they can, I would appreciate it to keep it under 5 minutes. But Senator Miller has some questions which he feels quite strongly about and he will be recognized for 10 minutes.

Representative CURTIS. Mr. Chairman, at this point, having conferred with you, we would like to submit some written questions. They will be sent to all of the members of the committee so they will know what has been asked. We would appreciate it, Mr. Secretary, if you would supply the answers we need.

Chairman DOUGLAS. That will be done.

Secretary DILLON. I will be very glad to do that.

(See p. 324.)

Chairman DOUGLAS. Senator Miller?

Senator PROXMIRE. Mr. Chairman, I would like to ask when Senator Miller is through for about 5 minutes or less.

Chairman DOUGLAS. Yes.

Representative CURTIS. I have about 5 minutes.

Chairman DOUGLAS. Yes.

Senator FULBRIGHT. I want to ask one question.

Chairman DOUGLAS. You will be recognized first after Senator Miller.

Senator MILLER. Thank you, Mr. Chairman.

Mr. Secretary, following on Senator Pell's question, I understand that you had estimated about a billion dollars of lost revenue as a result of failure to report interest and dividends.

Inasmuch as most of that would be due to inadvertence rather than deliberate cheating or tax evasion I wonder if we may not expect that most of that will be eliminted as a result of the information return forms which have now been put into the law in the last revenue act.

Secretary DILLON. The information returns, I would hope—I want to be optimistic—that a substantial amount would be recovered that way. There is no way we can tell that. Based on experience, the present opinion of the Internal Revenue Service, that while this would do good it would not solve more than about somewhere between a quarter to a third of the problem. But it is perfectly possible that they underestimate that effect and that the change will do better. So that is why I am perfectly happy to see what the results are, and I certainly am hopeful that you prove to be right and that this will work, because if it does work, we have the problem solved. I know our experts are afraid that it won't.

Senator MILLER. Thank you. Going back to my original line of questioning, if we have a tax cut of $2.7 billion for fiscal 1964, that gives us additional purchasing power in the hands of the taxpayers of $2.7 billion; but if that is offset by an inflation tax of $8 billion for that year, wouldn't we be worse off than we are now?

Secretary DILLON. No; because inflation—the fact that the GNP price deflator, goes up—isn't necessarily a tax on everybody because a great many people will be actually receiving more income, more salaries in dollar figures and won't be actually hurt by this. They will just stay the same, though they won't be getting the full benefit of their increase in pay.

Senator MILLER. It seems to me they would be coming out worse. I asked Mr. Hodges yesterday about whether or not he would feel that it was worthwhile to have a tax cut on the one hand, if it was offset on the other by an equivalent amount of reduced purchasing power of our money and his response was that he didn't think that it would be worthwhile. We would just be standing still. I take it then, that you do not agree with that position?

Secretary DILLON. I am not quite sure I fully understood the question. But I don't feel that the fact that there is a GNP price deflator of about 1 percent or 1½ percent means that at the end of the year everybody is worse off. The fact that the GNP goes up so much in current dollars is not the best measurement of how much the real national product goes up, is the key element.

If the national product goes up—instead of as you said $50 billion, it goes up $35 billion, if instead of 5½ percent it goes up 3 percent or something like that, if that happens to be the percentage you are talking about, the fact that it has gone up means that there is on a net basis more to go around and that everybody is better off.

Certainly there is no arguing with what you say, if your point is: If there was no increase in the deflator and our GNP went up the full $50 billion in real terms, we would be better off than if it only went up $35 billion. You are absolutely correct.

Senator MILLER. I appreciate your agreeing with me on that. I just wish you would go a step further and agree with me if we increase purchasing power by $2.7 billion on the one hand, but take away $8 billion in purchasing power on the other we would be worse off. But I don't wish to press that with you, Mr. Secretary.

Now the gold outflow problem: I must say that I want you to understand I am not one to level any criticism at your Department in this area. As a matter of fact, some people—I think rather superficially—talk about the gold outflow that occurred during the Kennedy administration and during the Eisenhower administration. I don't subscribe to that. I think it is squarely on the shoulders of the Members of Congress.

Now, I detect that the reason why we have had this continued outflow of almost a billion dollars a year during the last 2 years, and even worse than that prior to that time, is because there was a loss of confidence in our money on the part of some of the bankers over there in Europe; is this not correct?

Secretary DILLON. No; not entirely. Originally in the early years of our balance-of-payments deficit, which has now run some 13 years, with a slight, almost imperceptible, interruption in 1957 at the time of the Suez crisis, there was a great deficiency of dollars to use as currency, to use to finance world trade, so countries wanted to build up their backlogs of dollars.

After a time certain countries reached a point where they had more than they needed, and these are countries that traditionally have held a substantial part of their assets in gold just as we do, and they felt that they wanted to take a portion of any increment in gold. That varied between countries.

Now, the British pound sterling is also a reserve currency used by many areas of the world as such. They have the belief that they should fundamentally keep their reserves in gold, and, therefore, to the extent that their situation improves, it isn't a question of confidence in the dollar. They believe that theirs is a reserve currency, and their reserves should be in gold, just the same way as our reserves are fundamentally gold. So it isn't a question really of confidence or lack of confidence.

Now, there was a period, and there are certain periods, when there is a question of currency confidence. That has been particularly reflected in price levels and actions on the London gold market. There you can, at certain times, just sort of measure confidence by what happens. The big outburst occurred in the fall of 1960 when the price of gold momentarily shot up one day to $40 an ounce, and then stayed for quite a period of time at $35.50 or $35.60, which is considerably over the cost of buying it here, and shipping it to London.

Recently it has been below that level, so that indicates that there is renewed confidence on the part of private individuals in currencies. They are not trying to run into gold. However, there was a period last summer when, after the Canadian devaluation, the price on the London market ran up in a much more minor way, but it ran up from about $35.07 to $35.15 or $35.16. That was an indication there were bigger purchases—private purchases—and a certain amount of skepticism. That wore off during the fall and I would say at the moment there is very considerably more confidence in currencies as opposed to gold among private individuals, taken on an overall worldwide basis as shown in the statistics and in the gold market, than there has been for some time.

Senator MILLER. How far can we have this gold balance reduced before we are bankrupt?

Secretary DILLON. Well, if we have none of it, I guess, if it is all gone, then I guess we are bankrupt at that time.

Senator MILLER. Let me ask this: As I understand it we have to have $12 billion of gold to back up our own currency and I have heard statements made to the effect if we get our reserves of gold down to $12 billion, then we won't be able to go any further; is that right?

Secretary DILLON. That is not technically correct. There is a provision in the law that our currency and deposits in Federal Reserve banks should be covered 25 percent by gold. That figure fluctuates with the amount of currency outstanding and the amount of deposits. In recent years it has been fluctuating generally around $12 billion. That is the figure you have in mind.

However, there is also a provision in this law which specifically allows the Federal Reserve Board, if they feel it is necessary, to waive this provision and to keep on waiving it, with gradually increasing penalties in the way of a tax on the Federal Reserve banks or eventually the necessity of increasing the discount rate—things of that nature.

Those penalties, however, don't really start to take any noticeable effect until you get down to a figure of 20 percent of our currency alone, not currency and deposits, which is about $6 billion. So there is quite an area there of Federal Reserve discretion, and the Chairman of the Federal Reserve Board has indicated from time to time that the Federal Reserve regards this as a very important authority which they are fully prepared to use should the circumstances require their using it. So that is why I say it is not quite as simple as it seems on the surface.

Senator MILLER. Thank you very much.

Chairman DOUGLAS. Senator Fulbright.

Senator FULBRIGHT. Mr. Secretary, I have just one question which is really to satisfy my constituents and certain friends and colleagues.

You started from the fact, I think, that we have a sluggish economy and persistent unemployment, but many people have voiced very strong opposition to your proposal. Assuming that you might miscalculate it and that you do not get a response to this proposed stimulation, do you see any serious, disastrous effects to our economy even if you make a mistake?

It is not an irremedial situation. You are experimenting in a way and you would move on to some other program of public works or various things. But even if it is mistaken, it isn't really a serious mistake, is it?

Secretary DILLON. No; I think that is quite correct. There is no indication that it could bring any catastrophe, because if it is mistaken—I don't think it is, but if it is proved that the stimulus is not there—it would mean that our economy would continue to operate with an excess of capacity over demand, and there would be very little if any inflationary pressure.

The real danger is inflationary pressure. That is what everybody wants to avoid, and what has to be avoided. That is only likely to arise to the extent that the program is oversuccessful in stimulating the economy more than it should. But I doubt if indications are that that will be done.

Senator FULBRIGHT. In fact, there is no excuse for the very vile and vigorous opposition to this program; even if it is wrong, it is not going to destroy the country, is it?

Secretary DILLON. That is quite correct.

Senator FULBRIGHT. Thank you.

Chairman DOUGLAS. Mr. Curtis.

Representative CURTIS. There are some of us who think it is very serious if it might destroy the country.

Secretary DILLON. That is what I was saying. It is a very difficult thing to destroy.

Representative CURTIS. You know this country has taken a lot of abuse.

Chairman DOUGLAS. It took a lot from 1920 to 1932. [Laughter.]

Representative CURTIS. I thought the period of the depression was 1932 to 1940?

Chairman DOUGLAS. 1920 to 1932 turned it into a terrible mess.

Representative CURTIS. Mr. Secretary, I want to pinpoint a little better the tax cut theory in this particular economic climate.

You pointed out that it was not designd to stimulate the amount of investment money available, but rather to provide incentive.

Secretary DILLON. That is right.

Representative CURTIS. So the tax cut is not designed to get more investment money?

Secretary DILLON. No, I think it is not primarily designed to do that because at least at the moment there is enough. I think that as and if you did reach a fuller capacity operation, there would be increasing demands for funds and then you would need those moneys released, but not today.

Representative CURTIS. Yes. The point I have been making is that the incentive feature of the tax program, the 5 percent corporate tax reduction, is one-tenth of a percent as far as increased profits, in investments, is concerned assuming a million dollar investment.

Secretary DILLON. Increasing the profits 10 percent.

Representative CURTIS. A tenth of a percent.

Secretary DILLON. What?

Representative CURTIS. Take——

Secretary DILLON. I don't figure that out.

Representative CURTIS. Take this figure with me for simplicity.

Secretary DILLON. Yes.

Representative CURTIS. Two-percent profit on $1 million investment.

Secretary DILLON. Yes, I see. You mean the profit rate on the investment.

Representative CURTIS. That is right. It only increases the profit rate by about a tenth of 1 percent. That is what I am showing. Of course, there are other areas where we could increase our profits in the cost-price squeeze.

Secretary DILLON. It depends on what rate you start with as to the profit you make on investment.

Representative CURTIS. Oh, yes. I was assuming 2 percent for simplicity. If it went up to 4 percent——

Secretary DILLON. Most people don't like to invest new money on an equity basis unless there is about a 10-percent return.

Representative CURTIS. You are certainly correct on that, but in fact, this is our big problem.

Secretary DILLON. Sure.

Representative CURTIS. I am merely showing that the tax credit, or the release of taxes, is a relatively small percentage point change in the 2, 3, 4 or whatever percent you use.

Secretary DILLON. It would be 1 percent if we had a 10-percent factor.

Representative CURTIS. No. I think it would be one-half of 1 percent at 10 because at 2 it would be one-tenth of 1 percent. This is a matter of mathematics that can be straightened out, but I did want to state the relationship.

Now, turning to the second area—namely, the release of consumer dollars. Even here we find that the base of the administration's theory assumes that the savings rate, is traditional, as Secretary Hodges referred to it, running between 6 and 8 percent of disposable income. But I have pointed out that it is hardly traditional. In the thirties of the New Deal, that Senator Douglas likes to bring to mind—[Laughter.] The average was about 3 percent. In fact, it was 2.9 percent, Senator, and in the twenties it was around 5.5 percent. So the savings rate is not anything that we can look upon as traditional, and yet the administration assumes it is.

In our August hearings, on page 673, tables were inserted that estimate saving income ratios by income class during 1950. The vertical bracket shows incomes after taxes under $1,000, then $1,000 to $2,000, $2,000 to $3,000, and so forth. The horizontal bracket shows that the percentage of savings increases rapidly as you get into the higher brackets. Inasmuch as the benefit from a tax cut only goes to taxpayers, the lowest income groups are eliminated. Yet when we use this figure of 7 percent savings, it has been applied against all disposable personal income. The rate should not be 7 percent. It should be scaled on the basis of the income groups that are going to have the money. I am having this computed, by the way, and I don't know how it is going to come out, but I suspect the average rate will be closer to 10 percent.

I simply point out that this is a very hazardous theory which the administration uses to explain that the only apparent solution is a tax cut.

Do you have any comments?

Secretary DILLON. Well, I think you are certainly correct that there are different savings rates as you move up and down the scale here. Of course, the largest reduction in taxes occurs in areas we have bracketed in this table. Making a rather broad group the area between $5,000 and $10,000 accounts for $3,800 million of a total reduction of $8,600 million.

Representative CURTIS. Between five and what?

Secretary DILLON. Between 5 and 10.

Representative CURTIS. And the 1950 rates in the $5,000 to $10,000 brackets of savings begins at 6.5 percent then 10 percent, and 16 percent. The last figure for $10,000 is 16.3 percent so I think I am not far from wrong in thinking that our figure would be around 10 percent.

Chairman DOUGLAS. Senator Proxmire.

Senator PROXMIRE. Apropos of Senator Fulbright's question what happens if this doesn't work, it seems to me, the following: No. 1, you are left with a huge increase in the national debt; No. 2, a big increase in the cost of servicing the debt, just the deficits we are going to have this year and the next fiscal year will increase the debt $20 billion and the servicing about $600 million a year; No. 3, a prospect of much deeper deficits if we follow the policy advocated, implicitly suggested by Mr. Heller of then another tax cut, or a greater deficit certainly if we follow the policy implied by the President in the state of the Union message if this doesn't work, or increased Government spending; No. 4, a totally inadequate tax system, because if this doesn't work, we have greatly diminished the income tax; No. 5, the prospect of eroding the income tax to such an extent then we have to turn to a manufacturer's excise tax which many people advocate anyway.

So it seems to me there can be some very, very serious consequences if this does fail from the standpoint of those of us who believe in taxation based on ability to pay, and also who feel that the burden of servicing the national debt is a very real burden. Isn't that correct?

Secretary DILLON. I feel it is a very real burden servicing the national debt—and I certainly think it would be very serious if we entered on a major program like this and after 3 years it hadn't had any effect.

But we believe that experience indicates it will have an effect, and certainly there seems to be a substantial consensus in that belief, of and among leading business groups, labor groups, and economists. Now, maybe they are all wrong, but certainly the best indications we can get from experts in all different types of activities is that this particular medicine will work.

Now, the exact measurement of how it will work of course, is open to future decision.

Senator PROXMIRE. In your discussion of international trade I was delighted to see your heavy emphasis on the substantive things you want to do in terms of our aid program, in terms of military commitments, this kind of thing. Because it seems to me almost inevitable that the tax cut, inasmuch as its main thrust is to stimulate demand, is likely to worsen our international balance-of-payments situation.

This is certainly the classical analysis. As our people buy more they buy more from abroad as well as buy more from this country. You don't necessarily sell more from abroad by increasing the demand in our own country. There are certain possible peripheral benefits, but the overall thrust of the tax cut is certainly to worsen our balance-of-payments situation and it seems to me we ought to open our eyes and recognize that.

Secretary DILLON. Well, I am not sure it is. The classical thing, at least in the first instance, is correct as far as the trade balance is concerned. But capital flows are a much more important part of the balance of payments now than they used to be in times past and they would tend to work the other way and they might offset it.

Senator PROXMIRE. They might; but I think objective analysis would suggest they will not. I would also like to say that I commend for your approval the very excellent bill that I understand two members of this committee have introduced, Senator Douglas and Congressman Reuss, which would make it possible, in view of the disastrous De Gaulle action, for us to really trade with a Common Market as if Great Britain were part of it. As I understand it there is a provision in the Trade Expansion Act that says we can't reduce tariffs to zero in cooperation unless the trading group with whom we are dealing handles 80 percent of the world trade in the particular commodities. This would knock out all but 24 of the 26 commodities with which we are dealing, and Senator Douglas, and Congressman Reuss, as you may know, have introduced this legislation, and I would hope that we can get administration support for it.

Secretary DILLON. Yes, I am familiar with the amendment.

Senator PROXMIRE. Just one other question because I have been doing this consistently and I want to be consistent and fair. The fact is that the Treasury Department will have increases in the budget for the number of its employees by about 5 percent in the coming year, from 87,000 to 91,643. The Department of Agriculture, Department of Labor, the Department of Commerce have all come before us and admitted, agreed they had to increase their personnel.

The Defense Department will reduce their personnel in the coming year, as you know, and in view of the fact we are getting lots of criticism, some of it justified, that we are increasing this budget, and spending too much in the domestic area, what is the answer here as far as the Treasury Department is concerned with an increase from 87,000 roughly to 91,000?

Secretary DILLON. Well, that is 80 to 90 percent in the area of one portion of the Treasury Department, namely, the Internal Revenue Service. It is part of the implementation of a long-range program designed to collect more taxes and have a better audit program in the Internal Revenue Service. It has been underway for some 3 years now, and has a few more years to run before it is completely in effect. It has involved increases of around three to four thousand personnel a year in the Internal Revenue Service. This is, of course, each year looked at very carefully by the Appropriations Committee. We felt it brought in more revenue.

Senator PROXMIRE. This is, I think, an excellent investment.

Secretary DILLON. Yes.

Senator PROXMIRE. You get back far more than you put in.

Secretary DILLON. Yes.

Senator PROXMIRE. How long will this go on?

Secretary DILLON. I think it was supposed to be completed roughly at the time this ADP is all installed, which would be about 1967, fiscal 1967, and thereafter any increases would only be commensurate with general population growth or general growth.

Senator PROXMIRE. Are there any older programs you can cut back and which you can reduce and economize on?

Secretary DILLON. We are reducing every year the personnel we have in numerous areas, in the Bureau of Engraving and Printing, in the Bureau of Public Debt, Bureau of Accounts, and places like that by getting more effective——

Senator PROXMIRE. You would think the Treasury Department is one department in which computers and automation would be most effective.

Secretary DILLON. It is, and we are closing branch offices around the country steadily as we find we can centralize and, through computers, do the job with fewer people and fewer locations. This goes on every year. We closed half a dozen of our disbursing offices last year and the same number will be closed this year, with greater centralization and more efficient use of personnel.

Senator PROXMIRE. Thank you very much, Mr. Chairman.

I would like unanimous consent to include in the record at this point a table which I have composed showing the effect of this tax cut, if we include assumptions which I will make clear, of all the taxes, State and local as well as Federal, that people pay in the various brackets. Incidentally, it shows that those with $3,000 of income would have a 7-percent cut; $5,000, 8 percent; $10,000, 10 percent; $15,000, 13 percent; and $20,000, 14 percent.

This is because of the incidence of the property tax, local sales taxes, excise taxes, and so forth which are not touched by the President's program, and, therefore, I think the overall thrust, because it is concentrated in the income tax, is not as progressive as many have made out and I think to some extent it is regressive.

Chairman DOUGLAS. Without objection that will be done.

(The table referred to follows:)

Hypothetical changes in total tax liabilities

Income	Federal income tax	Other taxes [1]	Total tax before cut	Total tax after cut	Percent reduction
$3,000	$60	$600	$660	$614	7
$5,000	420	1,000	1,420	1,296	8
$10,000	1,372	1,500	2,872	2,568	10
$15,000	2,616	1,700	4,316	3,776	13
$20,000	4,124	1,900	6,024	5,182	14

[1] Property (or imputed rent), sales, excise, auto, etc.

Chairman DOUGLAS. Senator Pell, do you have any questions?

Senator PELL. No questions.

Chairman DOUGLAS. Before we adjourn, which we will do, I would like to say I think a large part of the increase in the staff of the Treasury is due to the decision which Congress made to use automatic data processing instead of withholding the basic tax on dividends and interest at the source.

Senator Proxmire. I voted with you on that.

Chairman DOUGLAS. I understand, but I think the record ought to show that that automatic data processing does not in itself collect a single dollar. It merely gives information to the Treasury which the Treasury must then use in making comparisons with the income statements of individuals and then going out and collecting any discrepancy, and Congress by its refusal to put into effect a withholding tax in spite of the efforts of the Senator from Wisconsin and the Senator from Illinois directly forced the Treasury to increase its personnel, and I know the Senator from Wisconsin didn't mean to do this but I don't think any inference should be drawn from this that this is the fault of Treasury.

Let me also say for some months I worked closely with certain members of the Treasury and I never knew a more devoted group of men who worked around the clock, and worked themselves almost to exhaustion in defense of the public, and this should be recognized as well.

Thank you very much, Mr. Secretary.

Secretary DILLON. Thank you, Mr. Chairman.

(The following was later received for the record:)

THE SECRETARY OF THE TREASURY,
Washington, February 14, 1963.

MR. JAMES W. KNOWLES,
Executive Director, Joint Economic Committee,
Washington, D.C.

DEAR JIM: In the Secretary's absence, I am forwarding the written answers that were requested to the supplementary questions by Senator Douglas, Senator Javits, and Representative Curtis for inclusion in the record as part of Secretary Dillon's testimony of January 31 before the Joint Economic Committee. Twenty-five copies of these replies are enclosed for immediate circulation to the members of the committee.

Sincerely yours,

ROBERT V. ROOSA, *Acting Secretary.*

REPLIES TO QUESTIONS OF SENATOR DOUGLAS

Senator DOUGLAS:

Question (a): Would the Treasury provide estimates of the effects which the entire tax program, as recommended, may have on imports and exports?

Answer: The effects of the tax program on our merchandise trade should be generally expensive with regard to both exports and imports. The growth in the gross national product resulting from the tax program can be expected to raise our imports more or less proportionately. In recent years imports have generally ranged around 3 percent of GNP.

The effect on our exports is more complex, and may take place over a longer period of time. In the first place, there is likely to be a substantial feedback effect on our exports that is associated with any increase in our imports. This happens because foreign countries, particularly outside of Europe, may use a part of the dollars they receive from our enlarged imports to purchase U.S. goods and services. Secondly, the tax program should contribute to our competitive position to the extent that it makes possible more efficient production at lower prices.

We would anticipate, then, that the tax program would result for a time in a somewhat larger rise in imports than in exports. It is important, therefore, that we press forward with our special efforts to increase exports as a part of the general program for improving the balance of payments. Over a longer period, the stimulus given by the tax cut to increased investment in cost-reducing methods of production should improve our balance of trade through an expansion of exports.

Question (b): Would the Treasury provide estimates of the effects which the entire tax program, as recommended, may have on investment by American firms abroad and foreign investment within the United States?

Answer: The effect of the tax program should be to improve our net investment position by increasing the relative profitability and attractiveness of investing in the United States as compared with investing abroad. Less U.S. direct investment abroad should be accompanied by larger foreign direct investment in the United States, but there is no way of estimating the extent of those changes attributable to the effects of the tax program alone.

Question (c): Would the Treasury provide estimates of the effects which the entire tax program, as recommended, may have on short-term monetary and gold movements?

Answer: With the stimulation of domestic business resulting from the tax program, an increase in business demand for working capital and credit would in time tend to raise short-term interest rates. This development, in the absence of corresponding changes in short-term rates abroad or in forward exchange rates, would attract to the United States funds that are responsive to international interest rate differentials. The improvement in the strength of our economy through increased business investment will also help to prevent speculative outflows of funds.

Moreover, the stimulus to business activity provided by the tax program, and the incentives it will provide to make use of available supplies of credit, will relieve monetary policy of some of the burden it is now carrying for encouraging expansion. In this way, monetary authorities will be permitted greater freedom for influencing the structure of short-term rates—should developments in the balance of payments made that desirable—without risk of impeding domestic expansion. This greater leeway for monetary policy will provide an additional element of protection against either interest-induced or speculative outflows of short-term funds, bolstering our defenses for the dollar.

Gold movements, of course, depend in part upon the course of our entire balance of payments, and in part upon the customary policies of foreign monetary authorities in holding gold or dollars in their reserves. Thus, the gold problem is more than a matter of short-term capital flows and interest rates. But so long as we avoid inflation and improve our international competitive position, gold losses should be moderate while our balance of payments is being brought into balance.

Question (d): Do you have any statistical information concerning the general willingness to spend by various income groups out of additional income they receive?

Answer: To our knowledge, there are no direct statistical estimates of the willingness to spend out of additions to income, by income group—or alternatively, of marginal propensities to consume, by income group—that can be used to analyze the effects on consumption of reductions in the personal income tax rates of particular income groups.

Estimates of the overall effect of a tax rate reduction on aggregate consumption are possible. They can be obtained from past experience—from observation of how total disposable personal income and total consumption have behaved over time in the past. The relationship between disposable personal income and consumption is stable enough to permit a reasonably precise estimate of how personal saving will respond to a change in tax rates and disposable income. Such an estimate was prepared by the administration in connection with its proposals for tax reduction and reform.

Numerous "cross section" or "budget" studies of consumer behavior are available. In some of these studies, average income (before and after taxes) and average consumption, by income class, are given. Thus, some idea of the way in which the ratio of total consumption to income—or the average propensity to consume out of current income—differs between income classes can be obtained. Relevant information of three recent budget studies—two of which were done in 1950–51, and one of which was done in 1960–62—are reproduced here in the attached tables 1–3. The clear impression one gets from these data is that the ratio of consumption to income, or the average propensity to consume, is lower for families in the higher ranges of the income scale than for families in the lower ranges.

It is not possible, however, to make valid inferences about how different income classes will respond to additions to their incomes on the basis of this sort of budget study information. Attempts have occasionally been made to derive marginal propensities to consume for various income classes from budget study data by calculating the changes in total consumption associated with moves from the average income of a given income class to the average income of the next highest income class. These calculations suggest that the willingness to spend out of additions to income decreases as income increases; high-income groups are evidently less willing to spend additions to their incomes than are low-income groups.

But this conclusion does not square with certain incontrovertible facts. Incomes, however measured, are much higher now than they were 100 or 50 or 10 years ago. Yet the overall personal saving-income ratio has shown no persistent or regular increases. And this contradicts the insight into consumption behavior given by calculations of marginal propensities to consume based on budget data.

One can only conclude that, when changes in disposable income are general or widespread, families do not respond over time as budget studies—which are, in effect, static or snapshot pictures of behavior patterns at a particular point in time—seem to suggest. This may be because saving habits are in large part related to families' relative positions on the income scale rather than to the absolute levels of their income. Thus, while the relatively wealthy may always tend to save higher-than-average proportions of their incomes, the amounts typically saved by families may change over time as the general level of incomes change. Moreover, any cross-section study of a single year's behavior will include some families whose incomes are temporarily high, and some families whose incomes are temporarily low relative to their longer run experience or expectations, but consumption spending is likely to be determined at least in large part by longrun income patterns. Since high-income groups probably contain more families with temporarily high incomes while low-income groups probably contain more families with temporarily low incomes, this suggests that in the long run, there is not as much difference in saving behavior of the various income groups as single-year cross-section studies would suggest.

Reply to Question of Senator Javits

Senator Javits:

Question: Mr. Secretary, in view of the changed situation caused by the European Economic Community's rejection of the British application for membership, what is the administration's policy as it affects the Trade Expansion

Act of 1962 and other aspects of our relationships with the EEC, the United Kingdom, the British Commonweath, and the European Free Trade Association?

Answer: This question will be discussed in material to be submitted for the record by Under Secretary Ball of the Department of State.

(The material referred to follows:)

FEBRUARY 15, 1963.

The Honorable PAUL H. DOUGLAS,
U.S. Senate.

DEAR SENATOR DOUGLAS: Secretary Dillon has called my attention to the transcript of his testimony before the Joint Economic Committee on January 31. In the course of his colloquy with the committee several members expressed an interest in the administration's appraisal of the implications for U.S. foreign economic policy of the breakdown in negotiations between the United Kingdom and the EEC.

The significance of this event can best be appraised in relation to other trends and events involved in the evolution of U.S. policy toward Europe.

I

It is generally recognized that the progress of Europe toward unity has been among the most constructive and promising achievements of the postwar period. Through the creation and development of the European Economic Community, Europe has moved a long way towar deconomic integration. That goal, however, is far from full attainment and many difficult problems remain.

The United States has consistently encouraged the nations of Europe toward greater unity. Both the legislative and executive branch of our Government have provided this encouragement—by word and by action. We regard greater European unity as essential primarily for political reasons—although, over the long run, the United States should also benefit economically from the contribution of the Common Market to a higher level of European economic activity.

A united Europe would eliminate the frictions and jealousies that have been the cause of so many past conflicts—conflicts that on two occasions have embroiled the whole world in catastrophe. Moreover, a unified Europe could effectively mobilize the common strength of the European people. It should thus be able to play the role of equal partner with the United States, carrying its full share of the common responsibilities imposed by history on the economically advanced peoples of the free world.

II

The basis for such a partnership is hard economic fact. In the North Atlantic world—Western Europe and North America—there is concentrated 90 percent of all free world industrial strength as well as the great bulk of the free world's technical skill and knowledge. This combined resource must be put to the defense and advancement of the free world.

Combined action is particularly important in three areas:

First, Europe and North America must join in a common defense against the aggressive ambitions of the Communist bloc. The defense of Europe is vital to the United States as well as to Europe itself. It is a costly task; the growth of European strength permits Europe to make an increasing contribution to it.

Second, the national economies of the nations comprising the great industrial complex of the North Atlantic are interdependent. This is becoming increasingly evident. A slowdown in growth rates in Europe could adversely affect our own growth rate, while an American recession should have serious repercussion in Europe. Our balance-of-payments deficit is, to a large extent, the mirror image of balance-of-payments surpluses of certain major European countries. If one nation or area adopts restrictive commercial policies, those policies will find reflection in compensatory or retaliatory actions by its trading partners.

The recognition of this economic interdependence has led us to seek new means to coordinate and harmonize our domestic economic polices. Substantial progress toward this end has been achieved through the Organization for Economic Cooperation and Development. Much further progress is required.

Third, the major industrialized areas of the free world—the Atlantic nations—must commit large amounts of money, equipment, and skill to assist the less developed countries in raising their standards of living, if political stability is to be achieved and the dangers of subversion reduced. The effective utilization of free world resources for this purpose requires a high degree of coordination of effort. We are beginning to achieve that coordination through the Development Assistance Committee of the OECD.

Fourth, if the resources of the free world are to be efficiently utilized, obstacles to the free flow of international trade must be reduced and trade expanded under conditions where the forces of comparative advantage can fully operate. This means that American goods must have greater access to the European markets, while we must provide greater access for European goods to our own markets. Just as in other fields, benefits and obligations must be reciprocal.

III

During the past few years U.S. policy has been increasingly based on the belief that these common tasks could best be achieved by the pursuit of two parallel lines of action—the attainment by Europe of a greater unity so that the European nations may act on a widening subject matter through common institutions and the attainment of a high degree of Atlantic cooperation through institutional arrangements designed for that purpose.

We have also felt that the effectiveness of our European partner would be greatly enhanced if a unified Europe were expanded to include the United Kingdom. We were, therefore, gratified when the United Kingdom Government decided to apply for membership in the European Economic Community. We recognized at that time, as we do now, that the organization of Europe was a problem for the Europeans, and that it involved grave national decisions for the participating nations. We have not, therefore, sought to influence these decisions but at the same time—since we have been repeatedly asked by our European friends—we have been frank in stating that, in our view, the accession of the United Kingdom to the Rome Treaty would contribute to the economic strength and political cohesion of Europe and thus advance the prospects for a full and effective Atlantic partnership.

During the course of the negotiations for the accession of Great Britain to the EEC—the U.S. Government was repeatedly assured by the Inner Six, including the French Government—that none of the parties had any political objection to United Kingdom membership in the EEC. We recognized, at the same time, that the negotiations involved complex technical and economic problems—and there was always the possibility that these problems might not be solved to the satisfaction of all parties. We, therefore, recognized the possibility—although not the probability—that these negotiations would break down.

The veto of the French Government terminating the negotiations occurred at a time when the technical and economic problems were well on their way to solution. This has been made clear by the statements issued by the Commission of the European Economic Community. In our opinion, the action of the French Government must be regarded as motivated primarily by political reasons.

It is still too early to know with precision what the French Government's veto may imply for future French policy. It seems clear enough, however, that this action has not changed the underlying facts that have dictated the need for greater European unity or effective Atlantic cooperation. We believe, also, that these facts are generally understood by the great body of European opinion.

They can be briefly summarized.

(1) Europe cannot defend itself today by its own efforts: its defense rests heavily upon the overwhelming nuclear strength of the United States.

(2) The nuclear defense of the free world is indivisible.

(3) The great industrial economies of the North Atlantic countries are to a high degree interdependent.

(4) To reap the full economic benefits of this interdependence requires a free flow of trade.

(5) The urgent needs of the newly developed nations require effective common effort on the part of the major industrialized powers of the free world.

The existence of these facts, it seems to us, determines the broad policy lines that we intend to pursue.

First, we shall continue to encourage the development of European unity and to express the hope that arrangements may ultimately be made for the accession of Great Britain to full membership in the EEC. Recent events have demonstrated a substantial body of European opinion in favor of Britain's participation in a uniting Europe and the British Government has made known its own desire that the United Kingdom should play a full role in this development.

But while we continue to regard the ultimate accession of Great Britain to the Rome Treaty as an objective to be encouraged, we recognize that it is unlikely to occur for some time. Meanwhile, recent events do not appear to have destroyed the vitality of the strong European drive toward unity nor seriously impaired the value of the integration so far achieved through the EEC. Obviously, it is in the interests of the whole free world that the EEC develop in an outward-looking manner and that it not acquire autarchic characteristics. We propose to use our influence to this end.

Second, we shall seek to advance the arrangements for close economic cooperation with Europe through the OECD. We shall also continue to develop close cooperation in the monetary field through the IMF, the Committee of Ten, and Working Party Three of the OECD.

Third, we shall continue to work toward the strengthening of NATO and the development of adequate conventional forces in Europe. We see dangers in the proliferation of national nuclear deterrents but we recognize the desire of Europeans to play a full role in their own nuclear defense. We have, therefore, proposed the creation of a multilateral nuclear force, within NATO, and we reached agreement with the British Government at Nassau for the mutual support of such a force. Ambassador Livingston Merchant is going to Europe next week for exploratory discussions.

Fourth, we intend to utilize to the fullest the powers granted to the President under the Trade Expansion Act in order to improve access to the European Common Market as well as other major world markets for products of U.S. farms and factories. Governor Herter intends to press liberalization of trade as rapidly as possible.

Since General de Gaulle's press conference on January 14, suggestions have been put forward for the United States to join in special commercial relations with one or another group of nations to form a trading bloc competitive with the European Common Market. We do not believe that this would be sound policy. For 30 years, the United States has consistently adhered to the most-favored-nation principle and to the expansion of trade on a nondiscriminatory basis. For us to enter into preferential trading relations with any nation or nations would mean discrimination against all other nations. Such a policy would be inconsistent with our position as the leader of the free world.

You and Congressman Reuss have raised the question of the adequacy of the powers provided by the Trade Expansion Act if it should develop that the United Kingdom does not become a member of the EEC prior to the opening of the Kennedy round of negotiations. You have introduced legislation that would so amend the act that the scope of the so-called predominant supplier clause would be unaffected by the failure of the United Kingdom-EEC negotiations. The administration's position with respect to this proposed legislation was stated by the President at his press conference of February 7 when he said:

"No, we haven't planned to ask the Congress, because we do have the power, under the trade expansion bill, to reduce all other tariffs by 50 percent, which is a substantial authority. We lack the zero authority.

"On the other hand, it is going to take some months before these negotiations move ahead. It is possible there may be some reconsideration of the British application. I would be responsive and in favor of legislation of the kind that you described. It is not essential, but it would be available, and if the Congress shows any dispositions to favor it, I would support it."

Fifth, we propose to continue to develop techniques to improve the cooperation of the major industrialized powers in providing assistance to the less-developed countries. This does not mean the abandonment of national programs of assistance but rather their more effective coordination. At the same time, we shall try to assure a greater contribution to this common effort on the part of the European countries.

The broad lines I have described suggest the general directions of our policy. These policy goals have been and will continue to be pursued through a variety of instrumentalities and in a variety of forms. The veto of British accession to the EEC is not an insuperable obstacle to those policies. In 1954, the French Assembly turned down the European Defense Community Treaty, but the next few years were years of unprecedented progress toward European integration along other lines. The basic soundness of U.S. policy was not affected.

So today we have sought to chart a course that corresponds to the requirements of U.S. interest—to pursue a positive line of policy rather than merely to react to, or to follow, the policies of other governments. This seems to us the only posture befitting the leading nation of the free world.

Sincerely yours,

George W. Ball.

REPLIES TO QUESTIONS OF CONGRESSMAN CURTIS

Congressman CURTIS:

Question 1(a): Mr. Secretary, in arriving at this program of tax reduction and reform to stimulate the economy, I assume that you and the other officials concerned considered each of the possible developments which could act to nullify the beneficial effects which you anticipate would flow from the tax program. Would you please tell the committee what are these possible offsetting developments?

Answer: The administration's program for tax reduction and reform is based on an intensive, detailed appraisal of the performance of the economy over recent years, and a careful survey of probable trends in coming months and years. Our conclusion is that, in the absence of the sort of stimulus that will be provided by our tax program, the U.S. economy will continue to operate at levels significantly below its reasonable productive potential, and that unemployment will remain a serious social and economic problem.

The tax program is designed to provide needed impetus to the economy, both by releasing additional purchasing power and by providing new incentives for work and investment through lower marginal tax rates on both income and profits. Both experience and theory confirm that the influence of the tax program will be expansionary, and we are convinced that, with this program in effect, economic activity will advance more rapidly and unemployment will be reduced.

In our judgment, there can be no reasonable doubt that the administration's tax program, taken by itself, will be expansionary. Whatever else happens in the economy, it will provide additional expansionary stimulus. In this sense, no future adverse development can nullify the beneficial effects of the tax program. Even if, as now seems very unlikely, strong deflationary forces, not now operative, develop in years to come—forces which partially or fully offset the beneficial effects of the tax program—the economy will still be better off for having had tax reduction and reform.

Among all the possible offsetting, but not nullifying, developments are the following: a large, sudden and unsettling cutback in Government spending; a sharp rise in consumer saving, brought on perhaps by international disturbances; a decline in business investment spending, or inventory liquidation, possibly induced by worldwide deflationary forces; a rapid drop in residential construction, in response maybe to a decline in real estate values. Developments such as these are, we feel, highly improbable; that they would all come about is that much more unlikely. We cite them only to indicate what it would take to offset the beneficial effects of the tax program, and note again that if one or more of them were to emerge in years to come the economy would, by virtue of the tax program, be better off than if it had not had tax reduction and reform.

Question 1(b): I am certain, too, Mr. Secretary, that you must have considered those possible developments which might reinforce the effects of the tax program and lead to a too rapid increase in business activity and a surge of inflationary pressures. Would you tell us what those possible developments are?

Answer: Given the existing amount of employment and excess capacity, it also seems quite unlikely that business activity will increase so rapidly as to result in shortages and inflationary pressures over the next year or two. However, as the beneficial effects of the tax program work their way through the economy for some time, this possibility will, of course, need continuous and careful attention. That is why we are determined to finance the prospective deficit in a manner that will not create excessive liquidity in the economy—liquidity that at some point might stimulate excessive demand—and why monetary policy should remain free to respond flexibly to new developments as they emerge.

A potentially inflationary expansionary movement after the tax program becomes effective would be characterized by a decline in the personal saving rate as consumers anticipate future needs, sharp increases in the rate of inventory accumulation and plant and equipment spending to the point that stocks and capacity were being lifted beyond the needs of a full employment economy, and an expansion of bank credit and the money supply to finance this expansion that could not be absorbed at stable prices. While none of these appear an immediate threat, they could arise either as the end product of a self-reinforcing expansionary movement, as a reaction to new international crises requiring further sharp increases in Government defense spending, or sharp inflationary pressures abroad.

Question 1(c): If offsetting developments occur to nullify the stimulative effects of the tax program, then what would be your recommendations for economic policy?

Answer: As noted previously, if deflationary forces, now unforeseen and judged to be highly improbable, should emerge in the future, they will not nullify the beneficial effects of tax reduction and reform. They may offset these beneficial effects, in whole or in part, but in so doing they will only prove how necessary the tax program was.

In the unlikely event that the stimulative effects of the tax program are offset by future developments, so that the economy does not, in spite of tax reduction and reform, achieve its full potential, it will then be clear, after the fact, that the underlying forces for expansion and growth in the U.S. economy were very weak indeed. And it is likely that if the U.S. economy is faced with forces strong enough to offset the effects of the tax program, then these forces will not be operating in the United States alone. In such a situation, basic reappraisal of the economic policies of this and other countries would clearly be in order.

It is also clear that appropriate policies cannot be determined in advance, without knowledge, that is, of the particular factors within the economy responsible for the overall situation, and without knowledge of the balance-of-payments situation and developments in other parts of the world. The advisability of further tax action, or of a change in monetary, debt management, or other policies, can be determined only in the light of immediate developments, international economic and political developments, balance-of-payments developments, and wage and price developments, which of course are still of the future, and cannot be accurately foreseen.

Question 1(d): If reinforcing developments occur which push economic activity up too fast and cause a new wave of inflation, what would be your recommendations for economic policy in that situation?

Answer: In the conduct of debt management and monetary policies, we are constantly alert to the need to avoid an expansion of credit and liquidity so large as to bring serious inflationary dangers in their wake. Should this danger develop, both monetary and debt management policies could promptly and flexibly be redirected to exert restraint on the economy. Longer range measures to improve the mobility of the labor force and other structural defects in the labor market will be helpful in permitting the economy to operate at higher levels without upward price pressures.

A rapid economic expansion will generate large increases in Government revenue, which in turn will help divert excessive demand from the private markets for goods and services. In these circumstances, it would be imperative to maintain firm restraints on all Government spending programs so that a very large proportion of these revenues could first eliminate our deficit, and then be channeled into the repayment of Government debt out of surplus. Barring the sort of international disturbance that would compel a rise of defense spending far above levels currently programed, the tax rates we are proposing will generate sufficient revenues to generate these needed surpluses.

Question 2(a): How much of the improvement in our balance of payments last year was accounted for by early foreign debt prepayments?

Answer: No improvement in 1962 compared with 1961. In 1962, prepayments totaled $664 million compared with $667 million in 1961. In comparison with 1960, when there were no debt prepayments, the improvement attributable to this item was $664 million.

Question 2(b): How much foreign debt remains to be paid, and what rate of payment can we expect in the future?

Answer: Roughly $11 billion of foreign indebtedness to the U.S. Government, payable in dollars, remained to be paid over a period of years, as of the end of 1962. Regular amortization payments should amount to over $600 million a year in the next few years, with an additional amount of nearly $300 million for interest receipts.

About $1.4 billion of the debt was owed by the Common Market countries. There is no indication of what debt prepayments, if any, may be made by these countries in 1963.

Question 3(a): Does U.S. direct foreign investment create employment opportunities for Americans at home as well as overseas?

Answer: When U.S. direct investment abroad is in the form of exports of U.S. products rather than dollars, employment opportunities in our export industries are created directly. When U.S. direct investment abroad takes the initial form of money instead of goods, the effect on employment at home depends largely on our competitive position relative to that of foreign countries. If we are competitive, some of the funds that pass into foreign hands initially will return for procurement in the United States, thereby indirectly increasing employment opportunities in our export industries.

Direct investment abroad also has further indirect effects on U.S. exports and imports and, therefore, on production and employment opportunities in the United States as the foreign facilities financed by U.S. funds come into production. Hence, the net effect of direct investment abroad in U.S. employment opportunities is a very complicated matter, involving an estimate of changes in the level of exports and imports solely attributable to direct investment abroad. It does seem clear that U.S. direct investment in less developed areas, as a group, generates more net new exports and stimulates more U.S. employment opportunities than direct investment in other industrialized countries. In fact, available evidence suggests direct investment in other industrialized countries opens up relatively few net new employment opportunities in the United States when all aspects of the problem are considered.

Finally, it should be noted that a dollar of direct investment anywhere abroad will create fewer U.S. employment opportunities than a dollar invested domestically, assuming that in both cases demand is sufficient to absorb the increase in output.

Question 3(b): Do you have any statistical information, or have any studies been made, on this relationship?

Answer: Exhibit III, paragraph 3A, pages 184–193, in part I of hearings on April 2, 1962, before the Committee on Finance of the U.S. Senate on the Revenue Act of 1962 deals with this relationship. The Department of Commerce has made some partial studies of the trade flows associated with U.S. direct investment abroad, and it plans to make additional studies of this subject. When completed, they may throw further light on the complex relationship between U.S. direct investment abroad and employment opportunities.

Question 4(a): Can you estimate the amount of tax reduction in dollars which would be received by each of the following income groups: Under $1,000; $1,000–$1,999; $2,000–$2,999; $3,000–$3,999; $4,000–$4,999; $5,000–$5,999; $6,000–$7,499; $7,500–$9,999; $10,000 and over?

Answer: A breakdown in the requested detail is being prepared and will be forwarded to you shortly.

(The material referred to appears at p. 637.)

A less detailed breakdown of what the proposed changes in personal income tax rates will mean in terms of additional disposable income for different income groups is given in the attached table, taken from the statement of the Secretary of the Treasury before the House Ways and Means Committee (February 6, 1963).

It should be noted that, because of limitations of data, a breakdown as fine as the one requested involves considerable estimation work, and this inevitably affects its reliability adversely. Consequently, the forthcoming breakdown cannot be treated with the same confidence as the one supplied here.

Question 4(b): What is the savings rate in each of the above income groups?

Answer: It is not possible to cite a single saving rate for each of the income groups specified in question 4(a). Different cross section or budget studies give different estimates of average saving ratios (or average propensities to consume), by income group. This is clear from the attached tables 1–3, in which the findings of three such studies are summarized.

Almost all budget studies—and the ones referred to here are unexceptionable in this respect—support the same general conclusion: at any point in time, the ratio of saving to income is greater the higher the family is on the income scale. But this conclusion cannot be used to indicate how families will use additional amounts of disposable income. There is strong evidence that cross-section studies do not provide a basis for predicting the response of spending to increases in disposable income. This evidence suggests that the saving habits of families reflect, at least in large part, their relative positions on the income scale at any point in time rather than the absolute level of their incomes.

Question 4(c): If the saving rate for all income groups is 6–8 percent of disposable income, what is the average saving rate for the over $1,000 income classes?

Answer: First of all, it should be noted that data from cross section or budget studies—which are the only studies that can be used to answer this question—do not always directly confirm the 6–8 percent saving ratios indicated by aggregate national income data. The principal reasons for this are two: definitions of personal saving used in budget studies are not always the same as that used for the national accounts; the estimating techniques used to measure personal saving in budget studies are not entirely the same as those used in the Department of Commerce, which is responsible for the national accounts measure of personal saving.

It can be demonstrated using budget studies, however, that the saving-income ratio for all income groups other than the "under $1,000" group differs only moderately from the ratio for all income groups. According to the widely quoted BLS-Wharton School budget study the average consumption-disposable income ratio for all income groups is 92.12 percent, when the consumption-disposable income ratios for the individual income groups are weighted by their respective shares of total disposable income. The weighted average for all but the "under $1,000" income group is 91.94 percent. (See table 4.)

Dropping out the lowest income group changes the average savings- or consumption-income ratio so little because this income group accounts for only 1 percent of all disposable income. Thus, the saving-income ratio of the "under $1,000" income group is relatively unimportant in the overall average ratio.

Question 4(d): How do you define personal savings?

Answer: Most broadly, the saving of any economic organization may be defined as the change in its net worth (i.e., the change in its total assets less the change in its total liabilities). But, in practice, estimates of personal saving differ for two reasons: Estimators sometimes use different definitions of personal saving for particular purposes, and they sometimes use different techniques in actually computing personal saving.

As defined in the national income accounts developed by the Department of Commerce, personal savings is the difference between personal after-tax income and personal consumption, with "persons" defined to include nonprofit institutions, unincorporated businesses, and private pension and welfare funds as well as individuals and families. "Consumption" includes expenditures for consumer durable and nondurable goods and services. Investment in housing and in producers goods are not counted as consumption in their computation. Both personal income and consumption as measured in the national income accounts, include some "imputed" items, for which a certain value is assigned despite the absence of any overt transaction (e.g., consumers are treated as if they paid rent to themselves for houses which they own and occupy).

Personal saving, so computed, has averaged 6 to 8 percent of personal income after taxes over the past decade. It differs from a "net worth" concept of saving only in that fluctuations in the prices of certain assets are not fully accounted for.

The Securities and Exchange Commission has developed figures on the basis of the same definition of personal saving, but a different technique of measurement is used. The SEC estimates personal saving by directly estimating changes in financial and tangible assets and liabilities of households and other "persons." Because of this difference in measurement techniques for personal saving, the Department of Commerce and the SEC data may show different totals for the same year.

Those who have developed cross-section studies of saving by income groups usually proceed on the basis of the "change in assets and liabilities" method of estimating personal saving. These "budget" studies typically eliminate nonprofit institutions and at least some unincorporated businesses from their calculations, and may or may not treat such items as accrued interest on U.S. Government bonds, charge accounts, and currency holdings. Because of these differences in concept, and because of sampling and measurement difficulties, the total personal savings implied by these cross-section studies will not be the same as the aggregate figures developed by either the Department of Commerce or the SEC.

TABLE 6.—*The program for individuals—Distribution by adjusted gross income classes of proposed tax changes excluding capital gains*

AMOUNTS

[In millions of dollars]

Adjusted gross income class (in thousands)	Tax liability under present law [1]	Change in tax liability resulting from:														Total change in tax liability
		Proposed rate change	Minimum standard deduction	Liberalized child care deduction	Revise aged treatment	Income averaging	Moving expenses	5 percent floor on all itemized deductions	Revise medical deduction	4 percent floor on casualty losses	Charitable contributions	Eliminate sick pay exclusion	Eliminate exclusion group term insurance	Eliminate dividend credit and exclusion	Natural resources	
0 to $3	1,450	−410	−180	(2)	−30	....	....	20	....	....	....	10	....	10	....	−580
$3 to $5	4,030	−1,090	−100	−10	−130	....	−20	110	....	10	....	30	....	20	....	−1,180
$5 to $10	18,300	−4,520	−30	−10	−150	....	−20	710	10	40	....	80	20	70	....	−3,830
$10 to $20	12,710	−2,690	....	....	−30	−10	−10	620	....	20	....	30	20	110	....	−1,940
$20 to $50	6,760	−1,410	....	....	10	−20	....	450	....	10	....	10	10	120	....	−820
$50 and over	4,170	−920	....	....	10	−10	....	370	−10	10	10	....	10	130	10	−390
Total	47,420	−11,040	−310	−20	−320	−40	−50	2,280	....	90	10	160	60	460	10	−8,710

PERCENT

Adjusted gross income class (in thousands)	Tax liability under present law [1]	Proposed rate change	Minimum standard deduction	Liberalized child care deduction	Revise aged treatment	Income averaging	Moving expenses	5 percent floor on all itemized deductions	Revise medical deduction	4 percent floor on casualty losses	Charitable contributions	Eliminate sick pay exclusion	Eliminate exclusion group term insurance	Eliminate dividend credit and exclusion	Natural resources	Total change in tax liability
0 to $3	100.0	−28.3	−12.4	....	−2.1	....	....	1.4	....	....	....	0.7	....	0.7	....	−40
$3 to $5	100.0	−27.0	−2.5	−0.2	−3.2	....	−0.5	2.7	....	0.2	....	.7	....	.5	....	−29
$5 to $10	100.0	−24.7	−.2	−.1	−.8	....	−.1	3.9	0.1	.2	....	.4	0.1	.4	....	−21
$10 to $20	100.0	−21.2	....	....	−.2	0.1	−.1	4.9	....	.2	....	.2	.2	.9	....	−15
$20 to $50	100.0	−20.9	....	....	.1	−.3	....	6.7	....	.1	....	.1	.1	1.8	....	−12
$50 and over	100.0	−22.1	....	....	.2	−.2	....	8.9	−.2	.2	0.2	....	.2	3.1	0.2	−9
Total	100.0	−23.3	−.7	....	−.7	−.1	−.1	4.8	....	.2	....	.3	.1	1.0	....	−18

[1] Excludes $1.2 billion of tax on capital gains at the 25 percent alternative rate.
[2] Less than $5 million or .05 percent.

NOTE.—All of above changes assume enactment of proposed rate changes.

Source: Office of the Secretary of the Treasury, Office of Tax Analysis.

TABLE 1.—*Saving-income ratios, by income class: Federal Reserve—Michigan survey research center budget study, 1950*

[In percent]

Disposable personal income	Personal saving-disposable personal income ratio		
	Total United States	Urban United States	Urban United States: Salaried families only
Under $1,000	−55.2	−48.9	−27.9
$1,000 to $1,999	−.2	.9	.5
$2,000 to $2,999	.1	−.7	.8
$3,000 to $3,999	5.6	4.9	4.3
$4,000 to $4,999	9.1	7.7	6.5
$5,000 to $7,499	12.7	12.9	10.9
$7,500 to $9,999	28.4	30.1	20.3
$10,000 and over	33.1	29.6	26.7
All	8.6	9.2	8.5

Source: I. Friend and S. Schor, "Who Saves?" Review of Economics and Statistics, May 1959, vol. XLI, No. 2, pt. 2, p. 217.

TABLE 2.—*Saving-income ratios, by income class: BLS-Wharton School budget study, 1950*

[In percent]

Disposable personal income	Personal saving-disposable personal income ratio		
	Urban United States	Urban United States: salaried families only	Urban United States adjusted [1]
Under $1,000	−105.5	−82.6	−81.7
$1,000 to $1,999	−13.5	−8.8	−6.2
$2,000 to $2,999	−5.0	−3.3	−1.7
$3,000 to $3,999	−0.7	0.1	2.4
$4,000 to $4,999	1.7	2.4	4.5
$5,000 to $5,999	5.2	4.5	6.5
$6,000 to $7,499			10.0
$7,500 to $9,999	12.3	12.1	16.3
$10,000 and over	26.4	19.7	30.7
All	4.3	3.9	8.2

[1] Adjusted for statistical bias (see source for details).

Source: I. Friend and S. Schor, "Who Saves?" Review of Economics and Statistics, May 1959, vol. XLI, No. 2, pt. 2, pp. 217, 232.

TABLE 3.—*Saving-income ratios, by income class: Michigan Survey Research Center, budget survey, 1960–61*

Personal income	Personal saving-personal income ratio (total United States)	Personal income	Personal saving-personal income ratio (total United States)
	Percent		*Percent*
Under $2,000	−5.2	$6,000 to $7,499	11.6
$2,000 to $3,999	3.9	$7,500 to $9,999	13.6
$4,000 to $4,999	6.2	$10,000 to $14,999	19.8
$5,000 to $5,999	8.8	$15,000 and over	23.8

Source: Survey Research Center, University of Michigan, 1961 and 1962 Surveys of Consumer Finance.

TABLE 4.—*Average consumption-income ratios (BLS-Wharton School budget study, 1950)*

Disposable personal income	Adjusted [1] consumption-income ratio	Disposable income as a share of total sample disposable income	Disposable personal income	Adjusted [1] consumption-income ratio	Disposable income as a share of total sample disposable income
Under $1,000	1.817	0.010	$5,000 to $5,999	.935	.132
$1,000 to $1,999	1.062	.048	$6,000 to $7,499	.900	.108
$2,000 to $2,999	1.017	.121	$7,500 to $9,999	.837	.076
$3,000 to $3,999	.976	.214	$10,000 and over	.693	.098
$4,000 to $4,999	.955	.193			

	Percent
Weighted average of the average propensities to consume of all income classes	92.12
Weighted average of the average propensities to consume of all but the lowest of the income classes	91.94

[1] For statistical bias. See I. Friend and S. Schor, "Who Saves?" Review of Economics and Statistics, May 1959, vol. XLI, No. 2, pt. 2, p. 232, for details.

Chairman DOUGLAS. We will meet tomorrow at 10 o'clock in this room and the gentlemen of the Federal Reserve Board will be up.

(Whereupon, at 1 p.m., the committee recessed, to reconvene at 10 a.m., Friday, February 1, 1963.)

JANUARY 1963 ECONOMIC REPORT OF THE PRESIDENT

FRIDAY, FEBRUARY 1, 1963

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

The committee met at 10 a.m., pursuant to recess, in room AE–1, the Capitol, Senator Paul H. Douglas (chairman of the committee) presiding.

Present: Senators Douglas, Proxmire, and Pell; Representatives Reuss and Curtis.

Also present: James W. Knowles, executive director; John R. Stark, clerk; William H. Moore, Roy E. Moor, and Donald A. Webster, economists.

Chairman DOUGLAS. The committee will come to order.

We are very happy to have with us this morning the distinguished Chairman of the Board of Governors of the Federal Reserve System, Mr. Willian McChesney Martin, Jr., and his associates.

Will you proceed in your own way, Mr. Martin?

STATEMENT OF HON. WILLIAM McCHESNEY MARTIN, JR., CHAIRMAN, BOARD OF GOVERNORS, FEDERAL RESERVE SYSTEM; ACCOMPANIED BY RALPH A. YOUNG, SECRETARY, FEDERAL OPEN MARKET COMMITTEE, AND DIRECTOR, DIVISION OF INTERNATIONAL FINANCE; AND GUY E. NOYES, DIRECTOR, DIVISION OF RESEARCH AND STATISTICS

Mr. MARTIN. Thank you, Mr. Chairman. It is nice to be back again. The focus of my remarks will be on the financial aspects of the economic situation and particularly on the role of monetary policy.

Individuals, business concerns and governments—national, State, and local—obtained financing in record volume in 1962. Altogether, through borrowing and the issuance of securities, they acquired additional funds in the net amount of $58 billion. That surpassed 1959's previous record by $5.5 billion. It exceeded 1961 by $12 billion.

Mortgage loans registered a record expansion of $24 billion. Consumer credit outstanding showed a marked rise of $5.5 billion—three times as much as in 1961. Corporations cut back the issuance of bonds and stocks but stepped up their short-term borrowing. New borrowing by the Federal Government equaled that of the previous year, while new borrowing by State and local governments continued in about the same record volume as in 1961.

A considerable part in supplying the financial needs of the Nation was played by the banking system. Commercial banks increased their outstanding loans and investments by a record $19 billion. The increase in loans amounted to $14 billion; purchases of State and local securities accounted for the rest. The rate of expansion, 8.5 percent for the year as a whole, was rising more rapidly as the last 5 months went by.

One particular display of enterprise by the banks seems worthy of special attention. The story behind it begins with the start of 1962 when, taking swift advantage of authorizations from the Federal Reserve and the Federal Deposit Insurance Corporation, banks in impressive numbers set out to gain deposits by raising the interest rates they pay for savings accounts and also for time deposits of 6 months or more.

The results were dramatic: the public responded to the higher rates by increasing its time and savings deposits some $15 billion, net, or 18 percent—at an annual rate—a development unequaled in postwar experience. Also dramatic was the aftermath: the banks responded to the mounting inflow of funds by lending on real estate in an amount unmatched since the war and by purchasing State and local securities in a volume unprecedented in history. Meanwhile, in further reflection of the effect produced by the rising supply of savings, interest rates on mortgages and interest yields on State and local securities moved generally lower despite rising borrower demands. Thus, the flow of funds that was given impetus by the offer of benefits for savers brought about benefits for borrowers as well, and, I might add, for the entire economy.

To backstop and sustain that movement of funds—plus the still more massive process of total bank credit extensions—the Federal Reserve provided the reserves required to support the considerable expansion of deposits entailed. Indeed, it went beyond that, so that, at all times in 1962, the banks had an extra margin of reserves that would have enabled them to meet an even greater loan demand than actually materialized. Over the course of 1962, the Federal Reserve provided a total of $1.9 billion of reserve funds, through its payments for Government securities purchased in the open market, to support bank credit and monetary expansion. For this purpose, it also released in late autumn another $750 million in bank reserves by reducing from 5 to 4 percent the reserves required against savings and time deposits.

Bearing in mind that the course of the economy is determined by a whole complex of individual, business, and Government decisions in which monetary policy plays only a modest part, it seems to me that the Federal Reserve System did just about what could and should have been expected of it in 1962. Monetary policy most certainly did not provide—nor could it have provided—a solution to the major economic problems which confronted us during the year. But it did contribute to credit conditions that were, I think, conducive to that end.

The American economy progressed in many respects in 1962. For the year as a whole, gross national product (in constant dollars) rose 5 percent, industrial production nearly 8 percent, nonagricultural employment 2 percent, personal incomes 6 percent, and corporate profits 12 percent. Consumer prices rose 1.2 percent during the year, but wholesale prices remained virtually unchanged.

Yet we continue to be plagued by relatively high unemployment and by a substantial deficit in our international balance of payments.

The number of people having jobs rose 1.2 million in 1962—and at the seasonal peak of employment last summer there were almost 70 million people at work suggesting that we may indeed top the 70 million job milestone this coming summer. Yet the average rate of unemployment declined only to 5.6 percent in 1962 from 6.7 percent in 1961. Furthermore, despite an increase in industrial production to a level 8 percent above the previous high in the first quarter of early 1960, the number of workers on the production lines of the Nation's factories declined 500,000 or 4 percent in the same period.

And even though continuing efforts to reduce the deficit in our international payments registered some success, the gap between our payments abroad and our receipts from international transactions continued large for the fifth consecutive year. In 1962, that deficit is now estimated at somewhat more than $2 billion, even thought it was held down, as it had been the year before, by large prepayments by foreign governments of long-term debt to the United States. Noteworthily, imports of merchandise, given impetus by expansion in the American economy, rose more than exports. In consequence, the trade surplus on which we count to help cover our military expenditures abroad, foreign aid programs, and our capital outflow narrowed to less than $4.5 billion in 1962, compared to nearly $5.5 billion in 1961.

Let me say here that providing a sound financial basis for a healthy growth in the United States and maintaining international confidence in the dollar as a reserve currency are but two sides of one indivisible problem. There is no set of policies that is truly good for the domestic economy, but bad for the dollar; and there is no course of action that is really good for the dollar, as an international currency, which is not good for the American economy.

There is the tendency to speak of international versus domestic goals. This seems to me to be only the latest version of a series of problem formulations in terms of unrealistic alternatives. Over the years, we have seen counterposed, full employment or price stability, social objectives or financial objectives, and stagnation or inflation. In the last case there was even serious discussion of the number of percentage points of inflation we might trade off for a percentage point increase in our growth rate. The underlying fallacy in this approach is that it assumes that we can concentrate on one major goal without considering collateral, and perhaps deleterious side effects on other objectives. But we cannot. If we were to neglect international financial equilibrium, or price stability, or financial soundness in our understandable zeal to promote faster domestic growth, full employment, or socially desirable programs, we would be confronted with general failure.

In the search for an appropriate policy in the monetary sphere, many factors must be weighed together to strike a balance. There is no ideal policy that will solve at one and the same time the balance-of-payments problem, the unemployment problem, and the growth problem, the wage-price problem, the profit-squeeze problem, the housing problem, or any other problem—for none of these problems can be attacked in isolation through monetary policy.

As we enter 1963, the banking system continues to be in a favorable position to extend further credits. Taken altogether, the banks continue to have more reserves than they are required to carry, and only a very small fraction of these excess reserves are attributable to borrowing from the Federal Reserve System. In other words, the banks as a group have a considerable margin of "free reserves." They also have a sizable portfolio of near-term Government securities that they can use to raise further funds for loan expansion as opportunities to extend private credit arise.

In the language of the marketplace, the posture of monetary policy has been and remains "easy." At the same time, we have tried to avoid placing banks in a position which would impel them to reach beyond the bounds of prudence and good financial judgment in extending credit. We have tried to keep enough give in the credit structure to meet the growing needs of the economy, but not so much as to encourage speculative excesses. This program has served the dual purpose of maintaining the soundness of domestic credit developments, and at the same time lessening incentives to transfer short-term funds abroad.

Keeping day-to-day policy in consonance with these basic System objectives is a never-ending process of evaluating the continuously changing scene, on both the domestic and international economic and financial fronts. One of the great strengths of the Federal Reserve System is that it has a 7-man Board of Governors and 12 regional Reserve banks from which a wide variety of views is brought to bear on all monetary decisions.

Quite naturally, and I believe quite helpfully, there have been some differences of view in the System over the precise course of current action most likely to achieve the objectives upon which we have been mutually agreed. On several occasions some members of the committee have felt that we would contribute more to the achievement of healthy expansion by increasing slightly the availability of reserves, while others have felt that the situation, particularly for balance-of-payments reasons, called for a modest move in the opposite direction. Yet the range of these differences was narrow and consequently the differences between the policies adopted and the alternatives proposed were, typically, quite small.

It is not my practice to attempt to forecast the future course of economic events or to comment on the monetary and credit policies that would be appropriate to them. Over the years I have found that viewing the economic prospects for the United States in the year ahead with cautious optimism is as good a working assumption as I have been able to discover. I agree with the statement in the President's economic message that the broad outlook is for continued moderate expansion.

Without in any way retreating from my position of cautious optimism, I would like to call attention to three things that concern me as I review our national situation and its prospects. First, the problem of financing the large Federal deficit that seems inevitable for fiscal 1964, whether or not the tax reductions recommended by the President are enacted. Second, the problem of finding an economically sound and workable program to reduce unemployment and to take care of those who, despite their efforts to find work, are caught in a maelstrom of economic forces that causes them prolonged joblessness. Third, and finally, the problem of achieving a satisfactory equilibrium in our balance of payments.

Let me take first the matter of deficit financing. As a widely read financial writer (Sylvia Porter, Washington Star, January 28, 1963), put it—very well, I thought—in a recent column:

> The method of financing the deficit can (1) lay the base for another inflationary upsurge and weaken the dollar's value; or it can (2) have some stimulating impact on the economy, just because the Government is putting more money into our pockets than it is taking out in taxes. But it must not flood the business stream with extra money, set off another speculative spiral, or undermine the dollar's value here or abroad.
>
> This is the crucial point, but it is so much in the sphere of technical high finance * * * .

and mind you, I am still reading from the article—

> * * * that very few people out of Washington grasp what it means.
>
> Consider what is happening to this year's budget deficit.
>
> We are running a budget deficit now estimated at $8.8 billion. Most of the money to cover this deficit already has been borrowed by the Treasury.
>
> How has it been borrowed? Almost entirely outside of the banking system—which is the heart of the whole matter.
>
> U.S. corporations have bought large amounts of the Treasury's short-term securities and have put their extra cash into Treasury IOU's instead of spending it. Foreign investors and foreign central banks have bought big chunks of the Treasury's IOU's and have been investing their extra cash instead of spending it. There is nothing inflationary about these operations at this time.
>
> Had the Treasury borrowed the money from the U.S. banking system, though, the picture could be drastically different. For when banks buy the Treasury's securities, they simply place a deposit in the Treasury's name on their books; they put up only a fraction of their own cash. When these deposits in the Treasury's name are on the books of the banks, the Treasury has the money to spend.
>
> As the Treasury spends the money for goods and services, the extra cash goes into the hands of the public in the form of profits and paychecks. This means the Nation has more buying power—and unless the supply of goods and services also rises, the base for potentially inflationary price increases is established.
>
> Today, there are no shortages of goods and services. Today, the supply of money and credit is ample, but it is not flooding the business stream. The Treasury has managed its borrowing in a primarily noninflationary way. The Federal Reserve System has kept its control over the money supply. The result is that price inflation is hardly a problem now.
>
> * * * * * * *
>
> This year's $8.8 billion deficit is not causing inflation. Next year's deficit need not do so either. It all depends on how the deficit is financed.

As a comment of my own, let me add that, in my judgment, the Open Market Committee of the Federal Reserve System would be derelict in its responsibilities were it—in the light of a large deficit—to add to bank reserves and to bring about substantial credit expansion solely to facilitate the financing of the deficit. It would be improper to risk unsettling the balance of payments or to tempt banks to make imprudent investments through a sudden expansion of liquidity. Above all, it would be ill advised to generate the danger of inflation, either long run or short, by creating redundant dollars, in order to make easier the financing of a deficit.

In our system of government, it is the duty and responsibility of the Congress and of the President to make the decisions on Government expenditure and tax policies by which the size of Federal deficits is determined. Determination of those policies is not the responsibility of the Federal Reserve, but the System does have a responsibility in helping to finance any deficits. It is the manner in which help is provided that is critical.

So, seeing to it that the Treasury is able to carry out its borrowing operation in an orderly manner is an obligation binding upon the Federal Reserve. On the other hand, there is a reciprocal obligation on the part of the Treasury to conduct its operations with recognition of the Federal Reserve's responsibility for healthy credit and economic conditions, and for stability of the dollar. The Treasury obviously would not expect the Federal Reserve to inflate the money supply, thereby putting the entire economy in jeopardy, merely so that the Treasury could get money at an artificially low rate. So, with complementary responsibilities, the Federal Reserve and the Treasury must work together in complementary fashion. Neither can ignore the forces of supply and demand that are reflected in the marketplace. Instead, both must assess market forces and determine their policies accordingly.

The accommodation of the Treasury's financing needs, without disrupting the money and capital markets, is always one important objective of Federal Reserve policy. But this does not mean that bank credit should be expanded automatically by the amount of each Treasury issue that goes to market. Our objective at all times must be, as it has been in the past, to foster growth and employment, a stable value for the dollar, and equilibrium in the balance of payments.

This question of financing deficits has raised, and will doubtless continue to raise, troublesome semantic problems. The word "saving" has many meanings. As I pointed out to your committee last summer, the total expansion of bank credit in our financial structure reflects both savings placed with banks as intermediaries and the creation of money through the expansion of demand deposits. After the fact of creation, these deposits become incorporated in our accounting of financial savings.

Once the semantic difficulties have been cut through, the difference of view among thoughtful people seems to me to be very small. I have never said that there should be no monetary expansion in a year in which the Federal Government is incurring a deficit, and, as the Council of Economic Advisers points out in its report, no one seriously contemplates that the Federal Reserve should increase bank reserves in an amount equal to the deficit. What we should do, and will try to do, is to maintain conditions of reserve availability in the banking system, which will help to match the rate of total bank credit and monetary growth to the needs of the total economy. This is not financing deficits with bank-created money. Nor is it offsetting or stifling any constructive impulse to economic expansion that may flow from tax reduction.

Let me turn now to the second of the problems I have singled out for special mention. Unemployment is a complex problem that has no simple solution. Many workers have gone through the cyclical ups and downs of the postwar period with little direct experience with unemployment, while some groups of workers have suffered severe hardship from it. Large clusters of unemployment have plagued certain communities, occupations, age brackets, and racial groups.

The continuing high levels of persistent unemployment reflect a combination of demand and structural forces. We need a higher rate of sustainable growth to absorb the unemployed and provide jobs for a rapidly growing labor force, and fiscal and monetary policies can help to bring that about. But other measures are needed to deal with structural problems.

Unemployment is not merely a count of interchangeable units of labor. The unemployed are people whose characteristics and abilities vary greatly. The existence of high and growing levels of long-term unemployment among certain groups in our population in good times and bad indicates some very serious imbalances between the developing demand for labor and the existing supply.

Demands for labor must be sufficient in total terms. But the characteristics and location of workers who are seeking employment must also be suited to those demands. Actions taken to upgrade the work force, to increase its mobility and productivity, will make it much easier for unemployed workers and new workers to meet the requirements of rapidly changing technology and job demands.

In the recession-recovery periods since 1953 the same underlying employment patterns have recurred. Although total employment and industrial production rebounded in 1962 to new record levels, as after each of the preceding recessions, the number of factory and related industrial workers required to produce an increased volume of goods declined. In contrast, in service occupations, both private and public, employment has continued to expand and new employment records are set month after month.

As we look toward the future, two features of special importance may complicate efforts to achieve low unemployment: First, technological changes in the economy have had an important influence in sharply altering the character and content of job opportunities. These changes are bound to continue, perhaps at an accelerated pace. They foreshadow a further rapid upgrading in the demand for labor which will outpace the upgrading of the labor supply. The transition to new jobs will be slow and difficult for the displaced worker. Action will be needed to ease the burdens of those who become unemployed lest restrictive work practices reduce productive efficiency.

Second, we also face the inescapable challenge of a faster growing population of working age. Many more jobs will have to be found each year. About a million and a quarter persons are expected to be added to the labor force in each of the next 5 years compared to only about 800,000 in the past 5 years. By 1965, the burgeoning population of 18 to 24 years of age will account for more than half of the annual growth in the labor force. Unemployment rates are now very high among these young people, especially those with insufficient education. The long-anticipated expansion in demand for homes, cars, and all sorts of goods and services will hardly materialize if we fail to find job opportunities for our growing population.

The likely characteristics of unemployment caused by structural change in the coming years also indicate the need for a wide range of approaches by State and local governments, the educational system, the parties to collective bargaining and other private organizations. Foremost is the need for continued increases in the productivity and quality of our work force to meet the rapidly changing content of jobs. For our youth, we must provide better vocational guidance and greater opportunities to get training for skilled and professional work.

Experimental programs for training and retraining unemployed workers have had some success in increasing skills and occupational mobility. Such programs should be given to more of the unemployed.

More intensive efforts are required to get unemployed workers in depressed areas to areas where jobs are available.

The reduction in unemployment which we are able to achieve will continue to depend importantly on the success we have in shifting the composition of the labor supply to meet the changing needs of our economy. At the same time, of course, I recognize that we need also to pursue fiscal and monetary policies that will help to encourage growth in the total demand for our labor force. The important thing, as I stated to this committee 2 years ago, is to proceed simultaneously, on the one hand, to invigorate the economy and, on the other, to alleviate unemployment resulting from structural changes.

Finally, let me comment briefly on our balance-of-payments problem. At the beginning of my remarks, I pointed out that balance in international payments is not a goal that monetary policy can pursue apart from its domestic goals. Indeed, the objective of payments equilibrium must be achieved at the same time we are achieving orderly and vigorous economic growth domestically or we will risk achieving neither objective.

As a result of five large successive deficits, we have transferred to foreigners some $7 billion from our monetary gold stock and added another $9 billion to our liquid liabilities. Through a combination of market processes and through some shifting in the balance of Government transactions, we have made progress in lowering the size of our deficit. But I agree with the view expressed recently by your subcommittee, under the chairmanship of Mr. Reuss, that this progress has not been satisfactory. Accordingly, we must more firmly pursue those policies that hold promise of eliminating our payments deficit and establishing a viable equilibrium in our international accounts.

The volume of Government expenditures abroad—for economic aid to the less-developed nations and for the defense of the free world—is and must be determined by broad considerations of national interest and security. The administration has been pressing, with some success, for a greater sharing of these burdens by our allies. As your subcommittee has recommended, continued efforts in this direction are certainly appropriate and will be made, I am sure.

But correction of the imbalance in our international transactions requires persistent improvement in the competitive position of our export industries and our industries competing with imports, and a related increase in the attractiveness of investing in the United States compared with investing in other industrial countries. This method can be effective only in the long run, but in the long run it is bound to be effective. Its accomplishment, however, requires the combined efforts of all of us.

Business management has a vital role to play because of its organizing role in a private enterprise economy. Businesses must meet the test of constant adaptation to the most efficient production techniques, and they must design and price their products with a view to the widest profitable distribution at home and abroad. Competitive pricing is vital.

Moderation in wage demands is also vital to our international competitive effort. Sustainable increases in wages can be achieved only within limits of realizable increases in productivity. And we need to remember that overrapid increases in labor costs add to the problem of unemployment by creating exaggerated incentives to economize on the use of labor.

To me, an encouraging development of recent years has been an increasing awareness by both business and labor that these considerations—which were always in their own interest—are now urgently in the national interest because of our difficult payments position. Part of the progress we have been able to make in reducing the payments deficit since 1959 comes from the relative stability of prices and labor costs in this country as compared with those in Europe.

Our national financial policies have a vital role to play in strengthening our competitive position internationally, both in markets for goods and services and in investment potential. Fiscal policy will need to avoid, on the one hand, a too-heavy burden on economic incentives to invest and consume, and, on the other, budget deficits too large to be financed without inflation. Monetary policy will need to facilitate the meeting of legitimate bank credit demands in our growing economy, but it must avoid a domestic monetary expansion so rapid as to induce rising costs and prices, unwise speculation, and excessive capital outflows to other countries.

In connection with our balance of payments problem, we need always to keep in mind the central role that the dollar plays in the international payments system and the fact that this role is founded upon freedom from exchange restrictions. Whatever temporary advantage might be gained for our payments deficit by direct controls over our international transactions would be more than offset by the damage such controls would do to the widespread use of the dollar in settlement of international transactions.

With the economies of the free world becoming more closely knit together by an international payments system based on convertible currencies and open competitive markets, cooperative international efforts are needed to restore and maintain payments equilibrium and to guard against disruptive exchange market developments. Fortunately, the need is widely recognized and the responsibility widely accepted.

This past year the Federal Reserve System gave formal recognition to this responsibility by inaugurating foreign currency operations under the supervision of the Federal Open Market Committee. This action put the System in a position to intervene in the exchange markets for the protection of the dollar under conditions of transitional unsettlement of those markets arising from volatile shifts in the stream of international payments.

The System has further supported its participation in foreign currency operations by cooperating more actively and directly with the central banks of our principal trading partners and with international organizations playing a coordinating role in the functioning of the world payments system.

Because of our balance-of-payments situation, the newly inaugurated Federal Reserve operations in foreign currencies have concentrated this past year on the establishment of a network of mutual currency credits with other central banks, principally on a standby basis. We now have arrangements totaling more than $1 billion with the central banks of Europe and Canada and the Bank for International Settlements in Basle, which are capable at our call of providing foreign currencies to that amount if needed to meet undesirable exchange market developments. It is our hope that these arrangments will remain a useful international device and a continuing symbol of active cooperation in preserving and strengthening the world payments system.

Closer cooperation among leading central banks has already contributed much to greater resiliency and flexibility of the world's payments mechanism. This was demonstrated in 1962 by its absorption of the shock of sharp worldwide decline in equity values in the late spring and early summer, of the potentially disruptive effects of the difficulties encountered by the Canadian dollar following its devaluation in the spring, and of the unsettlement of international markets occasioned by the Cuban crisis. And to the extent that the world's payments system absorbed these adverse developments with little unsettlement, the impact of these developments on the domestic financial markets was also cushioned.

From my remarks today, it should be clear that the year 1963 will confront us with important and difficult problems. We must work toward a solution of structural unemployment at the same time that we generate more aggregate demand for our manpower by healthy overall expansion of the economy. We must finance our prospective deficit in a noninflationary way. And finally, we need to make decisive gains in restoring our balance of payments equilibrium. If your review a year hence shows substantial progress in meeting these problems, it will indeed be a gratifying occasion.

Chairman DOUGLAS. Thank you very much, Chairman Martin. I am going to ask Representative Reuss to open the questioning.

Representative REUSS. Thank you, Mr. Chairman.

Mr. Martin, in your statement you refer to the fact that you have kept a substantial volume of free reserves in the banking system during 1962 and in general I have been very glad to see that. As you know, from our past discussions, I have always been inquisitive about that level of free reserves and rather consistently happy over the last 2 years that it has been in general around the $400 to $500 million mark.

However, I note that last November or December, there was apparently a change in the Federal Reserve System open market policy in this respect. Not only did the level of free reserves decline to around $300 million, where it has stayed ever since, but, as was reported by the magazine Business Week on January 19, 1963, and I quote from them:

> The first basic shift in Federal Reserve monetary policy in 2½ years is taking place. Ever so slightly the Fed is tightening credit, stepping away from the policy of active ease it adopted early in 1960 when recession threatened.

Naturally, since our job is, under the Employment Act of 1946, to review the past year, I am interested in what happened. Would you, therefore, so that I can inform myself intelligently on it, hand me the minutes of the meetings of the Federal Reserve System and the Open Market Committee for last November and December so that on reading the text of the directive of the Open Market Committee, I can ask you some questions about it?

Mr. MARTIN. I will take the matter up with the Open Market Committee, Mr. Reuss. I would not have authority to give you those minutes without their concurrence.

Representative REUSS. When would you do that?

Mr. MARTIN. I will do that at our next meeting which is on February 12. I won't make any forecast as to what their decision will be on it.

Representative REUSS. Let me read with you a couple of the statutes governing the relationships of the Fed and the Congress.

Section 10 of the Federal Reserve Act says that—

The Board of Governors of the Federal Reserve System shall keep a complete record of the action taken by the Board and by the Federal Open Market Committee upon all questions of policy relating to open market operations and shall record therein the votes taken in connection with the determination of open market policies, and the reasons underlying the action of the Board and the Committee in each instance.

The Board shall keep a similar record with respect to all questions of policy determined by the Board and shall include in its annual report to the Congress a full account of the actions so taken during the preceding year with respect to open market policies and operations.

You don't question that is what the law says?

Mr. MARTIN. That is what we do.

Representative REUSS. Let me read you section 7 of the Federal Reserve Act:

The Board of Governors of the Federal Reserve System shall annually make a full report of its operations to the Speaker of the House of Representatives who shall cause the same to be printed for the information of the Congress.

You don't dispute that is what the law says?

Mr. MARTIN. That is what we do, Mr. Reuss.

Representative REUSS. You are also familiar with the Employment Act of 1946 which says that on January 20 of every year, "the President shall," and here I am reading from section 3—

transmit to the Congress a review of the economic program of the Federal Government and a review of economic conditions affecting employment in the United States or any considerable portion thereof during the preceding year.

No doubt about that. You are familiar with the Employment Act of 1946?

Mr. MARTIN. I am, indeed.

Representative REUSS. You are also familiar with section 5(a) of the Employment Act of 1946 which defines the duties of this committee among others to review the economic history of the past year and to make a report to Congress by March 1 of each year. No doubt in your mind about that section of the statute, is there?

Mr. MARTIN. None whatever.

Representative REUSS. Is it not a fact, Mr. Martin, that habitually your reports to the Congress, which give us the only clue as to what the Open Market Committee did in the preceding year, come up on March 7, 8, or 9, just a few days after the March 1 deadline when we have to make our report?

Mr. MARTIN. That is a point that you are making, Mr. Reuss, which is true. Our report is not an easy report to write. We have tried to hasten its publication. We may find some means of hastening it even further.

Representative REUSS. Is it not also true that there is no statutory warrant whatever for your delaying it until after the March 1 deadline when we have to get in our report? As far as section 7 says, you have to make a report as soon as may be after the end of the year in which you are writing the report.

Mr. MARTIN. That is what it says and we try to make it just as quickly as we can. There is no statutory requirement for a specific date.

Representative REUSS. The President has to report on everything in the economy by January 20. Now you tell me that you can't even report on the monetary portion of the economy by January 20; you have even said that you cannot even tell me whether you will be able to do it by February 12.

Mr. MARTIN. You are asking for a different thing now.

Representative REUSS. That is why I read both sections. They contain the action of the Open Market Committee.

Mr. MARTIN. You have a point there. We ought to try to hasten this publication. But the reason for putting this in the law was to give us a reasonable chance to pull this together and not inject it into the market stream at a specific time.

Representative REUSS. That is so. The duties of this committee are very clear. I do not see how we can carry out our analysis of what happened——

Mr. MARTIN. I can assure you the Federal Reserve Board wants to help this committee in any way it can. Now that you have raised the point, we will see if there is anything we can do to hasten giving you this material. There is no intention on our part to delay at all.

Representative REUSS. I am sure there is not. There is no intention on my part to be critical, but the fact is—we both smiled at that. But the fact is that we cannot do our job if we do not know whether the Open Market Committee did embark upon a new tack in November or December. I would like to know what was done then.

Can you not, in this new cooperative spirit that we have developed in the last couple of minutes, get hold of your colleagues on the telephone and ask them whether that which the printer now has in his hands, the minutes of the Open Market Committee do not show a policy shift? I suspect that a copy of the minutes are here in this hearing room this morning. Why can't they be handed up to this committee so we can read them and then ask you some questions about them?

Mr. MARTIN. There is quite a difference, Mr. Reuss, between the policy record and the minutes. I think that we ought to try to hasten the policy record. I am in agreement with that.

The problem of the minutes is a different question. I am not sure whether we ought to keep minutes as extensive as we do if they are going to be made public. This is a problem that your committee has had before it for some time.

Representative REUSS. All I am asking is that you give us now what we will have 4 days after our report is due; namely, in March.

Mr. MARTIN. I will try to give that to you. I will say to you now that you are correct in your analysis that the Federal Reserve is pursuing a slightly less easy policy. I am not familiar with that article in Business Week. I don't think I have read it.

Representative REUSS. Good for Business Week. They seem to have scooped the Joint Economic Committee by about 6 weeks on this.

Mr. MARTIN. No, I think they have done the same thing in part that you have done in observing the level of reserves. I have often pointed out that is not an accurate measure. But, nevertheless, over a period of time we make the most complete statement of any central bank in the world. Our weekly statement that comes out gives any thoughtful person who reads it material that is meaningful and current. We frequently have to revise it because we are making only estimates on some items in it. But we give the most complete, prompt information of any central bank in the world every week in our statement.

Representative REUSS. You know my position. I think that the Fed should be an independent agency but not a sphinx. If we cannot tell what you did, let alone why you did what you did, we are not in a very good position to comment to the Congress on whether we think the Fed is adequately carrying out the duty which Congress has delegated.

Can we conclude this, because my time is up? Would you as a matter of urgency review with your colleagues whether you cannot now within the next few days present to this committee, so that it can have the benefit of them for its deliberations, that which this committee would see anyway on March 7, 8, or 9 when you get out your annual report?

Mr. MARTIN. I will, indeed.

Representative REUSS. If the printer can see it, and I am sure he has it now, I think we could.

Mr. MARTIN. I am not sure whether the printer has it or not, but I will review it.

Representative REUSS. Will you let the chairman know within the next few days?

Mr. MARTIN. I will.

Representative REUSS. Thank you very much.

Chairman DOUGLAS. Representative Curtis.

Representative CURTIS. Thank you, Mr. Chairman. First, let me commend you, Mr. Martin as I have in the past, for a very clear presentation. I want to investigate separately the foreign and domestic pictures, although I note in your paper you rightly point out that we tend to separate them too much, when they are in fact, very closely integrated.

As I understood the testimony of both Secretary Dillon and Secretary Hodges—and I think it conforms with that of Dr. Heller—they have identified plant investment as one of the causes of a slowdown in the rate of growth in 1962 over 1961.

Do you recall whether industrial investment was around 9 percent?

Mr. MARTIN. I don't know the figure. We will get it for you, Mr. Curtis.

(Mr. Martin, later, supplied for the record the following:)

Preliminary figures indicate that total business spending on new plant and equipment increased 9 percent in 1962 over 1961.

Representative CURTIS. I want the figures for the record. I want to identify it for the purpose of the question. At any rate, these witnesses have said that a slowdown in this area weakened the rate of growth in 1962 in relation to 1961. Would your observation be in accord with that?

Mr. MARTIN. That there has been a slowdown in investment?

Representative CURTIS. And that it is a major cause of this slowdown in 1962 in relation to 1961?

Mr. MARTIN. Yes, I think so.

Representative CURTIS. There seems to have been no shortage of investment dollars in this area. In other words, the liquidity situation of our corporation is ample. Do you agree with Secretary Hodges and Secretary Dillon who believe that was the situation?

Mr. MARTIN. I agree with that.

Representative CURTIS. I think Secretary Hodges, in particular, described it as a matter of incentive for business to invest. The problem lay in an inadequate profit margin.

Would you feel that analysis still holds?

Mr. MARTIN. Yes, there is no question of that.

Representative CURTIS. Under this situation, a tax cut to the investment dollar is only of value as it might relate to incentive, not to the amount of investment dollars available.

Mr. MARTIN. I think that is right. I think one of the drags on the economy probably has been in this investment area. We have all been talking about tax revision and tax reform for a long time. The purpose of that is to improve incentive.

Representative CURTIS. The great problem in the profit margin, as I understand it, is the cost-price squeeze.

Mr. MARTIN. That is of equal importance. That is what I point out in my statement here. That is a very vital factor.

Representative CURTIS. A tax on profit, and that is what the corporate tax is, relieves a cost-price squeeze in only a minor way.

Mr. MARTIN. That is right.

Representative CURTIS. Our fundamental problem cannot be cured by a tax cut. I am talking now of the investment dollar.

Mr. MARTIN. I think there are many aspects of the problem, and I don't think that is the only aspect of it. But that is one of the aspects.

Representative CURTIS. I have always been in favor of tax reform, particularly in this area. But I do not base my reasons upon Dr. Heller's theory that releasing funds from the governmental sector through deficit financing, would have a strong impact on this incentive for business investment. If business has the funds, the tax aspect of the incentive to invest is only one of many deterrents that prevent corporations from investing further.

Mr. MARTIN. Yes. I think the justification—the only justification—for a deficit caused by tax revision and tax reform and tax reduction is an incentive. If it does not produce additional incentive, then there is no justification for it.

Representative CURTIS. Continued deficit financing, particularly of this size, would be more harmful to business incentive than any good which might arise from its mild impact on the profit margin or cost-price squeeze. Would you comment on that?

Mr. MARTIN. I am not enthusiastic for deficit financing. I am sure all the members of this committee here know that.

Representative CURTIS. I know you are not. I am relating it to incentive. What would be the impact on business incentive to invest? Would corporations pursue this novel tax cut theory advanced by the administration to stimulate the economy without any Federal expenditure reform?

Mr. MARTIN. I think that has to be a judgment on the type of tax reduction and the structural tax reforms that are being achieved.

That is out of my field. I keep out of that area because there are a lot of judgment values in that and I have not made any effort to familiarize myself with it. But that is the justification, really, for doing it. There is a calculated risk being taken whenever you increase your deficit.

Representative CURTIS. As I understand the administration's theory, it is partly predicated on the assumption that a released consumer dollar to improve disposable personal income would produce consumer demand. In this assumption there is a fixed savings rate of around 7 percent. In other words, 7 cents of every dollar would be for savings and 93 cents for expenditure.

As I have indicated before, this 7 percent is not a traditional figure. It occurred from 1950 to 1960. But in the thirties it was 2.9 percent. In the twenties it was around 5.5 percent.

Our studies also reveal that rate of savings varies markedly in relation to the various income groups in our society. It rises to over 30 percent in the higher income groups and drops to a minus figure in the lower income groups. It is around 10 percent, as I recall, for the $4,000 income group.

Inasmuch as a tax cut would only affect income tax payers, and, therefore, not the consumer dollar directly, it would add consumer dollars only to those in the known income tax paying brackets. Thus the savings rate for those who would benefit by a tax cut would be considerably higher than 7 percent. It would probably be around 10 percent.

Mr. MARTIN. I am not competent really to comment.

Representative CURTIS. You have not followed this theory the administration advanced?

Mr. MARTIN. No.

Representative CURTIS. Essentially, their theory has not been contested by scholars, or even exposed to them.

I regard you sir, as a scholar in this field. Yet if the administration is in error by as much as 2 percent, as Senator Proxmire has suggested, in their estimates of the saving rate, the full benefit derived from increasing consumer purchasing power would be wiped out.

Mr. Martin, this is important because this is the theory upon which the President's program is based. This committee has a duty to examine that theory and to encourage scholars in this area to direct their attention to it.

To be honest with you, I think it is a cockeyed theory, but I want to examine it with as much care as I can. I hope others will join me. If we are in error, the administration apparently has put all of its eggs in one basket. It says tax reform is the one program that will move this economy forward. If it does not accomplish that, I guess they are bankrupt in ideas.

My time has run out, but would you care to comment?

Mr. MARTIN. I would only comment to the extent that I think the Federal Reserve Board ought to devote its attention almost exclusively to the financing problem. I think in the field of monetary and credit policy, as I tried to point out in my statement, we don't have the specific responsibility for expenditures and fiscal policy.

Representative CURTIS. But you must consider these factors in your estimates of economic growth. This is all keyed to the question, of what will stimulate economic growth. This is all keyed to the question of what will stimulate economic growth. I think it is very much in your area.

Chairman DOUGLAS. Senator Proxmire.

Senator PROXMIRE. Mr. Martin, I think this is a fine statement. I very much agree with your emphasis on the structural problems of unemployment. I think frankly I have become more and more persuaded that much of your view is correct.

I still feel that demand is enormously important, as you do. But I feel if we are going to have real growth in our economy we must base it on improved education, particularly in the vocational area, upgrading our skills where we have jobs going begging, and so on.

Nevertheless, the fact does remain—and it is a hard, stubborn unhappy fact—that we have unemployment that is now as high in this period of recovery, the President said 22 months of recovery, as it has been in recessions in the past.

Just today it is revealed it is 5.8 percent. It is a nagging, continuous unemployment. I am convinced, as I am sure you are, we are not going to solve this in the next 2 or 3 years simply by structural changes. We have to increase demand.

I wrote you and you wrote me a very responsive letter on January 30, in which you quoted your speech, which I asked you about when I asked your comment on your speech, before the Savings Bond Division. I want to once again ask you about this here because I am very troubled by your answer.

You say that it is important, that regardless of what comes out of any deficit that may come about from a short fall in the economy or from additional Government expenditures, or from a tax cut, it can be financed in large measure through bona fide savings and not via the printing press.

I feel as long as we have unemployment in the area of 5½ to 6 percent, as long as we have an underutilization of our resources, that the prime objective of both monetary and fiscal policy should be to stimulate demand as vigorously as possible.

It seems to me that to the extent that we finance the deficit by selling bonds to the public we reduce the stimulation of demand. I don't see how we can refute that.

I think your answer to my example is interesting, but it is not persuasive. When I point out that if a man gets a $200 tax savings and he puts that $200 into savings bonds, it is my contention that whatever multiplier effect there might be in the economy has pretty much evaporated.

You say he might feel somewhat better and richer, somewhat in a better position to go out and buy something than he would have been if he didn't have the $200. This is certainly a much more modest stimulation than if he spends the 94 percent which most people do spend of their income right now.

I feel if we follow the policy of financing this deficit which is being deliberately created by the President, rightly or wrongly, and I don't think rightly, if we do finance it by selling bonds to the public, we just diminish its effect; isn't that right?

Mr. MARTIN. No, I don't think so, Senator. We have discussed this before. I made the point in that letter that a man who had acquired the bonds out of these savings might spend some other asset he had and enter the spending stream in that method which he might not do if he hadn't had the saving and bought the bond. That is one thing.

But I think the critical thing from the standpoint of reducing unemployment is that the purchasing power of money is of extreme importance here. And that depends on the extent to which you use the Federal Reserve capacity to buy or sell bonds. If we get entangled again in creating credit over and above and beyond what in our judgment we think the economy can utilize, merely for the sake of facilitating Treasury finance, we have put ourselves on the treadmill.

Senator PROXMIRE. You call this a period of credit ease, and most people seem to agree with you. It is very hard for me to understand that in view of the fact that your own statistics show a growth in the gross national product of 5 percent in constant dollars and maybe 6 percent in actual dollars, which is the important comparison; whereas, there has been a growth in 1962 of the money supply of 1½ percent.

Mr. MARTIN. That is the money supply in terms of demand deposits and currency in circulation.

Senator PROXMIRE. The time deposits have grown 3.7 percent. I would not be inclined to agree that the time deposits are necessarily the measure of the money supply. Certainly they are only to a limited extent.

Mr. MARTIN. Seven and a half percent would be the rate, Senator. The great bulk of the recent growth in time deposits in my judgment is really a basic portion of the money supply. I have gone around to various centers recently and talked to various people who are knowledgeable in this field, and I think most of them would agree with me on that. This is where these money supply people get themselves in trouble. You have to apply your commonsense to it. If it were an automatic operation, there would be no real need for the Federal Reserve Board. Our judgment may not be the best, but we have, as I pointed out, a seven-man Board and we have five presidents that meet in the Federal Open Market Committee and we arrive at a consensus. But we have to make a judgment with respect to the reserves that should be supplied to the economy.

Senator PROXMIRE. The money supply historically has increased since 1913 by about 5 percent a year. I am talking about the money supply as it has been traditionally defined, currency and demand deposits. Now it has slowed down substantially in recent years. It is true that there has been an increase in savings and loans and so forth. Maybe that is something we should take into consideration. But it is such a sharp dramatic difference between this 1½-percent increase in a period that you call a period of ease, 1½-percent increase in money supply compared to the much bigger increase in the gross national product.

Mr. MARTIN. I merely wanted to get away from the 1½ percent. I think it is considerably more than that.

Senator PROXMIRE. One and one-half percent certainly is the statistical increase in the money supply according to the indicators.

Mr. MARTIN. That is right.

Senator PROXMIRE. Two billion dollars between December 1961 and December 1962 on a money supply base of about $140 billion.

Mr. MARTIN. Yes, roughly. I think where you and I have a little different slant on this—I don't mean to deprecate statistics—I think the statistical measurement is a very poor one. You have to apply your commonsense to that.

Take the availability of money and the cost of money at any given time, which is a factor that comes in here. In order to get interest rates down, let us say, 1 percent from where they are now, we would have to just literally flood money into the stream when the economy is not using funds it already has. We always have to consider the problem of the availability of credit.

Senator PROXMIRE. What I am talking about here, after all, the past is prologue, if the economy expands and the President wants to try to expand it with his sharp proposed tax cut, what I am very concerned about is that the interest rate is going to rise.

I have here the article which we discussed yesterday, "Kennedy Reported To Increase Interest on U.S. Savings Bonds to 4 Percent." Some experts predict the general level of interest rates will start climbing significantly in 1963. Then the administration will raise the savings bond this year or early 1964. Interest rates are generally expected to rise as an indirect result of the President's tax program and the big deficit budgets. If this is the case, it seems to me that the real steam and drive in the stimulation of the economy brought about by the tax cut will be dampened and absorbed. Certainly it will be reduced.

Mr. MARTIN. I don't think so. I think it would be a sign that the economy is making real progress. I have never seen a period, as I have said to you on a number of occasions, of really good business that has not been accompanied by slightly rising interest rates.

Senator PROXMIRE. There is no question about it, when you get to a certain level. It is a matter of judgment.

Mr. MARTIN. It is the result of natural forces.

Senator PROXMIRE. If you get to 4½ percent unemployment or 87 or 88 percent utilization of our factory resources, then interest rates ought to begin to rise. If they don't rise, you will get in trouble with inflation. But this says 1963 and nobody has contended we will be able to reduce unemployment to a level of less than 4½ percent in 1963 or 1964. The goal of 4 percent is 3 or 4 years off.

Mr. MARTIN. Again, I don't know what the right level is, but I think you have to evaluate all these factors in the economy, and that is what we do at each of our Open Market meetings. We ought never to get entangled again as we were prior to 1951 in the meshes of creating money and credit over and above what the economy, in our judgment, is likely to use, simply to finance a Treasury deficit.

Senator PROXMIRE. I am not asking you to push the string. I am asking you not to pull on that chain as the economy starts moving ahead, which is what it seems to me would happen if the money supply doesn't keep pace, to some extent, with the growth in the gross national product as this tax cut takes effect in 1963 and 1964.

I think you would agree that monetary policy is much more effective in restraining expansion than in stimulating the economy when it is in a slowdown. If you are going downhill, there is not much that monetary policy can do. If you are moving ahead, it can be fairly effective as a restrainer.

Mr. MARTIN. I don't mean this facetiously, but I have come to question how effective monetary policy is on either side with all the forces that are involved in the picture. I think it is effective. But in order to judge its effectiveness in pulling on the string, I put it in the setting of the fact that it is my conviction after 12 years of being with the Fed that the tendency is for us to be on the easy money side most of the time.

Senator PROXMIRE. I wish that were true. My time is up.

Chairman DOUGLAS. Senator Pell.

Senator PELL. Mr. Martin, in connection with the President's tax program, I was wondering if you had any more specific recommendations or, rather, reactions than have come out in your testimony. Do you think that the reduction in taxes per se is fundamentally sound and the present tax structure is stifling the economy or not?

Mr. MARTIN. I personally—and I don't speak for the rest of the System on this—have felt that tax revision and tax reform has been something that we have needed ever since the end of World War II. I think we have wartime taxes built in.

I was Assistant Secretary of the Treasury and worked on the excess-profits tax at one time. I think we have a helter-skelter array of taxes. I think it would be very helpful to the economy if it could be improved and straightened out.

There are many difficulties in doing it, as you know. I welcome the initiative of the administration in tackling the problem. I don't like the deficit. I think the only justification for the deficit is if it creates incentives for people to do and to save more than they are doing and saving at the present time. I include saving in there as well as doing.

Senator PELL. Going back to the tax proposals for a moment, though, would you be in accord with the general philosophy that the ideal tax system would be one in which the tax rates are drastically reduced and at the same time the deductions are virtually eliminated? This program of the President is a good step in that direction.

Mr. MARTIN. I don't want to avoid your question, but I don't really want to get into the tax program as such. That belongs to the Treasury and the administration. I am not a tax expert. I think our responsibility is how to finance whatever deficit may result from it.

Generally speaking, as I have said before, I commend them for tackling the problem of tax reduction and tax reform and tax revision. I think it is one of the drags on the growth of the economy.

Senator PELL. Speaking personally, would you approve of a program which took the general direction of further reducing rates as well as deductions?

Mr. MARTIN. I would have some question about it.

Senator PELL. Along the same lines, and drawing on the experience of other countries, as you know, England and, I believe, West Germany and Austria have, in the last 10 or 12 years, introduced various kinds of tax reduction. I was wondering if you had any thoughts as to the role of the central banks in these countries in helping the effectiveness of this policy.

Mr. MARTIN. I have discussed this with several of my colleagues in central banks where this has happened. I don't want to paint with too broad a brush, but I think, generally speaking, they agree with the thesis that I have been expounding here. I have not pinned them down on their specific problem, but I think most of them agree with the view that the deficit should be financed in as large a measure as possible out of savings.

Senator PELL. Also, in connection with the current situation in Europe, would it be an economic possibility that if political relations between us and some of the Western European nations became further exacerbated, they could convert their dollar holdings into gold? What would be the impact on us?

Mr. MARTIN. That is a problem that would cause us some trouble if they should convert. This is the broad problem. The Federal Reserve sits these days with the sword of Damocles overhead with two time bombs. One is the balance of payments and the other is the possibility of the renewal of inflation. Also we are worrying about deflation. But these are our constant worries. At the present time, the time bombs that concern me are potential inflation and the balance of payments.

Senator PELL. Can you foresee the possibility that conversion would be used as a weapon for a Western European nation to wreak its will on us?

Mr. MARTIN. I think it would be very shortsighted and very foolish, but this is an area when, if people are exacerbated, as you say, you never know what would happen. I think we have excellent cooperation at the present time between the central banks. It would be self-defeating to do that.

Senator PELL. To refresh my own recollection, what is the total amount of the calls on American gold that presently exist outside of the United States?

Mr. MARTIN. The total amount? We have gold holdings of about $16 billion. We need about 12 for our cover, and there are foreign claims against us of considerably more than that.

Chairman DOUGLAS. The short-time foreign claims are about $9 billion.

Mr. MARTIN. That was a $9 billion increase in the last 5 years. The total is $20 billion.

Senator PELL. The total number of calls?

Mr. YOUNG. No, the total foreign holdings of dollars on a short-term basis comes to about $20 billion.

Senator PELL. How much gold do we hold?

Mr. MARTIN. We hold in gold, at the moment, just about $16 billion.

Senator PELL. In other words, the total call is more than the total gold we hold?

Mr. MARTIN. Yes. Except the amount which is held by foreign monetary authorities comes to a little over $12 billion. The remaining $8 billion represents commercial balances of traders and foreign corporations and international corporations and wealthy people and so on.

Mr. MARTIN. Those figures are not fully reflective of what the problem is.

Senator PELL. I understand.

Mr. MARTIN. It is a banking operation here.

Senator PELL. Thank you very much.

Chairman DOUGLAS. Mr. Martin, I would like to start off by raising some technical questions. I have noticed that in recent years the Reserve lays emphasis on the degree to which the System as a whole has net free reserves, or does not. You have generally said there is monetary ease when you have a total of somewhere around $500 million in net free reserves; sometimes when you have $400 million you say that indicates monetary ease.

The question that I should like to ask is, Are not these net free reserves almost entirely concentrated in the country banks? For instance, I have here the figures for a week ago on January 23. The free reserves for the New York banks amounted to only $5 million. Chicago was a minus $3 million. The Reserve cities as a whole, minus $86 million. So if you take the 200 banks in these communities you get a borrowed reserve of about $84 million.

On the other hand, the country banks had $403 million dollars of free reserves. I have just been looking up some of the figures. The so-called country banks only make about 41 percent of the commercial loans, and 60 percent, roughly, are in the two big cities and in the Reserve cities.

The question that I want to raise is this: Are not the surpluses in communities where only a minor fraction of the country's activity is carried on, and are not the deficits in those areas where major financial business activities do take place? So do you not have your surpluses where they are not so much needed and you have your deficits where they are needed?

Mr. MARTIN. I think at times that is correct. We have been struggling with this problem ever since we permitted vault cash to be counted as reserves.

Chairman DOUGLAS. That is another point. Vault cash is a large fraction of the reserves of the country banks that are really not loanable. Therefore, I have two questions to raise. Are you in such a condition of monetary ease, as you have assumed at times, when the surpluses are almost entirely or are entirely in the country banks, of which a large proportion of these and in the form of cash reserves required by law, and to the degree that there are any reserves in excess of these amounts, they are in areas where they are not needed, but the deficiency occurs in the areas where loanable funds are needed?

Therefore, I want to inquire whether you are quite right making a judgment as to whether there is monetary ease or not, as to whether you have a total of three to five hundred million dollars of net free reserves.

Mr. MARTIN. Senator, I think it was unfortunate that we ever got this free reserve figure into circulation.

Chairman DOUGLAS. Mr. Martin, I always thought you were responsible for this.

Mr. MARTIN. I am not trying to shirk responsibility. I have made many mistakes.

Chairman DOUGLAS. I thought you were the great exponent of them—I have heard you come up here time and time again when we have implied that the money situation was tight, and you have often brandished this free reserve figure at us. This is an honest repentance and public confession of error and I admire you for it and we can proceed from here. I have always been skeptical of this free reserve.

Mr. MARTIN. This is honest repentance, Senator.

Chairman DOUGLAS. Very good. What do you propose to use in the future for monetary ease or monetary restraint? What is going to be your thermometer?

Mr. MARTIN. I think you have to use a certain amount of commonsense with it. I think you can use these figures but you have to realize they shift very quickly. The large city banks never carry excess reserves. They buy bills or deal in the Federal funds market. You have all the correspondent relationships around the country, and you have to gage all of these factors and try to come out to some reasonable epitome of what you think the economy requires at the moment.

Chairman DOUGLAS. Judgment is not a substitute for the thermometer, you know. You have used the thermometer in the past. The thermometer now turns out to be faulty. I have to inquire what you will use as a thermometer.

Mr. MARTIN. You have to use a thermometer and commonsense. Sometimes you put it in a child's mouth—and I saw it happen—and it shows 105° temperature, indicating the child was almost dead, yet it was nothing but a temporary bug that blew it up. If you relied solely on that thermometer, you would have been in real trouble.

Chairman DOUGLAS. I would like to ask you a question about the technique of transferring free reserves to the banks which are in deficit. I notice that the reserves in these cities amounts to a borrowed figure of $86 million. They borrowed from the country banks which allegedly have a surplus; is that right?

Mr. MARTIN. There is a Federal funds market.

Chairman DOUGLAS. It is hard for us to know the full details of these matters. Do you manage that Federal funds market?

Mr. MARTIN. No, we do not.

Chairman DOUGLAS. In other words, the banks which wish to borrow have to get in touch individually with the banks which are willing to lend, is that true?

Mr. MARTIN. That is right.

Chairman DOUGLAS. And this requires a great deal of correspondence, telephoning and the rest. Would you say that is a perfectly organized market?

Mr. MARTIN. I think it is quite well organized.

Chairman DOUGLAS. How many banks are there in the country—14,000?

Mr. MARTIN. Yes, there are about 14,000 banks.

Chairman DOUGLAS. How many in the Reserve System?

Mr. MARTIN. About 6,000.

Chairman DOUGLAS. Do you manage this? Is this free market simply for those inside the Reserve System, or does it include those outside the System?

Mr. MARTIN. You mean our market?

Chairman DOUGLAS. You speak of the Federal funds market. Does that simply deal with Federal Reserve banks?

Mr. MARTIN. Only member banks can be sellers of Federal funds; any qualified buyer can enter the market on the purchase side.

Chairman DOUGLAS. Then it is mainly the 6,000 member banks. There are 210 banks, I believe, to be precise, in New York, Chicago, and the Reserve cities in the Federal Reserve System; isn't that right?

Mr. MARTIN. Something like that.

Chairman DOUGLAS. You have 210 banks which are generally in a deficit position. Then you have thousands of banks that are in a surplus condition. They have to make their dealings individually.

I would think this would be a highly imperfect way of disposing of any surplus funds that may exist.

Mr. MARTIN. There are money brokers, Senator, and you can get a telephone and get almost anything you want.

Chairman DOUGLAS. Money brokers. Who are they? Do you certify them? Do they have to come to you?

Mr. MARTIN. No.

Chairman DOUGLAS. I would say if you were dealing with demands for labor that the case would be pretty strong for a public employment office instead of going back into——

Mr. MARTIN. You went up and visited the New York bank.

Chairman DOUGLAS. I sat at the desk up in New York for 3 days trying to understand what was going on. Very little happened. I was a little wiser at the end. But I don't pretend to have mastered the details of the Federal Reserve System in 3 days.

This is very interesting. Have you ever thought of organizing this market yourself and having the banks which have surplus free reserves put them at your disposal and you lend them out to the banks which want to borrow?

Mr. MARTIN. We have discussed all phases of this money market endlessly.

Chairman DOUGLAS. Why have you turned down this proposal, then?

Mr. MARTIN. We have not felt that it was needed.

Chairman DOUGLAS. Would you be willing to explore it?

Mr. MARTIN. We will be very glad to explore anything.

Chairman DOUGLAS. While we are speaking of these net free reserves or net borrowed reserves, I have had prepared a chart showing for the last 6 years when the System was operating on net borrowed reserves, when it was operating on net free reserves. It is apparent that there have been several changes in Federal Reserve policy during this time.

Sometime in 1957, in the second quarter or toward the third quarter, you moved from a very tight situation into a period of monetary ease, and then accumulated free reserves running up to $500 million. Of course, I don't know how much these mean anyway. This is a temperature chart, so to speak, or a reading of the temperature of the Federal Reserve Board.

Then in the middle of 1958 you went into a period of restraint again and free reserves went down.

Then toward the spring of 1959 you started easing again. Then in the first part of 1961 you began to hold steady, and so on. You are very careful to say you don't ascribe too great importance to this and I don't want to ascribe too great importance to this. But it is very interesting that these changes in policy nearly always occur after you have been up here and we have consulted with you and given you advice.

So consequently your temperature charts may have been affected by the advice which we give, always disregarded at the time, but perhaps it has influence in the long run.

Mr. MARTIN. I assume, then, our moves have all been——

Chairman DOUGLAS. This is a psychological interpretation.

Mr. MARTIN. If we acted on your advice, I assume all our moves have been good, Senator.

Chairman DOUGLAS. I don't know that your decisions have been good, but the advice has been good.

Congressman Curtis.

Representative CURTIS. Mr. Martin, what would be your explanation of the fact that the average duration of unemployment was higher in 1962, about 14.7 weeks, than any other year since 1947, except 1961. This includes the recession years. Isn't this a sign of growing hard-core or structural unemployment that does not respond to increasing demand in the economy?

Mr. MARTIN. Yes.

Representative CURTIS. Although I have stressed structural unemployment, I have not wanted to leave the impression that I don't think that demand or cyclical factors had an impact. I do. But structural factors remain predominant.

Mr. MARTIN. That is right.

Representative CURTIS. I want to turn to the balance-of-payments problem. The National Foreign Trade Council has estimated that our balance-of-payments deficit in 1963 will be about $2 billion, or the same as 1962. Do you know whether any estimate has been made by this administration, or have you made any estimates of the 1963 picture?

Mr. MARTIN. No; we have not made any estimates, but I do not think the National Foreign Trade Council estimate is unreasonable.

Representative CURTIS. I have asked the Treasury to develop these figures for me. The balance of payments in both 1961 and 1962 was affected by nonrecurring items or advanced payments. I think that amounted to about $600 million each year. Is that about right?

Mr. MARTIN. Prepayments, yes.

Representative CURTIS. How much of that will continue in the future? Of course, there is a backlog amounting to about $80 billion. But of that $80 billion, only about $20 billion is what might be called firm loans.

Mr. MARTIN. I think we are getting close to where it is going to be difficult to count on these prepayments. That is one of the things that worries us in this picture.

Representative CURTIS. We must improve the base of the problem. We have had a temporary improvement by this very technique, which I am not criticizing. But I hope it doesn't fool us into thinking that we have hit at the base of our difficulty.

Mr. MARTIN. Yes. The discouraging thing, as I point out, in this period, is that our trade surplus had been $5½ billion and it was down to $4½ billion last year. It is still very good, but we have not made basic progress on that.

Representative CURTIS. Part of that was the increase of imports, was it not?

Mr. MARTIN. That is right.

Representative CURTIS. While our exports did not increase too much, at least they did not decrease.

Mr. MARTIN. That is right.

Representative CURTIS. This is my own comment. As you point out, we cannot separate domestic from foreign economics. Likewise, I have suggested, we cannot separate foreign investment from foreign trade. The two go closely in hand. If we are going to increase our foreign trade, including exports, we must increase our foreign investment. Do you not agree?

Mr. MARTIN. That is right.

Representative CURTIS. That is one reason I feel we chose a poor time to change our tax laws in relation to foreign investment, even though there might have been some arguments for equities. The net result was a deterrent to foreign investment.

Would you care to comment?

Mr. MARTIN. I think we ought not to discourage foreign investment. That is basic here. I think what I indicated in my paper is that we do not want to have controls come into the picture.

Representative CURTIS. We did that in the name of improving our balance of payments. That is about the most shortsighted action we could take. Our return on our foreign investment has been very handsome, and this is one of the bright spots in our balance-of-payments picture. We can always cash in on past foreign investments, but that is a capital outlay to improve a situation. The long-term result is going to damage the balance of payments; wouldn't you agree?

Mr. MARTIN. You mean the foreign investment?

Representative CURTIS. Yes. In other words, we can cut back and discourage our rate of foreign investment. But at the same time we are cutting down the future potential of a return on foreign investment.

Mr. MARTIN. I think it is very desirable to have this future return on foreign investment, and that is one of the strong points that we have.

Representative CURTIS. I agree. I am calling attention to this policy—and it is stated deliberately in the name of balance of payments—of discouraging or cutting down on the incentive of foreign investment.

How is the rejection of British membership in the Common Market going to affect our balance-of-payments problem?

Mr. MARTIN. I don't know, Mr. Curtis. That is a difficult one because when you get the political tempers up, as Senator Pell was indicating here, you cannot tell what reactions might come. I should think that it might, temporarily at least, help us.

Representative CURTIS. I am interested in that statement.

Mr. MARTIN. I say temporarily because I would think that Europe would not be quite as attractive a place to invest.

Representative CURTIS. You are going back on what we have agreed it would be desirable for us to continue.

Mr. MARTIN. You are talking about the Common Market.

Representative CURTIS. Yes.

Mr. MARTIN. I am saying that the breakdown of the Common Market might incline some people to think that it was——

Representative CURTIS. Not a good place to invest. On the basis of a good portfolio?

Mr. MARTIN. That is right. You were asking what the impact of this would be.

Representative CURTIS. Yes. Is not our balance-of-payments difficulty, in one sense, a discipline on increasing prices?

Mr. MARTIN. Yes. Competitive pricing is the key to it. I tried to stress that in my statement here. The longrun solution of this problem can only come that way.

Representative CURTIS. It seems to me that one reason the inflationary forces that exist in our domestic economy do not come out in increased prices is because of the price competition in the foreign market.

Mr. MARTIN. That is right.

Representative CURTIS. When we encounter this cost-price squeeze, we cannot increase our profit margin because of this discipline. I also suspect that when it hits the foreign market, it shows up in increased unemployment because companies merely shut down their operations.

Mr. MARTIN. There is no question of it.

Representative CURTIS. Could we examine our unemployment picture in relation to this impact? Do you think it has contributed significantly to our nagging, high rate of unemployment?

Mr. MARTIN. I think it has. I think that one of the important deterrents to growth has been the shadow that overhangs us from the balance-of-payments problem.

Representative CURTIS. Assuming tax reform is always appropriate, what impact would a tax cut have on our balance of payments and the problems that we have just discussed? It seems to me it would have a worsening effect rather than an improving one.

Mr. MARTIN. To the extent that it provides incentive for investment in labor-saving devices or other more efficient, more effective things.

Representative CURTIS. This would cause further incidence of frictional and structural unemployment. I would agree if it increased the incentive. But in my opinion the reason for the lack of incentive lies in other unfortunate governmental policies. The incentive that might come from a theoretical tax cut, not based on reform, is in light of no need for expenditure reform. In fact, quite the contrary, it has been stated that if this does not work, increased Federal expenditures and deficits are the alternative. That has been spelled out by scholars advancing this theory.

I think the Fed's economic growth studies cannot ignore these economic theories. At least, you must come to some conclusion yourself as to whether or not they are sound. That is why I have been seeking to involve you in this debate.

Chairman DOUGLAS. Senator Proxmire.

Senator PROXMIRE. Mr. Martin, are you familiar by any chance with an article by Prof. James Buchanan? He is chairman of the Economics Department of the University of Virginia. He was a Fulbright professor last year. The article appeared in an English publication and discussed, I thought, in an extraordinarily far-sighted and thoughtful way, what is likely to happen in our democratic society in this country and Europe because of the pressure for loose fiscal policy and a contrary pressure that builds up through the business cycle, and so forth, for a relatively tight monetary policy.

I would like to read you if I could very briefly a couple of short paragraphs and ask your reaction.

Mr. Buchanan writes:

> If political reality is recognized at all, surely the suggestion that the strong bias of fiscal policy toward the creation of budget deficits rather than budget surpluses, politicians faced with any sort of responsive citizenry are surely cognizant of two powerful and ever-present forces: constant pressures exerted to reduce the level of taxes and at the same time expand—not reduce—both the range and extent of the various public services. The situation during booms is exactly the reverse. To carry out effective stabilization measures through the

budget then requires that both pressure groups be countered. In other words, in a period of recession there is a tendency to reduce taxes and to expand spending or one or the other or both.

Then he goes on to say:

In the period of inflation, it is extraordinarily hard to counter these pressure groups by increasing taxes. I have not heard anybody suggest that if we move into an inflationary period we will restore this tax cut that we are being asked to impose now, or increase any taxes, or seriously suggest that we will then cut spending. I would like to see us do it and I would vote for it. But I do not think we will get anywhere with it.

On the other hand, in a period of inflation, there will be a tendency to put some brakes on to prevent inflation which is the monetary brake.

This theory that I have just enunciated which is Professor Buchanan's seems certainly to be true but I want to ask why. Why does not an increase in interest-bearing debt arouse this antagonism on the part of the public while a tax increase certainly does?

The answer is a very old and simple one and one that has been understood by sensible men for centuries.

The issue of national debt allows the real cause of the restrictive measures to be postponed in time to be shifted to individual taxpayers in future accounting periods. Actually, there should be little point in discussing this elementary principle of debt, were not the great weight of modern intellectual opinion that comes down heavily on the side that denies its validity.

I think Mr. Buchanan is absolutely correct here.

What we are doing is deliberately creating a situation which in a period of expansion and recovery we are going to have a deliberate planned big deficit. We are going to cope with the prospective inflation by raising interest rates.

This means that we may be better off today with our lower taxes. But in the future that increased burden and increased interest rate is going to greatly increase the burden of servicing the national debt.

Why is not this logic correct, No. 1; and No. 2, why should not the Federal Reserve Board be very concerned with this fiscal policy, although I realize it is outside of your immediate responsibility, because it is going to so directly affect the monetary policies which you, as a responsible public official, feel you have to support?

In other words, if we are going to have these loose budgets, it will be incumbent upon you perhaps in the future to follow policies that are restrictive and unfortunate for future generations.

Mr. MARTIN. I have a feeling, Senator, that we have relied or we rely too much on monetary policy on both sides. That is what, in a sense, Professor Buchanan is saying there.

Senator PROXMIRE. You put it very gently.

What he is saying is we rely too much on fiscal policy. I should say we rely too much on fiscal policy to stimulate and monetary policy to restrain.

Mr. MARTIN. I think this idea of monetary policy being such a powerful restraining force, in a portion of a boom merely indicates the failure of the other elements of policy.

If monetary policy went along—to use my favorite illustration of this—if we had unsound budgetary policy and unsound fiscal and debt management policy and unsound wage cost price policy and monetary policy merely went along with these in order to conceal any indication that there was anything wrong, then it would not be monetary policy, it would just be the printing press.

It is a fact that interest rates show a tendency to rise from the natural forces in a boom. I don't think monetary policy can make the market on either side for very long. I think the forces of demand and supply are too big in the economy for that.

I think when we try to make trends, make easy money, or make tight money, we are ineffective. All we do is influence from time to time, moderate, or make more orderly a trend that develops in either direction. That doesn't mean I am playing down the role of monetary policy at all.

You can see how disastrous monetary policy can be.

After the end of the war in many European countries and in this country, when you had a pegged market, then it becomes, as one of my predecessors in this job said, an engine of inflation.

We had, as Senator Douglas well knows, prior to 1951, a first-class engine of inflation.

Chairman DOUGLAS. And when you were Assistant Secretary of the Treasury, Mr. Martin.

Mr. MARTIN. That is right.

Chairman DOUGLAS. When I was acting as a restraining influence on the Treasury.

Mr. MARTIN. That is right.

Chairman DOUGLAS. And the Treasury was hell bent for pegging.

Mr. MARTIN. The chairman was the Federal's warmest defender, that is correct.

But that is the nature of the problem. The thing that interested me—and it is not completely germane to Professor Buchanan's point—is that everybody talks about these other aspects of the economy, but when they want something done the political pressure is always directed toward monetary policy. People say, "Well, it won't harm to make money a little easier." Or, "It won't harm to let money tighten a little bit here." But to raise taxes is a difficult thing. That is the point.

Senator PROXMIRE. The difficulty is this: That the pressures on the politician are to cut taxes—are to increase expenditures. I am really inclined to feel that the pressure on the money managers is in fact to increase interest rates. It is a rifle shot pressure. The people who are really interested in this are the bankers and their price supports are the interest rate and the higher the interest rate the better off they are.

Furthermore, many of the people who are in the seats of power are ex-bankers. They are fine men with great integrity, but their whole viewpoint is colored with this kind of thing.

Therefore, it seems to me Mr. Buchanan's thesis is likely to be correct for the very reason that there is a real moving force in the society.

What we are going to do now is to reduce taxes, run a deficit, and increase interest rates and let the future take care of itself.

Mr. MARTIN. I just don't agree with you on the impact. I am sure there are some bankers who like high interest rates. I have never been a high interest rate man. I want as low interest rates, as I keep saying, as is possible to have without producing inflation because I think it leads to the greatest capital formation. But I think you destroy capital when interest rates are being kept artificially low in order to——

Senator PROXMIRE. What is artificial? I have here a chart which shows how the velocity of money has been rising rapidly.

You appreciate much better than I do, and the chart is not necessary to show you, that the velocity of money has been increasing steadily for a number of years now at a considerable rate. This is another indication, it seems to me, of the relative tightness of money, just as the reserve figure that Senator Douglas showed is another indication, which has been dismissed now as not a very good one. It seems to me if there is a demand for funds that somewhat exceeded the supply there will be a tendency for money to turn over faster. The velocity always increases in a period of relative prosperity and tends to decline in a period when there is less business activity.

I realize and I would concede that one of the reasons for the increase in velocity is the institutional factors. We have done a better job of utilizing our funds. You can see that by walking into any bank.

The other factor is that the money supply is not as easy as it has been in the past.

Mr. MARTIN. Again at some point you have to use your judgment on this, but the quality of credit, in my judgment—I don't like to say this, I don't think it is disastrous—has been going downhill in this country. In some places, we are overbuilt, yet people will borrow money, and there is plenty of it freely available today, to build something as a speculation on the assumption that the population increase will absorb it.

Senator PROXMIRE. You would feel that interest rates are not high enough in that sense?

Mr. MARTIN. I think there has been a tendency that way. With our balance-of-payments problem, this is all one and the same problem, that we are in the position today in this country where we have money abundant every place. Statistically, you don't have to measure that. All you have to do is go out and try to get it.

I have been in half a dozen centers and talked to people on the street and I have never found anybody that is having any trouble today getting money.

Senator PROXMIRE. We have 78 Wisconsin firms who have applied to my office to help them with the Small Business Administration to get money. They are having trouble getting it. I know in many cases the quality of the credit is not very high and the quality of the lender's position is not very good, but, nevertheless, people want money. There is no question about that.

Mr. MARTIN. Of course.

Senator PROXMIRE. They want to borrow money and they want to use money and expand their business, if they can get it.

Mr. MARTIN. If you print hundred-dollar bills and give them out, everybody will take them, of course. It just dilutes the purchasing power of everybody else's money. It is another form of taxation at that point.

The point I am driving at is that we did—and I think it was very helpful, in order to meet this—permit banks to pay more on time and savings deposits. Some banks may have used that authority unwisely. They ought not to be paying so much for the money. But the money flowed in to them.

I happen to think that this country has been undersaving, not oversaving. I think that the longrun growth that we are talking about that we want must come out of bona fide savings.

Senator PROXMIRE. We have been increasing the percentage of savings. If we increase it as we indicated in the hearings several times from 6 to 8 percent of personal income and have an $8 billion tax cut, there is no effect of the tax cut at all.

If a man who is sitting in a very important position to influence that rate of savings pursues policies that would do so, then the effect of the tax cut is nullified.

Mr. MARTIN. I don't agree with you.

Senator PROXMIRE. Not nullified, greatly reduced.

Mr. MARTIN. No, I don't think so. If we impair the purchasing power of our money, I think that the longrun effect will be twice as bad as any harm or any good that can come out of a temporary stimulus.

Senator PROXMIRE. Let me try one more thing here. I think you and I have very much the same viewpoint.

I believe very strongly that we should not have a deficit if we can possibly avoid it, especially in a period of prosperity. At the same time, I look at this hard tough figure of 5.8 percent unemployed. I want to rely on conventional methods of stimulation and conventional methods of permitting business to move ahead and people to buy houses and cars, and so forth, and the conventional traditional conservative method has been by monetary policy and not by the drastic radical notion of running a big planned deficit in a period of prosperity, by reducing taxes when the spending already exceeds your income.

It is just very discouraging to get these answers from a man who undoubtedly has the greatest confidence of any public official in our Government from business people. Business people share my view, I think. They do not want to see a deficit.

I have gotten 65 letters opposed to this tax cut and 2 for it, largely from business people, entirely based on their feeling that they have that the deficit is something in a period of relative prosperity which we simply cannot accept and reduce taxes at the same time.

Mr. MARTIN. I am not unsympathetic to the problem you are wrestling with, but I don't think the answer is to decrease the purchasing power of money.

Senator PROXMIRE. Let me ask you just one more question.

I have asked Secretary Dillon this and I understood that he tended to agree with modifications. Is it not true that this tax cut, whatever it can do for our domestic economy, will have the general effect of worsening our balance of payments situation for this reason: the main thrust of this tax cut is to increase demand. Eleven billion dollar tax cut in the personal income tax sector. If people buy more they will buy more from abroad and in this country, too. There is very little in this tax cut to increase production and even less to reduce costs.

The tendency will be to increase costs as people buy more. Therefore, why would this not tend to have, just by itself, an adverse effect on our trade balance, not just on our trade balance, on our balance of payments?

Mr. MARTIN. I think we have this major problem: that any increase in our economy, unless it is an increase that in part makes our exports more competitive—this is the competitive pricing problem—if any increase in our economy develops and our exports are not fully competitive when that increase comes, then there is going to be an increase in imports from abroad and that will work against our balance of payments.

So the point I was trying to stress in this paper is that competitive pricing is the only possible way that we can solve this problem in the long run.

Senator PROXMIRE. In other words, you are saying that the effect of the tax cut in increasing demand will somewhat increase our balance-of-payments problem and makes it all the more important that we concentrate on our competitive price situation?

Mr. MARTIN. Our competitive pricing, but it may be that more efficient machinery and modernization of plant and equipment will come through the tax reduction also.

Senator PROXMIRE. We had an investment credit bill to achieve that last year.

Mr. MARTIN. That is right.

Senator PROXMIRE. Thank you very much, Mr. Chairman. Thank you, Mr. Martin.

Chairman DOUGLAS. Mr. Martin, I was struck by the fact that you seem to refer to financing the Government deficit by bank credit as the creation of "printing press money." Were you using that term to signify the increase in the quantity of currency or in the quantity of bank-created credit?

Mr. MARTIN. I am using it in the sense of bank-created credit, yes, sir.

Chairman DOUGLAS. In other words, you take the position that a bank can create monetary purchasing power?

Mr. MARTIN. There is no question that a bank can do that. It has its capital and its surplus and its undivided profits and it has recourse to the Federal.

Chairman DOUGLAS. I am very glad you say that because this is a truism which is frequently denied by private bankers, as you know.

What you are saying is that you can have an inflation of credit as well as an inflation of currency?

Mr. MARTIN. That is right.

Chairman DOUGLAS. Now, as I read in your statement, let me see if I understand you correctly. What you are saying is that Government borrowings coming as a result of deficits should be financed through savings of individuals and corporations not by the creation of additional bank credit, is that right?

Mr. MARTIN. That is right.

Chairman DOUGLAS. Let us assume that the administration is correct and that the tax reduction which creates the deficit also releases individual purchasing power which translates itself into an increased demand for goods which translates itself into a reduction in unemployment.

Do I understand that you would allow credit to expand to lend to industry the sums necessary to finance the added payrolls and added purchase of raw materials? In other words, while you would not finance the Government in the matter of the deficit, you would finance any increase in the production of private industry flowing from the deficit. Am I correct in that?

Mr. MARTIN. This is the old discussion that we had a number of years ago, Senator, on private or public monetization of the debt.

I think there is a difference between public and private monetization, although the theorists won't concede it.

Chairman DOUGLAS. You say we should maintain conditions of reserve availability in the banking system, which will help to match the rate of total bank credit and monetary growth to the needs of the total economy.

Then you say this is not financing deficits with bank-created money.

Let us assume that the administration is correct and that tax reduction does release purchasing power—a net increase in purchasing power—which results in a net increase in demand, which results in a net increase in production, a net increase in employment, a net increase in the purchase of raw materials to be processed, and the like, and consequently a demand for greater credit on the part of private industry. Does that phrase, "which will help to match the rate of total bank credit and monetaary growth to the needs of the total economy,"—does that mean that you would allow the total amount of bank credit to expand to meet the increased volume of physical production?

Mr. MARTIN. Yes.

Chairman DOUGLAS. In order to do this, you would be willing to go into the open market and create reserves which would permit member banks to expand their loans?

Mr. MARTIN. That is the sort of judgment that we have to make at every meeting of the committee.

Chairman DOUGLAS. In other words, you will not finance the deficit but you will see that the banking system, as such, finances any increase in physical productivity or in the real gross national product which may come as a result of the tax reduction; is that correct?

Mr. MARTIN. That is always our intention. The one thing that we don't want to do is to let the deficit entangle us once more.

Chairman DOUGLAS. I understand. I think this diminishes the possible friction which might exist between the administration and the Federal Reserve.

Senator PROXMIRE. That is a very important and comforting answer.

Chairman DOUGLAS. Yes. I think it diminishes it very much. I hope the Federal Reserve holds to this policy.

Now we come to the question of the financing of the deficit. You say the deficit should be financed only by savings. If these savings would otherwise be invested, and to the degree that the savings would be invested, does this create any additional total demand or does it merely divert funds which would otherwise be used for investment to consumption and hence cause no increase in aggregate demand?

Mr. MARTIN. I don't have any question on that at all, Senator. I think that the savings that people have is a part of their operating apparatus. But the Government can't be any different from anyone else when it comes to drawing on those savings.

Chairman DOUGLAS. Is your answer, therefore, that there will be no net increase in demand if the deficit is financed out of savings?

Mr. MARTIN. We always come to this point, the fact that in money management you provide some additions for growth in a normal way anyhow. That is really what is involved in discretionary monetary management. When you try to pinpoint that, as I said to Senator Proxmire here, with respect to an individual who gets a tax cut and has $200 more and puts it into a savings bond, he certainly feels a lot better off and may use some other item in his portfolio and become a spender, or it may add to the overall spending of the economy.

Chairman DOUGLAS. It is very hard to tell from your response what your reply actually is.

Mr. MARTIN. I think that is the nature of this problem. This problem is not something that you can give precise answers to. If it were, our job would be very simple indeed.

Chairman DOUGLAS. Let me try another tack. Businesses have not been distributing in cash or investing in their businesses or in other businesses all the profits which they retain; is that not true? There is a large accumulation of liquid savings on the part of corporations.

Mr. MARTIN. One of the reasons that there has not been a greater demand for bank credit over the last year has been that retained earnings and depreciation in a good many new companies——

Chairman DOUGLAS. Depreciation not spent to replace wornout machinery.

Mr. MARTIN. That is right.

Chairman DOUGLAS. How much do you estimate that to be in the economy?

Mr. MARTIN. I don't have the figure.

Mr. NOYES. You might go ahead and I will look for it.

Chairman DOUGLAS. This is a very important question. I suppose it is true that to the degree that the Government bonds are purchased by companies which otherwise would not invest, that will release into the spending stream amounts of money which would otherwise not be there and hence would constitute a net increase in demand, but if the Government bonds are purchased by people who merely cut down their expenditures or investments in other lines by an equal amount, there is no net increase in demand.

Mr. MARTIN. The net addition comes to the psychological reaction that people have to these things because they have other assets.

Chairman DOUGLAS. Do you have a rough estimate?

Mr. NOYES. Mr. Young has turned up the increase in nonfinancial corporation holdings of Government securities. That is not precisely the question you asked, but he can give you that one.

Mr. YOUNG. That was $2½ billion in the past year and the total they hold is $22 billion.

Chairman DOUGLAS. Do you have any idea why these sums have not been invested in industries? They have been invested in short-terms Governments. The rate on short-term Governments has not been far from 3 percent. This is a very low rate of profit so far as industry is concerned. I think the profit in industry is somewhere around 8 to 10 percent, I guess, after taxes. Why is it that you have this tremendous amount of liquid reserve put into low-yield Governments rather than into high-yield industrials?

Mr. MARTIN. The very nature of their holdings. They are not investors, but they place surplus cash in Government securities on a temporary basis.

Chairman DOUGLAS. This is an extraordinary amount, $22 billion.

Mr. MARTIN. For the corporate wealth of this country, I wouldn't think it was a large amount.

Chairman DOUGLAS. In other words, you do not think this is a real problem at all; that is, corporate retained earnings?

Mr. MARTIN. You mean what they have retained is a real problem?

Chairman DOUGLAS. Yes; if you do not think it is worthy of attention.

Mr. MARTIN. I think it is always worthy of consideration. Businessmen are making big decisions on this. If they had more confidence in the future perhaps they would pay out more of the retained earnings. If they had more confidence in the future they might draw down some of these funds and invest in something else.

But those are the business decisions that the managements of these corporations have to make.

Chairman DOUGLAS. Do you think they have any effect on economic stability? Do they have any effect on the financing of the public debt? Do they have any effect on the total volume of employment?

Mr. MARTIN. I think they do.

Chairman DOUGLAS. What are they?

Mr. MARTIN. I think that involves, in the composite, what our economy is.

Chairman DOUGLAS. I would not say that was particularly responsive.

Thank you very much, Mr. Martin.

I have here several tables and charts on interest rates in this country and abroad, prepared by the joint committee staff, which are relevant to the present discussion and I ask that they be included in the record at this point.

(The material referred to follows:)

Total Federal Reserve credit and net free reserves by class of bank

[In millions of dollars]

	Total Federal Reserve credit [1]	Net free reserves [2]				
		New York	Chicago	Reserve cities	Country banks	Total
1950	18,567	60	−6	122	506	682
1951	23,916	31	−5	98	412	535
1952	23,753	−2	−11	−58	471	400
1953	25,752	117	−18	−31	296	364
1954	25,642	49	7	92	563	711
1955	25,002	2	−43	−168	377	168
1956	25,203	−33	−111	−356	305	−195
1957	24,785	−185	−48	−486	210	−509
1958	25,967	7	12	57	408	484
1959	27,627	−15	−63	−536	101	−513
1960	27,383	16	−59	−120	204	41
1961	27,988	40	5	66	438	549
1962	31,062	−12	−3	−4	389	371
Monthly (last Wednesday each month):						
1962—July	30,808	18	6	3	416	443
August	31,300	7	−14	2	441	436
September	31,550	−19	−10		408	378
October	31,625	34	−1	5	382	419
November	32,046	13	−7	−19	483	470
December	33,529	−62	−11	−52	391	265
Week ending average (daily averages):						
1962—Nov. 7	31,686	−6	−35	−49	483	391
Nov. 14	31,868	11	−13	−41	470	427
Nov. 21	32,299	−27	5	−21	557	514
Nov. 28	32,259	60	6	−11	401	455
Dec. 5	32,373	−31	−2	−22	348	288
Dec. 12	32,629	34	3	−6	308	339
Dec. 19	33,163	−25	−4	−49	431	352
Dec. 26	33,733	−77	5	−64	391	254
1963—Jan. 2	34,104	−150	−55	−178	702	320
Jan. 9	33,286	39	5	19	311	375
Jan. 16	32,784	−8	−13	−28	493	444
Jan. 23	32,464	5	−3	−86	403	319

[1] Yearly data as of Wednesday nearest June 30.
[2] Averages of daily closing figures. 1950–52: for second half of June. 1953–62: for all of June.

Annual rates of change of reserves and money[1]
Month indicated to December 1962

Period	Total reserves	Money supply	Money supply plus time deposits
February 1961	3.2	2.3	7.2
December 1961	3.2	1.5	7.5
January 1962	2.9	1.5	7.3
February 1962	3.5	2.0	7.3
March 1962	4.2	2.0	7.0
April 1962	4.3	1.8	6.8
May 1962	3.7	2.6	7.4
June 1962	4.1	3.2	7.7
July 1962	4.8	3.6	8.0
August 1962	7.1	5.8	9.8
September 1962	6.8	7.2	11.2
October 1962	4.1	7.4	11.7
November 1962	4.9	8.2	12.3

[1] Adjusted for changes in reserve requirements, Nov. 1, 1962. Adapted from Research Department, Federal Reserve Bank of St. Louis.

Maturity distribution of marketable U.S. Governments outstanding, held by Federal Reserve banks and other investors

Maturity	Jan. 31, 1961[1]			Dec. 31, 1962			Increase		
	Outstanding	Held by		Outstanding	Held by		Outstanding	Held by	
		Federal Reserve	Others		Federal Reserve[2]	Others		Federal Reserve	Others
Within 1 year	75.6	14.4	61.2	87.3	17.4	69.9	11.7	3.0	8.7
1-5 years	70.8	10.7	60.1	61.6	10.8	50.8	−9.2	.1	−9.3
5-10 years	18.7	1.2	17.5	34.0	2.1	31.9	15.3	.9	14.4
Over 10 years	24.2	.3	23.9	20.1	.2	19.9	−4.1	−.1	−4.0
Total	189.3	26.6	162.7	203.0	30.5	172.5	13.7	3.9	9.8

[1] On Feb. 20, 1961, the Federal Reserve officials announced that the "bills only" policy was being dropped.
[2] Jan. 2, 1963.

Source: Economic Report of the President, Jan. 1963, pp. 236-237.

Market rates: Short term and long term

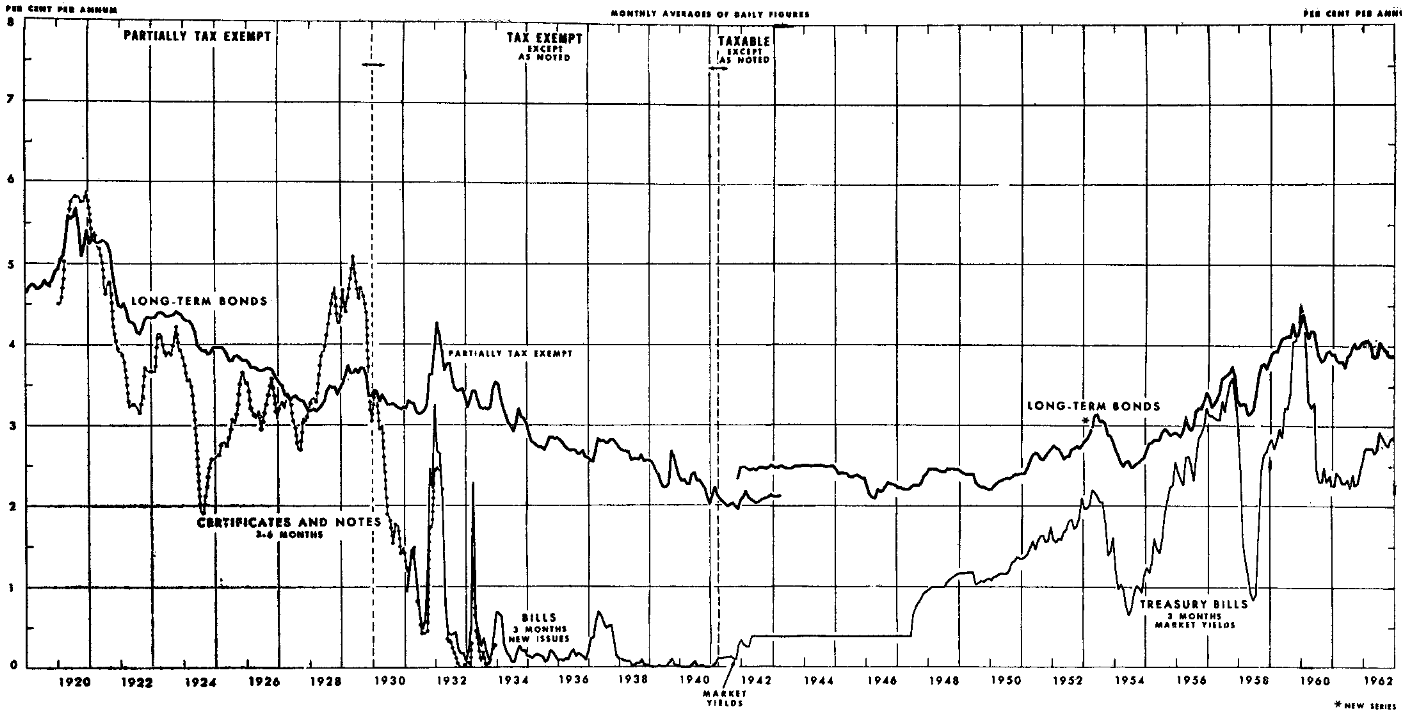
	3-month Treasury bills	Long-term bond yield		3-month Treasury bills	Long-term bond yield
1946	0.375	2.19	1959	3.405	4.08
1947	.594	2.25	1960	2.928	4.02
1948	1.040	2.44	1961	2.378	3.90
1949	1.102	2.31	1st quarter	2.376	3.83
1950	1.218	2.32	2d quarter	2.321	3.80
1951	1.552	2.57	3d quarter	2.324	3.97
1952	1.766	2.68	4th quarter	2.475	4.00
1953	1.931	2.94	1962:		
1954	.953	2.55	1st quarter	2.739	4.06
1955	1.753	2.84	2d quarter	2.712	3.89
1956	2.658	3.08	3d quarter	2.858	3.98
1957	3.267	3.47	4th quarter	2.803	3.88
1958	1.839	3.43			

Market rates: Average of daily figures for the 3d month of each quarter

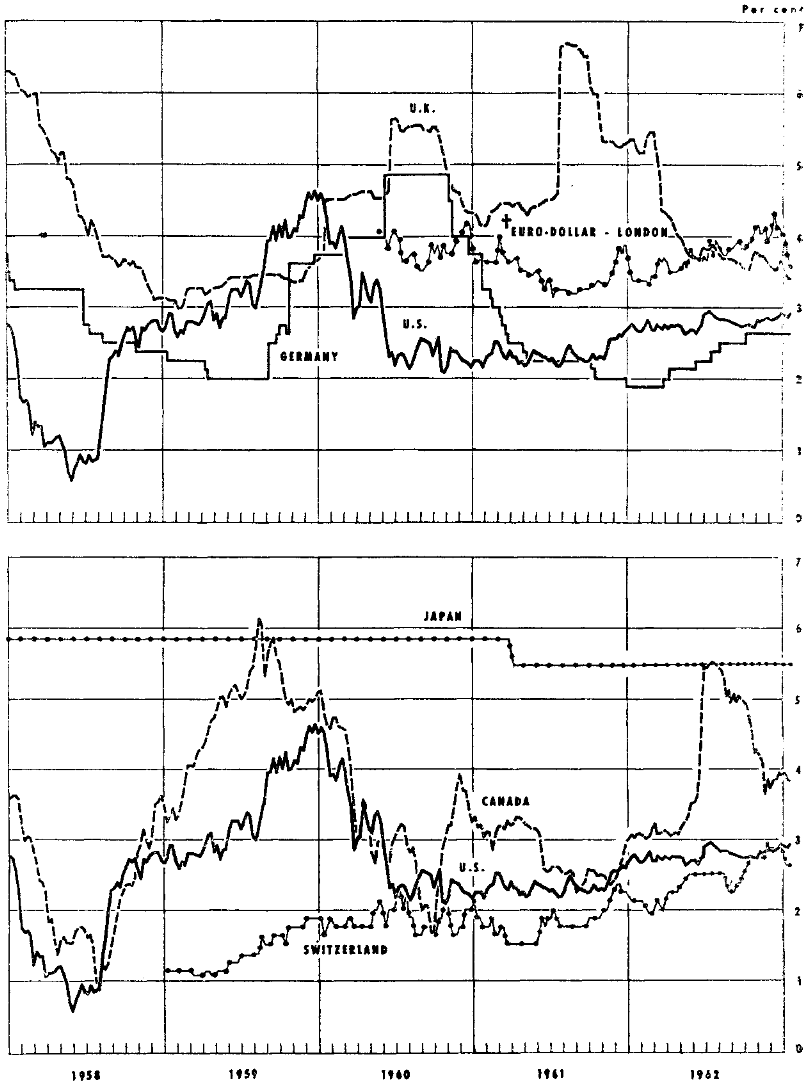
	Federal funds rate	3-month bill rate	Government bonds over 10 years
1953:			
1st	(1)	2.01	2.89
2d	(1)	2.11	3.09
3d	(1)	1.79	2.97
4th	(1)	1.60	2.79
1954:			
1st	(1)	1.03	2.51
2d	(1)	.64	2.54
3d	(1)	1.01	2.51
4th	1.26	1.14	2.57
1955:			
1st	1.35	1.28	2.71
2d	1.62	1.41	2.76
3d	2.18	2.07	2.88
4th	2.48	2.54	2.88
1956:			
1st	2.50	2.25	2.90
2d	2.71	2.49	2.89
3d	2.95	2.84	3.19
4th	2.94	3.21	3.43
1957:			
1st	2.96	3.08	3.26
2d	3.00	3.29	3.58
3d	3.50	3.53	3.66
4th	2.98	3.04	3.30
1958:			
1st	1.20	1.30	3.25
2d	.93	.83	3.19
3d	1.76	2.44	3.75
4th	2.42	2.77	3.80
1959:			
1st	2.80	2.85	3.92
2d	3.39	3.25	4.09
3d	3.76	4.00	4.26
4th	3.99	4.57	4.27
1960:			
1st	3.84	3.44	4.08
2d	3.32	2.64	3.99
3d	2.60	2.49	3.82
4th	1.98	2.27	3.88
1961:			
1st	2.02	2.42	3.78
2d	1.73	2.36	3.88
3d	1.88	2.30	4.02
4th	2.33	2.62	4.06
1962:			
1st	2.70	2.72	4.01
2d	2.68	2.72	3.90
3d	2.90	2.79	3.94
4th	2.93	2.86	3.87
WEEKLY			
1962:			
Dec. 1	2.89	2.85	3.88
Dec. 8	2.79	2.86	3.89
Dec. 15	2.88	2.81	3.88
Dec. 22	2.98	2.86	3.86
Dec. 29	3.00	2.89	3.85
1963:			
Jan. 5	3.00	2.93	3.87
Jan. 12	2.77	2.92	3.87
Jan. 19	3.00	2.88	3.87
Jan. 26	2.95	2.92	3.91

[1] Not available.

YIELDS ON U. S. GOVERNMENT SECURITIES



SHORT-TERM INTEREST RATES *



* 3-month treasury bill rates for all countries except Japan (3-month interbank deposit rate) and Switzerland (3-month deposit rate).

† 3-month rate for U. S. dollar deposits in London.

Short-term interest rates: Selected countries

[In percent]

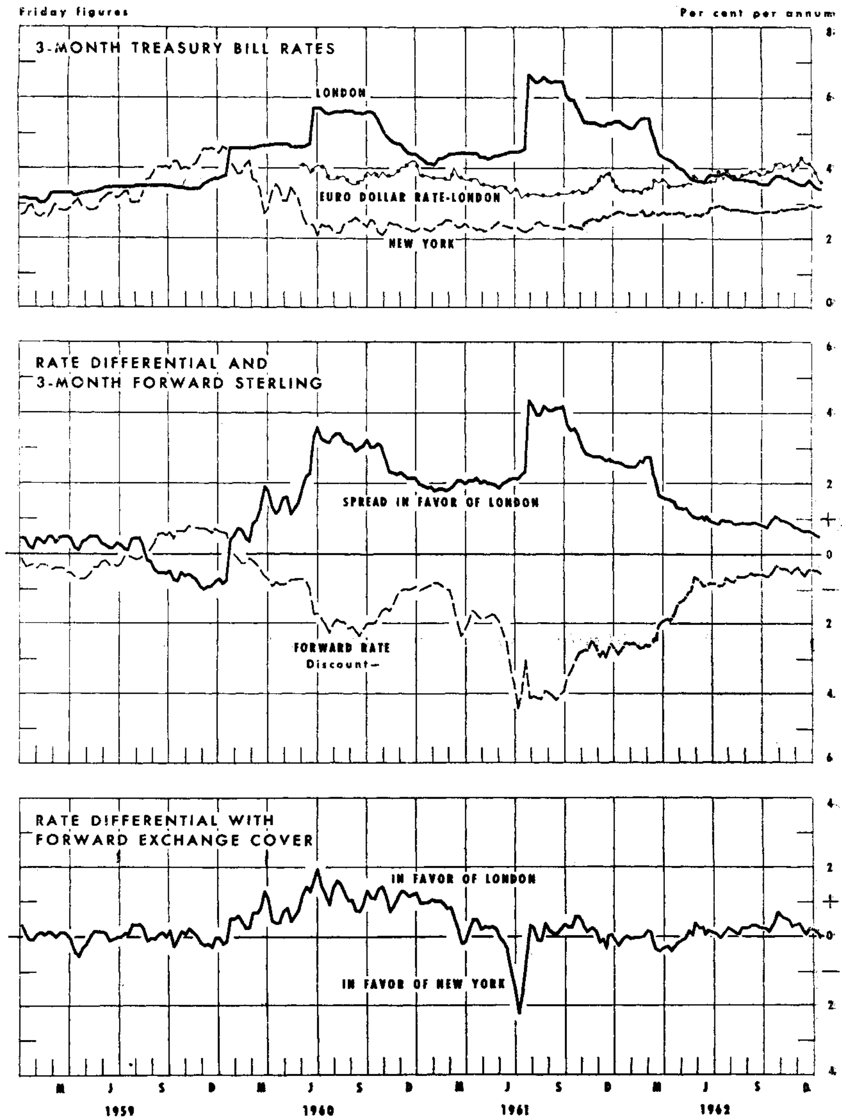
	United Kingdom bill rate	Canada bill rate	Germany interbank rate	United States
1962—Aug. 24	3.69	5.12	3.38	2.82
Aug. 31	3.69	4.95	3.19	2.80
Sept. 7	3.66	5.07	3.19	2.79
Sept. 14	3.63	4.98	3.25	2.78
Sept. 21	3.63	5.06	3.19	2.76
Sept. 28	3.56	4.99	3.19	2.74
Oct. 5	3.55	4.94	4.38	2.76
Oct. 12	3.53	4.72	4.38	2.77
Oct. 19	3.69	4.22	4.50	2.74
Oct. 26	3.78	4.27	4.50	2.73
Nov. 2	3.78	4.16	----------	2.83
Nov. 9	3.72	4.09	4.38	2.80
Nov. 16	3.72	3.62	4.38	2.83
Nov. 23	3.66	3.82	4.31	2.84
Nov. 30	3.63	3.71	4.25	2.86
Dec. 7	3.56	3.81	4.31	2.84
Dec. 14	3.53	3.84	4.31	2.85
Dec. 21	3.53	3.94	4.25	2.88
Dec. 28	3.66	3.91	4.44	2.93
1963—Jan. 4	3.50	3.94	----------	2.90
Jan. 11	3.41	3.85	----------	2.89
Jan. 18	3.41	3.84	2.63	2.92
Jan. 25	----------	3.78	----------	2.94

Short-term bill rate differential with forward exchange cover

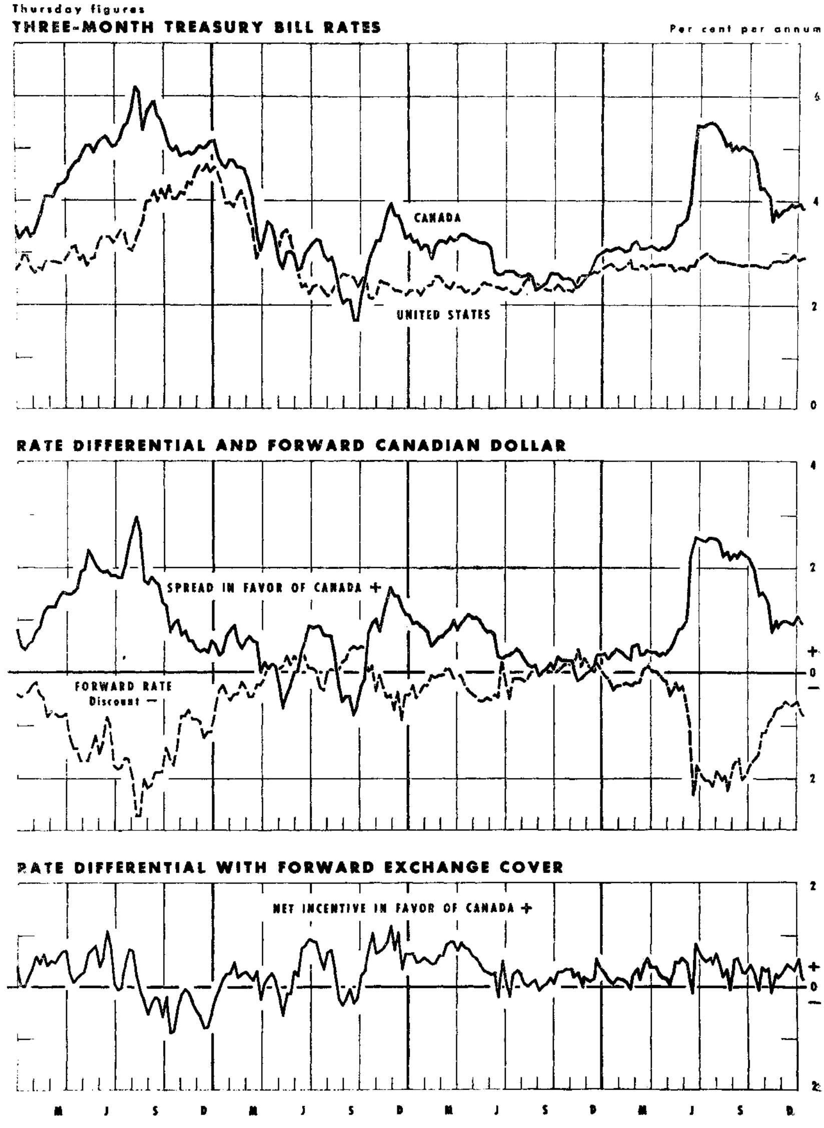
[In percent]

	London	Canada	Germany (interbank rate)
1962—Aug. 17	0.07	0.20	----------
Aug. 24	.26	.35	0.41
Aug. 31	.26	−.07	.13
Sept. 7	.27	.53	.10
Sept. 14	.33	.58	.09
Sept. 21	.33	.29	.50
Sept. 28	.26	.28	−.12
Oct. 5	.22	.43	1.07
Oct. 12	.14	.27	.97
Oct. 19	.41	−.07	1.09
Oct. 26	.74	.39	.87
Nov. 2	.54	.30	----------
Nov. 9	.52	.35	.82
Nov. 16	.46	−.10	.82
Nov. 23	.28	.24	.68
Nov. 30	.33	.17	.81
Dec. 7	.35	.30	.75
Dec. 14	.17	.45	.50
Dec. 21	.03	.36	.62
Dec. 28	.25	.31	.81
1963—Jan. 4	.16	.54	----------
Jan. 11	.06	.22	----------
Jan. 18	−.05	.12	----------
Jan. 25	----------	.23	----------

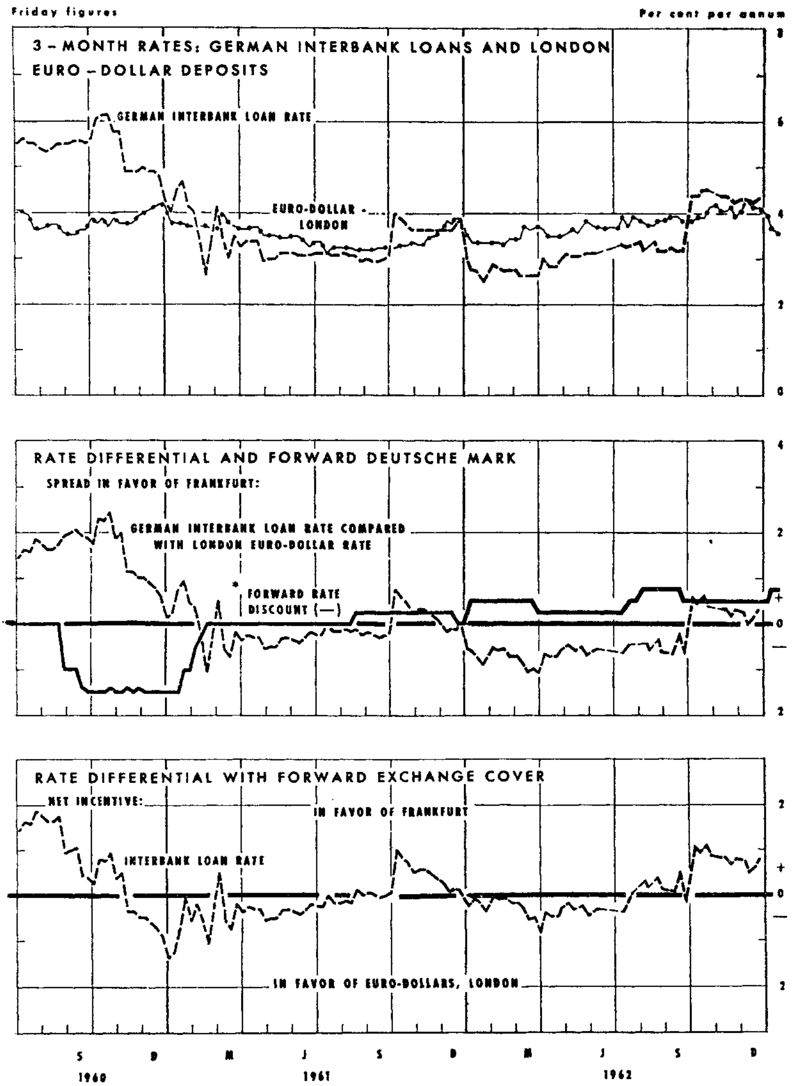
INTEREST ARBITRAGE, NEW YORK/LONDON



INTEREST ARBITRAGE, UNITED STATES / CANADA



INTEREST ARBITRAGE FOR GERMAN COMMERCIAL BANKS



*Note: Special forward rate available to German commercial banks.

Chairman DOUGLAS. This afternoon we will meet at 2:30 and we will appreciate very much if Mr. Mitchell, who is a member of the Board of Governors, and Mr. Swan, who is president of the Federal Reserve Bank of San Francisco, will be here and testify.

(Whereupon, at 12:25 p.m., a recess was taken until 2:30 p.m., this same day.)

AFTERNOON SESSION

Chairman DOUGLAS. The committee will be in order.

Dr. Mitchell, do you wish to start?

STATEMENT OF HON. GEORGE W. MITCHELL, MEMBER, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Mr. MITCHELL. Yes, sir.

Two problems—slack growth in the domestic economy and an adverse balance of payments in our international accounts—now occupy the stage of economic policy discussion. Not so many years ago, a persistently rising price level and an apparent dollar shortage in the world economy were the dominant problems of such discussion.

Though the problems have changed, the tools to deal with them are unchanged: fiscal policy, monetary policy, and structural alterations in particular institutions, practices, or programs. The mix of these alternative and complementary approaches depends on varying judgments of their relative efficacy and on the current economic environment and outlook. In my remarks today, I want mainly to focus on the recent role of monetary policy in coping with both problems and to suggest in very general terms the role that monetary policy might play in the developing situation.

Much of the commentary on the recent performance of the U.S. economy has noted that 1962 was the most prosperous year in our history. This is true but not especially notable. Real output per capita rose during the year but 1 percent. Total output increased less than 3 percent from the end of 1961 to the end of 1962 even though we had excessive unemployment and idle plant capacity throughout the year.

At the same time, the continuing deficit in our balance of payments acted as a constraint on efforts to stimulate higher levels of domestic economic activity. A trade surplus of between $4 and $5 billion was exceeded by our payments abroad on account of private capital, military outlays, and foreign aid. To reduce this deficit is a most pressing problem for the year ahead.

BUSINESS OUTLOOK

At the moment, it seems to me that the immediate economic prospects are favorable—more favorable than for some time past. Spurred by the excellent public reception of the 1963 model cars, retail sales rose substantially in the fourth quarter, and consumer demand generally now appears more vigorous than at any time during 1962. Government purchases, especially at State and local levels, are clearly destined to continue upward, under the pressure of our defense, space, and international requirements and the needs of our rapidly growing population. Total construction expenditures have been running at record highs, and the recents volume of contract awards suggests a continued high level of construction activity in the period ahead.

The expansion in final sales, if continued, should soon call for a higher rate of industrial output and should serve to augment business demands as well. Business inventories, for example, have changed very little in recent months, but, with final sales up strongly, some restocking to accommodate a larger volume of business may now be in order.

The outlook as regards business capital outlays is more doubtful. The rate of expansion in such outlays last year was disappointing, reflecting mainly the lack of pressure on existing productive facilities, and the official surveys project a small decline in the current quarter. But operating rates in many industries have been inching upward, and it seems to me that the combination of rising final sales, continued high-level profits, and the considerable incentives provided by the tax credit and accelerated depreciation actions last summer and the prospective tax reduction for this year, should give renewed impetus to investment plans and outlays as the year progresses.

The basis for accelerated economic expansion which I have sketched here owes much to the dramatic turn in business and public psychology which followed the quick and successful conclusion of the Cuban crisis. Since then the pronounced recovery in stock market prices, the more buoyant attitude of consumers revealed by recent surveys, the strength in new car sales and housing starts—all point to a marked improvement in the business tone. It is important to note also that the stimulating effect of tax reduction on consumer buying and business investment plans will be buttressed by the record increase last year in public holdings of liquid assets and by the ready availability of credit on relatively favorable terms.

I have characterized the balance-of-payments problem as a most urgent issue. I say this because delay in its solution increasingly exposes us to pressure from our creditors and because it inhibits our freedom to stimulate a sluggish domestic economy, which has performed below par for several years.

I fully agree with those who say that we cannot neglect either the domestic or the international problem as we pursue a solution to the other. On the other hand, the two problems may call for different types of solution.

In these circumstances, what contribution can monetary policy make to achievement of fuller use of domestic resources and to improvement in the balance of payments?

MONETARY POLICY IN 1962

The bare financial facts usually used in an evaluation of monetary policy over the past year are as follows: While GNP in current dollars rose about 4 percent, bank credit—that is, total loans and security holdings of commercial banks—increased about 9 percent. The money supply, narrowly defined as currency and demand deposits, increased about 1½ percent, but time and savings deposits went up 18 percent. The rate of turnover of the money supply increased about 8 percent. Market interest rates were relatively stable over the year, as long-term yields crept downward and short-term rates edged up.

On the surface these facts are conflicting in that (1) bank credit and time deposits rose by large amounts and this would seem to indicate that monetary policy was strongly stimulative; but (2) the money supply rose very little for the year as a whole, and not at all until the fourth quarter, and its rate of use increased sharply, suggesting that monetary policy was not actively expansionary. When analyzed in the context of other developments during the year, these facts seem to me to show that monetary policy was inhibited throughout much of the year by balance-of-payments considerations and was less stimulative than was appropriate to the domestic situation.

All of the monetary and credit magnitudes for 1962 were significantly affected by the upward movement a year ago in the interest rates paid on commercial bank time deposits, following the change in the Board's Regulation Q. In order to interpret and appraise monetary developments during the year, it is vital to disentangle the various effects of this change, which enabled commercial banks to attract a large inflow of time and savings deposits.

Where did these time and savings deposits come from? Do they represent in effect a net addition to the community's stock of money, which the public chooses to hold as time rather than as demand deposits? Or does the buildup in time deposits reflect a rechanneling of the flows of saving, as the public decided to hold more of its financial assets in the form of interest-earning deposits at commercial banks and less of its financial assets in the form of securities and deposits in other institutions?

I believe it is correct to say that a sizable fraction of the buildup in time and savings deposits at commercial banks last year simply represented a shift in the public's attitude toward the commercial bank as a financial intermediary. We know, for example, that individuals acquired a considerably smaller volume of State and local government bonds and corporate stock in 1962 than in earlier years, even though their total savings increased. It is reasonable to think that as individuals reduced their purchases of securities they put the funds into time and savings deposits on which interest payments were now higher. Similarly, corporations acquired a substantial volume of newly available negotiable certificates of deposit at commercial banks in 1962. These funds, too, would presumably have gone directly into Treasury bills and other short-term securities if they had not gone into commercial bank time accounts.

What happened, in other words, was that, to a degree, the public chose to invest indirectly through acquiring commercial bank time balances rather than directly by purchasing securities. The banks' role as financial intermediaries between savers and credit markets was thereby enlarged. To the extent that this happened, the resulting increase in total bank deposits and total bank assets should not be regarded as constituting monetary expansion or as contributing to total credit expansion. Rather, it represented merely a rechanneling of the financial flow of funds, as the public exchanged securities for bank time deposits.

Chairman Douglas. Dr. Mitchell, may I raise a question there?

Mr. Mitchell. Yes, sir.

Chairman Douglas. On page 30 of the current Indicators we have figures on liquid assets held by the public that show, as you indicated, that time deposits in commercial banks went up $15 billion, roughly, from eighty-two and a half to ninety-seven, from December 1961 to December 1962. Deposits in mutual savings banks rose 3 billion from 38.3 to 41.3. Savings and loan shares rose by 10 billion, from 70.5 to 80. We have now reached total increases of 28 billion. Demand deposits and currency rose by 2 billion.

The same thought occurred to me this morning when Mr. Martin was testifying, but I noticed that all of these were expanding.

Is it your feeling that this represented in part a shift away from individual purchase of Government bonds and corporate purchase of Government bonds and investment corporate securities, and so forth?

Mr. MITCHELL. Yes. This is one of the reasons why time deposits rose. There are two other reasons that I am going to discuss later.

The first and perhaps the most important reason was the use of a bank as a financial intermediary where there was no intermediary before.

Chairman DOUGLAS. A sort of direct investment.

Mr. MITCHELL. Yes. For example, I think corporations presently have something on the order of $5 or $6 billion of negotiable CD's, an instrument that was hardly in existence at the beginning of the year.

Chairman DOUGLAS. Have you been able to make an estimate of what the shift consisted?

Mr. MITCHELL. No, we do not have estimates of the amount as I am going to have to say a little later on.

May I proceed now?

Chairman DOUGLAS. Yes, indeed.

Mr. MITCHELL. Another portion of the increase in commercial bank time deposits includes funds that would have gone into other savings institutions if commercial banks had not raised their rates. Although deposits at mutual savings banks and shares at savings and loan associations increased substantially in 1962, they might have gone up even more if commercial banks had not become more attractive as savings depositaries. Here again, to the extent that commercial banks increased their role as savings institutions at the expense of these other outlets for savings, the resulting increase in bank assets and deposits does not represent injections of new money and credit into the economy.

Finally, there is no doubt that the advance in bank interest rates induced some individuals and business corporations to shift from demand deposits to interest-earning time deposits at commercial banks. That is, the attractiveness of a prominent near-money asset was enhanced and the public was thereby induced to economize further its holdings of cash balances. Or, to put it differently, as bank credit expanded in 1962, the public found it desirable to place the monetary counterpart of the credit expansion into time and savings deposits. To the extent that such conversions occurred, our comparative statistics on money supply fail to take into account the increased substitution of time for demand deposits.

It is unfortunate that we are unable to measure and compare these various components of the buildup in time deposits. All we can say is that the growth of total bank credit and deposits exaggerates the degree of monetary stimulus in 1962, while the growth of money supply understates the contribution of monetary policy to economic expansion. Let us, therefore, examine two other variables that usually express the extent to which the economy has been supplied with new money and bank credit.

The turnover of demand deposits, a measure of the velocity or rate of use of money balances, has trended upward in the postwar period. If we look at the cycles around this rising trend, we find that they conform rather well to the business cycle. We also find that turnover has generally increased faster in years of monetary restraint and slower in years of monetary ease. In the year just ended, the rate of turnover rose by as much as it did in some earlier years of vigorous economic expansion and restrictive monetary policy. I take this as an indication that the public has not been supplied with redundant amounts of new money in relation to its transactions and income.

This observation is confirmed by what happened to interest rates in 1962. As I noted earlier, short-term rates crept up during the year. Although long-term rates sank a little, they remain high by historical standards. Reflecting, as they do, the interaction of the supply of funds with the demand for funds, interest rate movements in 1962 reveal to us that the supply was not pressing very strongly on demand.

All in all, therefore, I would characterize monetary policy in 1962 as having been passively responsive to the bank credit and monetary needs of the economy but not actively stimulative. And this judgment is borne out by the fact that it was not until the final quarter of the year, when business and consumer psychology strengthened and business loan demand picked up, that money supply rose. It was at this point that the economy overtook the monetary posture of supplying reserves on terms consistent with a short-term rate pattern based on balance-of-payments considerations.

Could monetary policy have done more to encourage economic expansion in 1962? I believe that the answer is "yes" but judgments may differ on this—and particularly would they differ as to the consequences on the balance of payments. The range of difference is not very wide and would not cover, so far as I am concerned, a sufficiently aggressive monetary policy to have single handedly restored the economy to full use of its resources. As far as longrun growth is concerned, the major contribution that monetary policy can make is shortening the duration, and cutting down the amplitude, of cyclical downswings and extending the period and amplitude of upswings. The secular tilt of the economy is more appropriately the concern of fiscal actions and structural reforms.

BALANCE-OF-PAYMENTS CONSIDERATIONS

Just how is monetary policy constrained by balance-of-payments considerations? Since 1961 the objective has been to maintain a level of short-term interest rates in the United States that is tolerably competitive, exchange risk considered, with the level of short-term rates in other money markets, mainly in London, and, to a lesser extent, Western Europe. This competitive level has succeeded in limiting, though not eliminating, incentives that U.S. banks and corporations, or foreigners with short-term dollar holdings, would otherwise have to add to the U.S. balance-of-payments deficit by switching from short-term dollar investments to short-term investment abroad.

Flows of funds of this kind are sometimes interpreted by important dollar holders, domestic as well as foreign, not as rate-conscious money seeking gain from interest differentials, but as the consequence of apprehensions about the strength of the dollar. Thus, monetary policy has in effect been directed at maintaining a psychology of international confidence in the dollar.

This is a perfectly proper objective for monetary policy to pursue but it is not one that can have a significant impact on correcting whatever basic imbalance exists in our trading-investing relationships with the rest of the world. And it is only through changes in these basic factors that a real solution to the problem can be achieved. Can monetary policy also play a role here? First, as to investing relationships.

A number of domestic and foreign observers have noted that our international transactions on current account and Government economic aid have in fact given rise to nearly equal U.S. payments and receipts in recent years. In consequence, they have identified our deficit on all transactions with our deficit on private capital account. They have argued that in order to bring our overall payments flows into balance, we must sharply reduce net outflows of private capital. They have thought this result might readily be accomplished by a tightening of monetary policy and a rise in interest rates.

I would not deny that reduced credit availability and higher interest rates might have some significant and lasting effects in reducing net capital outflows. They could; but much depends on the circumstances. In the economic environment of today, my judgment is that it would take more monetary action than is desirable to significantly curtail net capital exports.

The largest outflows of U.S. capital represent direct investments by U.S. corporations in foreign branches and subsidiaries. Basically, these investment decisions must take into account the relationship between long-term interest yields on market investments and the prospective profit yield of a particular investment. If credit conditions in this country should tighten as a result of vigorous, but noninflationary, domestic economic expansion in which the relative profitability of investment in this country was rapidly improving, then indeed U.S. firms would invest more at home and less abroad, and foreign capital, too, would be attracted here. But if last year's climate of less than vigorous growth, with some slack in resource use, were to continue and credit conditions were tightened by restrictive monetary policy alone, a large retarding effect on the direct foreign investments of U.S. business could only be significantly effective at the expense of declines in other closely linked sectors of the domestic capital markets and therefore domestic expenditure.

Other flows of capital are probably more responsive than direct investments to changes in credit and interest rate conditions, but some of these flows, too, are less responsive than is often supposed. Much foreign borrowing last year, for example, through bond issues in our markets—the second largest category of capital outflow—was by foreign governments whose demands for external funds were not very flexible because they could find no other international capital market open and able to accommodate their transactions. Also, a good deal of lending abroad by U.S. banks was associated with U.S. exports whose financing could not readily be transferred to foreign credit markets.

Furthermore, it can hardly be argued that reduced credit availability and higher interest levels could have big effects on international capital flows but only minor effects on domestic credit flows. To have tightened monetary policy last year enough to have exerted significant restraint on those outflows of capital that are responsive could, in my judgment, also have had a strong braking effect on the lagging domestic economic expansion.

How could monetary policy be used to improve our basic trading position; to make our exports of goods and services more competitive? There is traditional orthodox prescription for a certain situation. The classical case for the application of monetary discipline so-called, is that in which a country is suffering from excess demand and is attempting to deal with the twin phenomena of inflation at home and a deficit abroad. Here monetary restraint has the dual purpose of tempering the climate of the domestic economy and reducing the deficit in the international accounts. But our current domestic problem is not one of inflation but of lagging expansion and to attack the balance-of-payments problems with stringent monetary measures would risk imposing a costly drag on an already sluggish pace of economic growth.

Thus, the role of monetary policy can be, under present circumstances, only of limited effectiveness in dealing with the basic balance-of-payments problem just as it is of limited effectiveness in dealing with the domestic problem of lagging long-run economic growth.

In the past 2 years a good deal of direct attention has been given to the conditions and environments which can be altered to improve our basic international economic position—through the reduction of tariffs, lowering of barriers to capital outflow by other high-savings industrial nations, the tying of foreign aid, and the fuller sharing of free world burdens for mutual security. But the situation fails to show the degree of improvement needed to clearly indicate to the rest of the world our capacity and intent to reach an equilibrium payments position. We probably should be giving consideration to alternatives that up to now have been rejected.

For example, we might consider a more direct attack on the capital outflow problem. The United States has the largest and most accessible capital market in the world, and it ought to be kept free of exchange restrictions. It is proper and desirable that capital-poor developing countries should utilize this market to meet a portion of their enormous needs for foreign capital. It is not so clear, however, that it is either necessary or desirable for advanced countries, with balance-of-payments surpluses, to have recourse to our capital market on the recent large scale while they restrict and hamper entry of outside borrowers to their own capital markets. If these countries are unwilling to open their capital markets, possibly we should look toward tax measures that might help to remedy this unbalanced position. In general, we need to explore the possibilities of various tax measures that might, consistent with our obligations as an international good neighbor, and with the status of the dollar as a world reserve currency, discourage capital movements that appear to flow "uphill" to countries that are already capital rich.

We also need to explore the possibility that tax measures might be used to encourage exports. As a matter of principle, there is no good reason why our exports should bear U.S. taxes. Taxation is a means by which we pay for Government services. Why should foreign purchasers of our exports help to pay for the services provided by the U.S. Government to its citizens and why should our exporters be expected to be so competitive that their product prices have to absorb U.S. as well as foreign taxes and tariffs?

Chairman DOUGLAS. Are you speaking of excise taxes?

Mr. MITCHELL. I am speaking primarily of income taxes.

Chairman DOUGLAS. Corporation income taxes?

Mr. MITCHELL. That is right.

It may be that foreign countries in their tax policies also discriminate against their nationals' exporting activities. This is not easy to ascertain given the complication of various National, State, and local tax laws and conditions under which tax burdens are shifted to customers. But the discrimination against exporters of our country can hardly be doubted.

MONETARY AND FISCAL POLICY IN THE YEAR AHEAD

If the proposed tax reduction is successful in stimulating more rapid economic expansion, bank credit and monetary needs will in all likelihood accelerate. Business demands for loans will increase, consumers will impose larger calls on credit markets, and the Treasury will be financing an enlarged deficit. In such circumstances, the supply of bank credit and money can increase without downward pressures on interest rates and aggravation of capital outflows. In fact, bank credit, the money supply, and interest rates might well rise more in relation to advancing GNP than in comparable periods of expansion. This is so because monetary expansion has lagged during the past year. The fact that deposit turnover or velocity has continued to rise rapidly over the past year suggests that we cannot count as much as in other recent periods on past monetary creation to satisfy future monetary needs.

As to the question of how the enlarged budget deficit will be financed, I see this as a problem that can only be considered in the economic environment in which it occurs. The budget went into deficit during the recession of 1960 and, just as the recovery in the economy has been incomplete, the restoration of balance in the budget has been incomplete. The past year's deficit has been successfully financed outside the banking system.

The proposed tax cut will enlarge the deficit, but gradually rather than all at once. In view of the purpose of the tax cut, which is to stimulate the economy, a consistent national policy would hardly call for monetary action to offset its effects if the economy continued to operate well below its capacity. Similarly, if excess demand develops, generating inflationary pressures and psychology, offsetting action by the Federal Reserve would be clearly appropriate. Thus, the economic climate at the time should determine the posture of our monetary policy.

In judging monetary policy in relation to deficit financing, what matters most is not whether the banks or the nonbank public purchase the securities to finance the deficit, but whether the economy as a whole is provided with a volume of money and bank credit consistent with sustainable expansion at relatively stable prices. This is not to say that the Treasury does not have a debt maturity problem. Its market offerings need to be fitted into a balanced structure of maturities. In financing an enlarged deficit, the Treasury may find it necessary at various points to compete with other borrowers in the different maturity sectors of the market. Under the economic environment that we hope to achieve, the competition may prove to be strong and the Treasury should be prepared to meet it.

Chairman DOUGLAS. Thank you very much, Dr. Mitchell.

We are very happy to have Mr. Swan, who is president of the Federal Reserve Bank of San Francisco with us.

I think before we begin the questioning, it would be well to have your paper.

STATEMENT OF HON. ELIOT J. SWAN, PRESIDENT, FEDERAL RESERVE BANK OF SAN FRANCISCO, SAN FRANCISCO, CALIF.

Mr. SWAN. Mr. Chairman, I will not attempt to review the record of the economy in detail in 1962, since that has been done for you most capably by a number of others. I will offer some general observations in this regard, however, for what they may be worth.

Since early 1961, we have had a broadly based recovery, with remarkably few distortions. The economy absorbed without serious difficulty a sharp stock market decline earlier this year, took the Cuban crisis in stride, and shows little indication of unsustainable growth or speculative weaknesses in inventories or new plant and equipment, the principal areas of fluctuation in the past. The index of wholesale prices has been remarkably stable, the behavior of consumer prices not quite as satisfactory. At the same time, however, overall growth has been disappointingly modest, the level of unemployment continues to be of real concern, and there seems to be no clear and imminent prospect of a significantly more rapid upward pace of business activity.

The other pressing problem that has persisted throughout the recovery is the deficit in our balance of payments. The improvement in 1962 over 1961 was disappointingly small, and there is clearly a considerable way yet to go to reach a satisfactory position.

Despite these serious and persistent problems, I believe monetary policy was reasonably satisfactory in 1962. Continued reserve availability resulted in a record increase in bank credit, longer-term interest rates declined, in contrast to their behavior in other periods of rising activity, and short-term rate levels, in combination with foreign currency operations of the Treasury and the Federal Reserve, helped to discourage outflows of short-term funds, whether for speculative reasons or because of interest rate differentials.

There are those who would say that the level of unemployment requires a much easier monetary policy, and there are those who would say that the balance-of-payments situation requires a much tighter monetary policy. I fear that I could not satisfy either group of critics under present circumstances, although I am fully aware that a significant decline in business activity—or a real loss of confidence in the dollar leading to a run to other currencies and gold, neither of which I hope will occur—might well raise considerations of a marked policy shift in the one direction or the other. While I do not believe developments so extreme in either direction are imminent, I do believe that either might well be encouraged by an arbitrary and abrupt switch in monetary policy at this time. At this point, a shift to really tight money could place a roadblock in the upward path of the economy; a shift to substantially easier money could contribute to a loss of confidence in the dollar and to an exchange crisis. Under present conditions, I see no alternative to making haste slowly with monetary policy, frustrating as that may be to the impatient who hope for simple solutions to extremely complex problems.

In no sense am I decrying the importance of monetary policy. The wrong monetary policy can do incalculable harm, and the right monetary policy can help to provide a climate in which appropriate adjustments can take place. However, no monetary policy can directly make or assure such adjustments—nor should it, so long as we depend on the greater share of our economic decisions taking place through market processes.

In my opinion, monetary policy has been easy in 1962. Time deposits increased markedly throughout the year, and demand deposits have risen significantly since August. Business spending, however, must be motivated by prospective profits, which result in large measure from market opportunities that can be developed from new processes at lower costs and new products. Some portion of our unemployment appears most unlikely to respond directly to increased demand.

Job opportunities and unemployment unfortunately may be found together, as evidenced by the demands of defense-related industries on the west coast for skilled personnel, even though we have many people looking for jobs in the same areas.

Under present circumstances, relative price stability is doubly important: not only to discourage unsound and speculative developments in the domestic economy, but also to encourage our industries to become increasingly competitive throughout the world if we are to increase exports further relative to imports. But again, the search for new markets in other countries and the development of products and marketing efforts that will expand markets abroad are essential. Many other factors in the balance of payments are also obviously outside of the realm of monetary policy. The need for greater sharing of military and foreign aid burdens by our allies, for lowering of barriers to our exports, and for removal of limitations in foreign capital markets are familiar problems to all of you.

Certainly, I share the compelling concern for economic growth. But growth that is not sustainable, growth that creates imbalances that lead to severe readjustments and recession, growth that does not reflect the mix of goods and services desired by the American people, as expressed both in the market and collectively through the processes of government, is not an adequate answer.

In the monetary area, policy should basically be directed toward facilitating the flow of funds in the money and capital markets without inflation, and this is what the Federal Reserve is seeking to accomplish. In this connection, the question of the degree to which the prospective Federal deficit should be financed through the banking system, which has been given further currency by the proposed tax reductions, involves the difficulty of seeking an answer, in isolation, to a problem that cannot be isolated. I do not believe a categorical answer can be provided, since the problem is really the ever-present one of the sources of funds to meet total credit demands, both public and private. This is a continuous process, involving a continuing judgment about the relation of bank credit expansion to the flow of saving and spending, the availability of labor and other productive resources, the behavior of the price level, and our international economic position.

Monetary policy can assist significantly in providing a climate or a setting favorable to balanced and sustainable economic growth, but such growth itself can only be the result of a complex of factors related to the whole range of private decisions and public policy.

Chairman DOUGLAS. Thank you very much, Mr. Swan.

I would like to open the discussion by touching on the short-time interest rates of the various countries and of the United States.

It is sometimes said that we must increase short-time rates markedly in order to prevent a possible run on the dollar. In this connection, I would like to call attention to the fact that on the 16th of January, the short-time interest rate in the United States was 2.92 percent. This was below the rate in the United Kingdom which was 3.41. In Canada, it was 3.484. The Canadian situation has been unusual.

I am not certain that the recovery in Canada is not permanent. I had not thought that the British situation was assured of sufficient stability so that there would be great transfers of loan funds to Great Britain. But notice that the German rate was 2.63 percent which was approximately a third of a percent less than the American rate. The Netherlands rate was 1.85 or almost a full percent below, and the Swiss rate was a flat 2 percent, or almost 1 percent below the American rate.

Commonly we hear there is danger that the Zurich bankers will decide that the United States is a poor risk and withdraw their funds, and the judgments of the Zurich bankers are held over our heads as a weapon to deter us from any lowering of interest rates.

I would like to ask you gentlemen if, in the light of these comparative statistics from the chief capitalistic countries of the world—I think I did omit France, where the day-to-day money rate is above ours—whether in light of these comparative statistics, you feel there is much danger of a run on the dollar for economic reasons.

Mr. Mitchell?

Mr. MITCHELL. I would say that the really large money market we have to worry about is the London money market. The United Kingdom bill rate is only one part.

There are two other rates there: the hire purchase rate, which in effect is the consumer credit paper rate, and the rate on local government issues. The British authorize their local governments to borrow short term on a 7- or 14-day basis.

Chairman DOUGLAS. Nobody can say that the British consumer credit rate is higher than the American consumer credit rate.

Mr. MITCHELL. It is the wholesale rate rather than the retail rate. These are places where U.S. funds sometimes go. The hire purchase rate and the local authority rate are two rates that are above the British bill rate, and attract a fairly substantial amount of U.S. investment.

As far as I can recall, the only recent time we have noted a flow of funds to Britain because of rate differentials was in October. I think this was the last one. The Canadian rate is competitive but the Canadian market is a relatively small market. I think the EURO dollar rate, which is now 3¾, is a competitive type rate.

I would say at the moment, Mr. Chairman, that we are fully competitive with these rates especially on a covered basis.

There have been times during 1962 when the margin between our rates and their rates was so large that we could see our corporations moving funds.

Chairman DOUGLAS. There is no compelling reason at the present why we should raise the interest rate in order to retain liquid funds?

Mr. MITCHELL. I do not think so at the present time.

Chairman DOUGLAS. Mr. Swan?

Mr. SWAN. I would agree with Governor Mitchell.

Chairman DOUGLAS. Toward the end of Mr. Martin's colloquy this morning we developed what seemed to me to be a very interesting point. He said he was opposed to the financing of the deficit by banks creating additional monetary purchasing power which would be directly loaned to the Government. But he said that if the fiscal policy of the Government in reducing taxes caused an increase in consumer demand which in turn translated itself into increased production and employment payrolls, that he would have the Reserve System create additional monetary purchasing power to float the System and would advocate the Federal Reserve going into the open market to acquire the reserves which would enable the banks to expand their loans.

I do not wish to stir up a dispute within the ranks of the Federal Reserve Board on this matter, but I thought, Dr. Mitchell, that you were saying substantially the same thing.

Mr. MITCHELL. Everyone puts it his own way, I presume, Senator Douglas. The way the Treasury finances the deficit is by selling securities. This last year it sold securities to corporations. Banks operated as underwriters and nothing more than underwriters because they did not add in the past year to their holdings of governments. The reserves which had to be supplied to make this possible were relatively nominal in the past year. As I have been pointing out, I don't distinguish whether they were supplied to make it possible for the Government to finance its deficit or to finance a higher level of economic activity. It is all part of financing the total level of economic activity in the country, and I would not distinguish between the two.

Chairman DOUGLAS. I was coming to this as a second point.

There is a difference in time flow that the deficit would occur before the expansion and demand in production occurred. If one did not have faith that the tax cut would result in a considerable stimulation in demand and production, I suppose you would be justified in saying you are not going to expand credit, but if you had faith that there is such a thing as a multiplier, then could you not expand credit in anticipation of the increase in production which you later expected?

Mr. MITCHELL. I think we have passed this stage in the business cycle. If you go right down to the bottom of the trough an aggressively stimulating monetary policy creates reserves which at least the money market banks use to buy securities with, whether there is a loan demand or not.

So the reserves are put to work. We have gone a long way up from that point.

Now what monetary policy is doing is really accommodating expanding loan demand. In this sense, it is not aggressively stimulating.

Chairman DOUGLAS. You mean at present?

Mr. MITCHELL. Yes.

Chairman DOUGLAS. This is a concern of many of us, on how the deficit will be financed.

As I understood Chairman Martin, he said there would be no purchase of Government securities in the open market, no building up of the bank reserves to enable the banks to then buy Government securities, but that if this later resulted in an increase in demand and production, increased employment, increased purchase of raw materials, then the Reserve would permit banks to expand and finance this with no decrease in prices through open market operations.

But apparently he wants to wait for a time before this policy takes effect.

I asked if we had any robust faith that the policy is going to work. Could you not take the increase in bank reserves before the physical increase in demand occurs?

Mr. SWAN. I was just going to say, Senator, I am not so clear about how definite this lag may be. These funds will be spent presumably. There will be some responses in expectations, I suppose. I don't feel that you can separate one segment of demand for credit from the total here.

Chairman DOUGLAS. In other words, you would be willing to move simultaneously?

Mr. MITCHELL. This is the way the Federal Reserve does move, really.

Chairman DOUGLAS. I do not wish to get you into a dispute with your Chairman.

Mr. MITCHELL. We dispute all the time.

Senator PROXMIRE. I am sure you do.

Mr. MITCHELL. The way the deficit is financed is by the Treasury going into the capital and money market. Last year the capital and money market grew by $58 billion. In this, monetary creation accounted for about 2 billion. What the Treasury has to do is face the market.

Really, you are the one that made it impossible for the Treasury to ignore market terms. You and some other people, including Chairman Martin, made it impossible for the Treasury to walk in and borrow on its own terms. The Treasury has been meeting the market since then. Therefore, it is competing with all other users.

Chairman DOUGLAS. Before you point your gory finger at me let me say that——

Mr. MITCHELL. You had a role in stopping the business of pegging the Government bond market, a very important role.

Chairman DOUGLAS. I am very proud of that.

Mr. MITCHELL. I am sure you have not forgotten that.

Chairman DOUGLAS. You go back a long time. I am very proud of that role.

Mr. MITCHELL. You should be.

Chairman DOUGLAS. But you can carry any principle to excess. My time is up.

Senator Proxmire?

Senator PROXMIRE. I am delighted to see the Federal Reserve Board is not a monolithic unity speaking with one voice because I think you can only get progress when you disagree.

These are both very fine papers. I had a chance to read, Mr. Mitchell, your paper at some length and study it and I think it is marvelous. I think it is so good to get this kind of a breakdown for once of what we are talking about in money supply.

For a long, long time now I have been after the monetary experts who have appeared before us on this money supply concept. We had a discussion this morning.

It seemed to me just as you set forth so well that our money supply has not been growing very rapidly in the technical sense. It is so good to get a breakdown of the extent to which time deposits can appropriately be considered a part of the money supply or not. This is a real contribution, and I will do all I can to call it to the attention of my colleagues.

This morning Senator Douglas elicited from the Chairman of the Federal Reserve Board the response that to the extent that there was a real growth in the gross national product—I want to be sure I state this correctly—that there would be an expansion of credit availability to keep pace with it, to the extent that the Federal Reserve Board could influence that expansion. This was most heartening to me. But I wondered if the GNP figure, in constant dollar, real increase, is readily available. I am wondering if you can give us a hint as to what other statistics we can use to measure a proportionate increase or to come close to approximating a proportionate increase. It may not be the money supply as technically defined. Would it be some reserve of bank reserves and deposits? What statistics would be most appropriate?

Mr. MITCHELL. I don't know that I would say that you could fasten on one statistic.

Senator PROXMIRE. Or a series of statistics.

Mr. MITCHELL. I was saying we ought to expect money supply, if we get the kind of recovery we are hoping for—say we got over 600 billion by year end, the fourth quarter of this year, which would exceed our expectations by quite a bit and most people's expectations by quite a bit.

Senator PROXMIRE. The administration's estimate for 1964 fiscal year year is 578, so their prior calendar year 1963 figure would be 578.

Mr. MITCHELL. You would get clearly more than a proportionate expansion of the money supply.

Senator PROXMIRE. A more than proportionate expansion in the money supply.

Mr. MITCHELL. Yes; narrowly defined.

Senator PROXMIRE. Narrowly defined?

Mr. MITCHELL. Yes. Actually, I don't think there is much slack in the money supply narrowly defined right now.

Senator PROXMIRE. This would mean that if the gross national product, which expanded 5 percent in real terms last year, should expand 5 percent in the coming year, which would exceed our expectations, that the money supply should also expand a little more than 5 percent.

Mr. MITCHELL. Probably a little more.

Senator PROXMIRE. As technically defined, demand deposits and currency.

Mr. MITCHELL. As I was trying to say in my formal remarks, the commercial banking system is really two "animals": It is a savings intermediary and it is also a creator of money, or at least a part of the monetary creation mechanism. When the commercial banking system is gaining at the expense of the other financial intermediaries and is gaining at the expense of direct holdings of debt, you have a monetary concept in total bank credit which makes it impossible to forecast how it should rise relative to a growth in GNP.

Senator PROXMIRE. You argue that the expansion in time deposits may not have increased at this great pace that it has before?

Mr. MITCHELL. I don't think it will unless there is another change in regulation Q.

Senator PROXMIRE. You anticipated that the limited technical definition of the money supply should tend to keep pace and go ahead?

Mr. MITCHELL. Yes.

Senator PROXMIRE. Let me ask, Why is it that the money supply should not increase with the dollar increase in the gross national product? This is really the job that the money supply has to do; is it not?

Mr. SWAN. It seems to me this then takes into account what happens to prices over a given period.

Senator PROXMIRE. That is a good answer. Incidentally, I was also very pleased to note your analysis of the velocity of money, the increase in the velocity of money, also indicating the degree of tightness. As the velocity increases, this is one index of tightness, which has also been my contention.

Do you feel that the various institutional developments which undoubtedly contributed to the increase in velocity of money, that those are pretty much worked out?

Mr. MITCHELL. No; I don't think they are worked out.

Senator PROXMIRE. The banks are moving awfully fast now with their handling of funds.

Mr. MITCHELL. This business of economizing on balances could go on quite a bit further. The 343 centers' turnover was 20 times a year in 1953. It is now 32 times a year.

In New York City it is now 90 times a year.

What is the ceiling on it? I don't know. It is hard to believe it would get to be 300 times a year but it might go quite a bit higher than it is at the present time through institutional type changes. If you paid everybody every day they wouldn't have to keep much of a balance on hand. Corporations are learning how to manage their accounts so that they are at a very small minimum.

Senator PROXMIRE. One of the reasons they are doing it is because——

Mr. MITCHELL. They can use the negotiable certificate of deposit which pays a return competitive with the Treasury bill.

Senator PROXMIRE. This is sparked by a shortage of money.

Mr. MITCHELL. Yes, and the interest rate.

Chairman DOUGLAS. I was pleased by this reply.

Senator PROXMIRE. In your statement, Mr. Mitchell, you say:

As far as longrun growth is concerned, the major contribution that monetary policy can make is shortening the duration, and cutting down the amplitude of cyclical downswings and extending the period and amplitude of upswings. The secular tilt of the economy is more appropriately the concern of fiscal actions and structural reforms.

This is the basis for the President taking this very sharp and drastic and new kind of fiscal action, cutting taxes for secular purposes.

Mr. MITCHELL. Yes, sir.

Senator PROXMIRE. Is it not true that monetary policy cannot take a lot of steam out of that, however, if the money supply is not increased and the interest rates do rise rather sharply and begin to rise in 1963? I have called this to the attention of the other witness and I would like to call it to yours.

The headline in the Star the night before last, "Kennedy Reported Planning To Increase Interest on U.S. Savings Bonds to 4 Percent." Some predict the general level will start climbing significantly during 1963. If that happens the administration will probably raise the savings bond rate this year or early 1964. Interest rates generally are expected to rise as an indirect result of the administration's tax program and the big budget deficits. If this was true, would it not be true that monetary policy would tend to retard the rate of economic expansion?

Mr. MITCHELL. It seems to me that the posture that monetary policy has been assuming and would be assuming would be one of looking at the economy and seeing if we get the kind of performance we want. It would not be restrictive if the economy still had a lot of slack in it, because otherwise the whole operation would be self-defeating. I think that the assumption seems to be, by some people, that this is going to be such a successful program of stimulating the economy that we are going to have to fight inflation before the middle of the year, maybe even before it goes into effect.

Senator PROXMIRE. I am getting back to the same kind of question Senator Douglas was asking, in a way. The fact is that you cannot get any stimulation out of this tax cut except by anticipation until late 1963 at the very earliest and probably not until late 1964 or 1965 because of the fact that it is not even going to be put into effect until July 1 at the earliest. The effect in this calendar year is $2.7 billion which is negligible in a $50 billion economy. So any rise of this kind, it seems to me, would indicate a monetary policy restraining necessary economic expansion. Is that not correct?

Mr. MITCHELL. I was saying in my prepared statement that in the final quarter of last year we got quite a significant rise in money supply. We got quite a bit of monetary action.

I think along with this we have had quite a change in business expectations. This is why I think the outlook for the economy in the next 6 months is fairly good. It is better than most people are saying at the present time.

If the economy should rise along these lines, we are going to get a larger demand for short- and long-term funds. We are going to get some pressure on capital markets.

If the Federal Reserve took a strictly neutral attitude it might lead to some rise in rates.

Senator PROXMIRE. It surely would. That is why in this period it seems to me that monetary policy and fiscal policy should pull in harness—both expansionary.

As long as we have 5.8 percent of the work force out of work and the slack in factory capacity, there is no reason in the world why monetary policy should not be aggressively, sharply expansive; is that not correct? Particularly, isn't that correct, in view of the traditional conservative acceptance which all of us have, of using monetary policy to stimulate the economy or help it expand at the beginning of this kind of a period at least, and the reluctance which many of us have, and I have very strongly, of using fiscal policy for this purpose.

Mr. Swan, I thought you wanted to say something.

Mr. SWAN. I do not know what you mean by "aggressively expansive," Senator. I would certainly hope that this expansion would continue this year.

However, we still have a balance-of-payments problem in front of us.

Senator PROXMIRE. I want to come to that next. Both of you gentlemen are concerned about the balance-of-payments problem. If we did not have a balance-of-payments problem there would be more agreement, presumably, about the wisdom of having a more expansionary monetary policy.

I would love to see a study that would support the assumption that rising interest rates will help us solve our balance-of-payments problems but I have asked every monetary witness that has come up here to give me one, at one time or another, and they cannot do it.

Dr. Bell has made a very careful study of the effect of interest rates on capital flow. It is on page 461 of the hearings which we had in August of last year.

I refer you to two short paragraphs which I will read:

> When we turn to the foreign short-term capital of the United States which is invested in liquid liabilities of their country we have again tried to see whether there has been any switching of balances over a 5-year period using quarterly data for the most part between the United States and other places in the world on the basis of the changes in interest rates.

Then he goes on to explain the situation:

> I find very little interest effect on short-term liabilities.

One very good study by Robert Gemmill of the Federal Reserve Board has come up with generally the same sort of conclusion.

These studies do not lend support to those who attach great importance to the role of interest rates in inducing short- or long-term capital flows.

The data do not suggest that no importance should be attached to interest rates or more generally to the degree of looseness or tightness of money markets. They say interest rates play a minor role in themselves, although in certain instances where the interest rate is favorable to the movement of capital, the role of interest rates may be more significant.

Mr. Bell made a very careful study. He is an accepted scholar of objectivity and intelligence and responsibility. He came before us and showed us this data. It has not been contradicted by anybody.

The Federal Reserve study to which he refers supported it, showing that the shifts have been on the basis of speculation, nothing to do with interest rates, although there have been occasional situations where there has been a very mild small movement that might conceivably be accounted for by interest rates.

It seems to me if we recognize this situation, it should persuade us to adopt a more expansive monetary policy in view of the answer you have just given me that we would not have to place this great concern on our balance-of-payments problem.

Mr. MITCHELL. I don't really think Mr. Bell's position is too different from the one I stated in my prepared remarks.

Senator PROXMIRE. I do not think so, either. You have also proposed tax measures that would help us solve our balance-of-payments problem.

Mr. MITCHELL. I think it is extremely important to explore these things because I am apprehensive that if a situation should arise in which we had a strong speculative outflow, then we would have a difficult problem to deal with and one which monetary policy would probably not be able to solve.

Senator PROXMIRE. As you say, monetary policy would not be able to solve the balance-of-payments problem.

Mr. MITCHELL. It can only postpone it.

Senator PROXMIRE. My time is up, Mr. Chairman.

Chairman DOUGLAS. At various times in the past when some of us have suspected that the Federal Reserve was following the policy of monetary restraint, there have been shown to us the volume of free reserves, and this has been advanced as proof that the Federal Reserve is following a policy of monetary ease.

I have always been very skeptical of these free reserves because on analysis I find that they are confined almost entirely or in some cases more than entirely in the country banks which do only a minority of the country's business.

Furthermore that they include vault cash which is certainly not available.

And finally, that the market for the transfer of these funds is very imperfect.

I was greatly pleased this morning when the Chairman stated that he had lost faith, as I understood him——

Senator PROXMIRE. He said he would have to confess his error.

Chairman DOUGLAS. Yes. He had lost faith in the free reserve figure as indicating either monetary ease of monetary restraint. I appreciate this. I lost faith in it years ago, if I ever had any.

I wonder if you would care to make any comments about this index or if you regard it as unreliable and what you would substitute, if anything, for it.

Mr. SWAN. It seems to me that no one figure here is ever completely satisfactory. Certainly free reserves can be affected by many things, and can fluctuate without corresponding changes. Yet I feel that if you do not take them too seriously they may be still of some use.

Chairman DOUGLAS. How seriously should you take them? Take the present situation, for instance. On the 23d of January the total free reserves for the country were stated to be $319 million. New York had a surplus of 5, Chicago had a deficit of 3, the Reserve cities a deficit of 86 and country banks had 403. This, as I say, included vault cash and you had an imperfect mechanism for transfer.

Would you say this indicated monetary ease? This is hot off the griddle, the 23d of January.

Mr. SWAN. As far as the Reserve city banks are concerned, as I think everybody admits, they try to use all their reserves in one form or another.

You also have to look at what is happening to total reserves and to borrowings.

In the net figure in the period when we had net borrowed reserves, this was a matter of the relation of borrowings, largely at the Reserve city banks, against free reserves, largely in the country banks.

Chairman DOUGLAS. Mr. Swan, when I was a high school student, I read the essays of Joseph Anderson and, as I remember, Sir Roger said in summing up a complicated argument "there is a great deal to be said on both sides." Is this your position?

Mr. SWAN. I am certainly not saying that net free reserves are a single or a conclusive answer.

Senator DOUGLAS. This is cautious but hardly illuminating.

Mr. Mitchell, do you wish to make any comments?

Mr. MITCHELL. When I was describing monetary policies in 1962 I did not use free reserves as a measure, you will notice. I think the most important measure is the interest rates. At times this is not too good but nonetheless it is better than free reserves as a measure of overall policy.

If you do not try to compare the free reserves of 1962 with those of 1954, or 1957, or something like that, I think there is more to be said for using the free reserve figures over a very short span of time.

As you know, they are made up of the difference between borrowings and excess reserves. Excess reserves respond to institutional changes. When we made vault cash reserves eligible you notice excess jumped up for 2 or 3 months and then came down. These totals went into the free reserve figure without real meaning.

Again as the Federal funds market developed better, there has been a tendency to pull excess reserves down. So you get to an operating institutional level where excess reserves become a constant.

It is just as enlightening and probably more enlightening to look at borrowings as a measure of the restraint in the economy rather than net free reserves.

I guess I would be looking at borrowings.

Chairman DOUGLAS. It has sometimes been suggested that the rediscount rate of the Federal Reserve should be equal to—not greater than, not less than—the yield on short-term Governments. What would you say to that?

Mr. MITCHELL. This is an important factor. I think the relationship between the bill rate and the discount rate particularly in the middle part of last year was a deterrent to the banks to expand by increasing their investments.

The relationship between them is very close at the present time.

Chairman DOUGLAS. Are you feeling your way toward saying that you do not think there should be a disparity between the rediscount rate and the bill rate?

Mr. MITCHELL. It depends upon the effect you are trying to produce at the time in question. At the present time, I think it is better to have the two rates in closer proximity to each other, as they are.

Chairman DOUGLAS. Under what circumstances would you think that there should not be proximity?

Mr. MITCHELL. If you put the discount rate well above the bill rate this will be much more restrictive.

Chairman DOUGLAS. This is an argument to have them in proximity. What about this? Would you ever have the discount rate below the bill rate?

Mr. MITCHELL. Here again I think you get into the problem at what level—at 4 percent or 1½ percent. I think there might be times when you would like to see the discount rate well under the bill rate but then you would be trying to be aggressively stimulative.

Chairman DOUGLAS. Senator Proxmire.

Senator PROXMIRE. I take it neither of you gentlemen knows of any study which supports the commonly held, almost universally held, notion that interest rates are of very great importance in our balance-of-payments situation, that would contradict the studies of Dr. Bell or the Federal Reserves study which was made by Dr. Roosa, when he was on the Federal Reserve Board—I am sorry, by Mr. Gemmill.

Mr. MITCHELL. I do not think I could. I have nothing I could say.

Senator PROXMIRE. This has troubled me a great deal. You indicate that monetary policy, in the judgment of those who studied it, is not likely to be endangering our balance of payments. Is it not true that the tax cut is likely to adversely affect our balance of payments, inasmuch as the main thrust of it as it is presently designed is to stimulate demand? After all, it stimulates the demand of our people. They buy $15, $20 billion more, including a great deal more from abroad. It does not mean they produce any more. We cut the corporation income tax modestly. Much of that goes in dividends which increases demand.

Mr. MITCHELL. If you actually got the economy moving in the direction and with the vigor we would like to see it move, you would be getting upward movements in interest rates and investment in this country would be much more competitive with investments abroad.

Senator PROXMIRE. Then you are saying the main effect will be the monetary effect?

Mr. MITCHELL. This means that the interest rate rises because of the factor of demand rather than that some arbitrary action is taken by a monetary authority.

Senator PROXMIRE. The Bell study shows that interest rate differentials do not make much difference and there is no contradiction of that.

Mr. MITCHELL. I think it is very hard to generalize. The interest rate in Switzerland is very low. The marginal efficiency of capital in Switzerland is very low.

Senator PROXMIRE. The anonymity of bank accounts is great.

Mr. MITCHELL. The political risk in South America is high. You have to consider the probability of expropriation or not being able to repatriate your earnings. All of these considerations also complicate the international levels of interest rates. I am talking about long-term rates rather than short-term rates.

Senator PROXMIRE. Nevertheless, as experts, as men who have devoted their whole lives to economic policy, you gentlemen would not deny the basic classical thesis that as demand increases in a country, as it expands, as its employment increases, its general balance of trade at least tends to worsen?

Mr. MITCHELL. Its imports rise.

Senator PROXMIRE. Yes; the classical equilibrium.

Mr. MITCHELL. The capital account will ordinarily move in the opposite direction.

Mr. SWAN. It, it seems to me, is a function not only of rates but also of equity investments of greater profit prospects.

Senator PROXMIRE. The capital might tend to move in the opposite direction particularly in view of what happened in the Common Market lately because of political developments. If the other countries continue to grow more rapidly than we are, in spite of the expansion there would still be a tendency to invest abroad.

Mr. MITCHELL. You have to put yourself back in 1956–57 when we had a tremendous capital boom in this country and people were scrambling at the profit opportunities they thought were opening up.

Under these conditions, you can see a capital inflow from foreigners as well as our own companies investing at home rather than investing abroad. We are not in this environment now, obviously.

Senator PROXMIRE. Realistically, we are not likely to get much investment from Germany and Italy and United Kingdom and France as long as their economy is growing more rapidly than we are, as long as their needs are so much greater than ours, as long as they have such enormous unmet needs.

Mr. MITCHELL. I am not too sure about that. Just remember there is only one truly politically stable country in the world and that is the United States and there is a lot of money that would like to come here just for basic security. It is perfectly willing to take a much lower return.

Senator PROXMIRE. Is that money not as likely to come in a period of stagnation or gradual growth as in a period of expansion?

Mr. MITCHELL. No; I do not think so. This is a little plus.

Senator PROXMIRE. Nevertheless, the aggregate effect of expanding the economy and increasing demand would be somewhat——

Mr. MITCHELL. It will hurt you on the import side. I am not trying to argue with that. All I am trying to say is on the capital side——

Senator PROXMIRE. There might be some offsetting capital investment?

Mr. MITCHELL. Yes.

Senator PROXMIRE. Mr. Mitchell, you suggest that recent Treasury financing may be too competitive in some sections of the capital market.

Mr. MITCHELL. I say it has to be competitive.

Senator PROXMIRE. Does this mean that the Treasury is absorbing too much of the loanable long-term funds?

Mr. MITCHELL. This gets to be the problem that the Treasury has to face. Suppose we manage to get the economy moving up strongly and we are then faced with inflationary pressures, and then monetary policy becomes restrictive. Then if the Treasury comes into the market for savings, it will have to pay a high rate.

Senator PROXMIRE. What I am worried about is if the Treasury lengthens its debt now, it tends to drive up the interest rates in the long-term area.

Mr. MITCHELL. That is right, other things being equal.

Senator PROXMIRE. This is bad economic policy if we are trying to stimulate the economy?

Mr. MITCHELL. Yes. But there are all sorts of considerations.

The Treasury is trying to get its debt maturities in better shape.

Senator PROXMIRE. That is right. But the main thing we want to provide is employment and get the economy moving more rapidly.

Mr. MITCHELL. As they say, there is never a good time for the Treasury to borrow.

Senator PROXMIRE. In conclusion, Mr. Chairman, I want to say that I am very proud and happy that this product of Richland Center, Wis., the University of Wisconsin, Mr. Mitchell is, he grew up in Wisconsin, and then made the mistake of going to Illinois, I must say.

Chairman DOUGLAS. The wisest decision he ever made.

Senator PROXMIRE. I did the reverse. I think he has done a superb job.

Thank you very much.

Chairman DOUGLAS. Mr. Mitchell, you say that it is not so clear, however, that it is either necessary or desirable for advanced countries, with balance-of-payment surpluses, to have recourse to our capital market on the recent large scale while they restrict and hamper entry of outside borrowers to their own capital markets.

I wonder if you could identify the countries which do so hamper and restrict entry of outside borrowers and how they do it and the degree of these restrictions?

Mr. MITCHELL. I think most of the Western European countries do it. Certainly, France, Italy, Switzerland, the Netherlands.

Chairman DOUGLAS. How do they do it?

Mr. MITCHELL. I think they do it very informally. They let it be known that they do not want their institutions to accommodate outside foreign borrowers, and they do not do it.

Chairman DOUGLAS. Can you prove that?

Mr. MITCHELL. We could, yes.

Chairman DOUGLAS. I wish you would assemble the evidence on this point and submit it for the record.

Then you suggest that we adopt tax policies which would reduce the taxes on goods which we export.

In reply to my question, you said this covered not merely reduction of excise taxes but perhaps even more, reduction of corporate income taxes.

How would you allocate the share of corporate income taxes paid by the export commodities? On a principle of average distribution or marginal distribution?

Mr. MITCHELL. Senator, in making this suggestion I guess I am scraping the bottom of the barrel in the sense that I do not know what can be done here. I feel that philosophically and logically there may be a good case for freeing our exports of a double tax burden. I do not know to what extent this would help but it is something that ought to be looked into.

Chairman DOUGLAS. When those goods get abroad, are they subject to excise taxes abroad?

Mr. MITCHELL. Ordinarily they are at least subject to a local excise tax equivalent to domestic taxes on the same type of commodity. They are also subject to a tariff. They are paying foreign taxes of these two natures plus whatever taxes we levy.

Chairman DOUGLAS. If the tax which the foreign countries levy upon our goods merely equal the tax which these same countries levy upon their own products, there is no discrimination against us.

Mr. MITCHELL. Start from the assumption that the income tax is shifted forward in the price of the product. So when the product gets to that country all U.S. taxes are included in its price. It now has to absorb the tariff and the taxes that that country levies on its domestically produced competing commodity.

Chairman DOUGLAS. What you are saying is that profits are not a residual but they are part of the cost?

Mr. MITCHELL. Yes. This is the argument I am making.

Chairman DOUGLAS. This is very different from what I learned.

Mr. MITCHELL. It is very different from what I learned. I also think you will find this is widely accepted in the business community, at any rate.

Chairman DOUGLAS. It is an interesting suggestion.

Do you know whether any of the European countries free their exports from taxes in a similar fashion?

Mr. MITCHELL. I think there are cases in which France is given some preferred treatment. I understand also that this has been true in Japan in some degree.

I think this is quite a hard thing to ferret out because it depends not only on the tax law but also on the tax practices in actual operation, at several levels abroad and at several levels at home. By the time you have uncovered the actual impact of the tax laws in the two cases, I very much suspect that you would find the U.S. exporters were at a clear disadvantage in relation to foreigners.

Chairman DOUGLAS. I hope, before we go to press on these hearings, that you will be able to supply us with some evidence that will stand up, because what you say sounds very reasonable and it could give us an added weapon.

(The information referred to follows:)

BOARD OF GOVERNORS,
FEDERAL RESERVE SYSTEM,
Washington, D.C., February 13, 1963.

Hon. PAUL H. DOUGLAS,
Chairman, Joint Economic Committee,
Washington, D.C.

DEAR MR. CHAIRMAN: In response to your request for documentation of my statement before the committee on February 1, 1963, to the effect that foreign industrial countries restrict access to their capital markets, I am sending you a report prepared in the Department of State entitled, "Government Restrictions on the Outflow of Private Capital Employed by the Principal Capital Exporting Countries" (INR Research Memorandum No. RFX–34, July 20, 1962). This report provides an excellent comprehensive summary both of exchange restrictions on capital outflow and of other kinds of restrictions.

Because this report is rather lengthy, I enclose also a summary prepared by the Board's staff and based on the State Department document.

Sincerely yours,

GEORGE W. MITCHELL.

SUMMARY OF RESTRICTIONS ON CAPITAL EXPORTS BY MAJOR EUROPEAN COUNTRIES AND JAPAN

BELGIUM-LUXEMBOURG

Almost no capital outflows from Belgium-Luxembourg are permitted at official exchange rates, but nearly all such transactions are permitted at the free market rate for foreign currencies, which is usually at premium compared with the official rate. In addition, foreign flotations of stocks and bonds, and trading in existing securities require the approval of the Minister of Finance.

Approval may be refused for political reasons, because of the tightness of the capital market, or for any other reason.

FRANCE

In France, direct investment abroad by residents requires prior authorization, but such authorization is freely granted. Portfolio investment abroad by residents is also freely permitted for securities listed on stock exchanges; the purchase of unlisted securities is subject to license. Commercial credits to foreigners for less than 5 years are also freely authorized. Other forms of capital outflow are strictly controlled and generally prohibited.

Both foreign and domestic flotations of both stocks and bonds amounting to over $200,000 must be authorized by the French Treasury, and no foreign flotations have been authorized in the postwar period. Loans to foreigners other than commercial credits of 5 years or less are also subject to individual licensing, and generally not allowed. Neither are French residents allowed to make bank deposits abroad.

GERMANY

The Federal Republic of Germany is the only Western European country that places no restrictions of any kind on capital outflows, but the Government has the authority to restrict capital outflows to safeguard the balance of payments or to protect the German capital market. The flotation of foreign securities has been limited by high interest rates in Germany and a securities issue tax of 2.5 percent and a capital market turnover tax of 1.25 percent.

ITALY

Italy restricts capital outflows through the licensing of many types of transactions under the exchange control laws, and also under banking legislation. Direct investment abroad by Italian residents requires prior authorization unless the business being invested in is the same as that of the investor. Portfolio investment abroad by Italian residents is now subject to licensing, with some exceptions, but this regulation is scheduled to be eased in April 1963. The exchange control regulations also presently prevent flotation of stocks and bonds denominated in foreign currencies on the Italian financial markets. In addition, foreign security flotations are subject, along with domestic issues, to control under banking legislation. Authorization to foreign entities to float issues on the Italian exchanges has not been granted since the war except to foreign firms with branches in Italy for use in Italy, and recently to the Inter-American Development Bank.

Italian residents are generally not permitted to make deposits in foreign banks. Loans by Italian banks to foreigners are subject to licensing under exchange control regulations, except commercial credits of under 1 year.

NETHERLANDS

In the Netherlands, capital outflows of every kind are subject to exchange control regulations and to control under banking legislation. In the case of direct investment abroad, however, the required authorization is always granted. Portfolio investment abroad by residents must take place via the free exchange market, which is supplied with funds by foreign purchases of Dutch securities. Foreign bond issues on the Netherlands capital markets are licensed by the Netherlands Bank, and the total amount permitted in any one year limited by the bank. Bank loans to nonresidents of over $2,600 per year require a special license. Deposits by residents in foreign banks are also subject to exchange controls.

SWITZERLAND

Foreign borrowing on the Swiss market is restricted by the requirement that the national bank approve all foreign placements of stocks or bonds and all bank loans to foreigners amounting to more than $2.3 million. Admission of foreign securities to the Swiss stock exchanges must also be authorized by the national bank. The export of capital by Swiss residents is otherwise unrestricted. Residents may freely make direct investments abroad, invest in foreign securities, and make deposits in foreign banks.

UNITED KINGDOM

The United Kingdom maintains exchange controls on the outflow of capital to the nonsterling area, and in addition controls the flotation of securities in the United Kingdom by both sterling and nonsterling area borrowers. In the postwar period, only sterling area borrowers with some minor exceptions have had access to the United Kingdom capital market. Direct investment abroad by United Kingdom residents is subject to individual licensing, the liberality of which varies with the balance of payments. Portfolio investment in nonsterling securities is subject to licensing, and the United Kingdom does not normally allot foreign exchange to allow the existing level of holdings to rise. Commercial credits of less than 6 months may be made freely to nonresidents, but longer credits require licensing. Bank accounts may be maintained abroad by resident firms if required for the conduct of business, but such permission is not usually granted to individuals.

JAPAN

All private investment abroad by Japanese residents must be licensed under the exchange control system. In reviewing foreign investment proposals, the Government inquires as to whether the output will expand or compete with Japanese exports. Portfolio investments by Japanese residents are rarely allowed, and then mainly for the purpose of promoting Japanese exports. The inconvertibility of the yen on capital account has effectively prevented the flotation of foreign security issues in Japan. All private loans and credits to foreigners are also subject to licensing under the exchange control system. Commercial credits of less than 1 year are granted to foreigners, as are longer term credits for the export of capital goods. Otherwise very little lending by Japanese residents to foreigners, either in yen or foreign currency, is permitted. As a rule, no resident (corporation or person) may hold foreign exchange in his own name or deposit money abroad; exceptions are made for export-import firms.

DEPARTMENT OF STATE

BUREAU OF INTELLIGENCE AND RESEARCH

Research Memorandum RFX–34, July 20, 1962

To: E—Mr. Johnson.
From: INR—Roger Hilsman.
Subject: Governmental restrictions on the outflow of private capital employed by the principal capital-exporting countries.

This paper revises and updates our previous reports covering governmental controls over capital outflows employed by the principal capital-exporting nations. These surveys have been made at the request of your Bureau, in view of the importance of international capital flows for the U.S. balance of payments and for investment in the less-developed countries.

ABSTRACT

Existing direct controls which limit international capital outflows include (*a*) laws on exchange control, and (*b*) laws governing capital markets; i.e., the raising of new money through flotations on stock exchanges or through borrowing from banks. Exchange controls are a means of regulating outpayments primarily to protect the balance of payments. Laws providing for direct controls over capital markets are frequently an arm of general monetary policy. Licensing of bank loans or securities flotations, sometimes both domestic and foreign (France, Italy, Netherlands), and sometimes foreign alone (Switzerland, United Kingdom, Belgium), is used to limit demand on the capital market during periods of a generally tight monetary policy, to maintain an orderly capital market by regulating the timing of large issues, or to keep capital at home for internal economic development. Such licensing also provides a means of limiting the outflow of capital from a country where such outflows are free of exchange control; e.g., in Switzerland and Belgium, and in the United Kingdom for outflows to the rest of the sterling area. Government control in this field, in some cases, is of very long standing, and has among other purposes to provide control over foreign borrowing for political reasons.

International efforts to liberalize controls over capital movements have not yet affected direct controls over capital markets under general banking legislation outside the exchange control field. The OECD code of liberalization of capital movements is written so that it could affect this field in the future, since it covers restrictions generally over transactions and transfers. The Common Market's first directive in this field is limited specifically to exchange restrictions alone. Given the more ambitious aims toward economic union in the Common Market, it would appear that eventually the Inner Six will turn attention to this area. This is also true of the Benelux economic union.

Concerning exchange controls, among the Development Assistance Committee countries and Switzerland—which takes in the most important capital exporting nations—only Canada, Germany, and Switzerland exercise no exchange restrictions of any sort on capital outflows; that is, the currencies of these three countries are fully convertible on capital as well as on current account. The rest restrict capital outflows in one way or another, but their currencies are at least externally convertible on capital account (with minor qualifications).

Under national policies, under the OECD code and elsewhere, there has been most progress in liberalizing the administration of exchange controls in the fields of direct capital investment, the repatriation of both direct and portfolio investments, and in the extension of short- and medium-term commercial credits (including export credits). However, the OECD code obliges members to authorize direct investments freely to each other unless this is considered "detrimental to the national interest," a proviso capable of very broad interpretation. There has been little progress as yet in the field of making new portfolio investments abroad, in the extension of financial loans (short, medium, or long term) or regarding freedom to hold bank deposits abroad. It is clear that remaining controls are motivated largely by the desire to control most short term and possibly speculative capital flows for balance-of-payments reasons, and at least a number of longer term flows for the same reasons or to keep capital for internal use, to contribute to the range of instruments for effectuating monetary policy, to enhance national freedom of action in monetary policy, and perhaps also to direct capital to regions of affinity to the country concerned.

On the question of discrimination in present control systems, little can be said regarding those types of capital movements subject to individual licensing of each transaction, since administrative discretion enters each case. Loans and securities flotations are generally individually licensed. Direct investments have been liberalized in large degree, but in a number of countries they remain subject to prior authorization to determine whether they are detrimental to the national interest, and administrative discretion is therefore a factor. In the case of those commercial credits which are either free of control or automatically authorized, discrimination is clearly absent. Discrimination is similarly absent in the case of portfolio investment, which is frequently not permitted at all, or where general licenses permit only trading with already existing holdings abroad, without any net call on foreign exchange supplies. This circumscribed type of trading, where sales of some securities have to be made before others can be purchased, is generally not limited to the securities of particular countries or areas.

While the OECD code requires nondiscriminatory treatment only among members, none of the countries covered here (the DAC countries plus Switzerland), have special exchange control regulations for the OECD area with the exception of Portugal and Italy.

Thus far the EEC members, too, have maintained nondiscriminatory treatment of nonmembers in the matter of exchange control over capital movements, with limited qualifications in the case of Italy.

The EFTA (European Free Trade Association) does not cover the field of capital outflows. There are, however, certain special arrangements on capital flows in Uniscan.

The principal regional discrimination in the field of regulations over capital outflows arises in connection with the monetary areas, which enjoy freedom from exchange control over outpayments from the metropole—though not from banking controls over the metropolitan capital market—i.e., the French franc area, the sterling area, and in part the escudo area.

Regarding future liberalization, there is obviously room for progress by nations acting individually or in the OECD forum (*a*) in improving operations under the present code through the review of practices in member countries and by attempting to lessen the number of reservations members have taken to the code, (*b*) by changing conditional clauses in the code—for example, that on direct investments and the national interest—in order to close loopholes, (*c*) by adding new obligations to those presently in the code, for example, concerning flotations of foreign securities in stock exchanges and foreign long-term bank lending, and (*d*) by extending the nondiscrimination provisions of the code to other countries. All of these matters are under study in the OECD. The multilateral approach, without special regard for those countries with little capital to export or with precarious balance-of-payments positions, remains quite practicable, since countries with difficulties of this sort may always reserve their position as advances are made by the group generally.

Concerning the Common Market, which will undoubtedly make further progress in the future in unifying capital market policies, it may be hoped that liberalization measures taken will continue to be on a nondiscriminatory basis.

Japan's controls remain somewhat more restrictive than those of OECD members, and some liberalization would be involved if Japan operated along the lines of the OECD code, at least vis-a-vis less developed countries and those OECD members extending reciprocal treatment to Japan.

Summary of controls over capital movements exercised by DAC countries and Switzerland—Type of capital movement

Country	Convertibility of currency on capital account	Direct investments abroad	Portfolio investment abroad	Commercial credits 5 years and under	Financial loans	Deposits in foreign banks	Flotation of securities issues by nonresidents	Repatriation of direct investments by nonresidents	Repatriation of portfolio investments by nonresidents	Areas where special regulations apply [1]
Belgium-Luxembourg.	External.	Control via free market.	Control via free market.	Control via free market.	Control via free market.	Control via free market.	Banking laws and free market exchange rate.	Control via free market.	Control via free market.	None.
Canada	Full	Free	Free	Free	Free	Free	Free	Free	Free	Do.
France	External.	Liberalized	do	Liberalized	Individual licensing and banking laws.	Generally not permitted.	Controlled under both banking and exchange control laws.	Liberalized	do	French franc area.
Germany	Full	Free	do	Free	Free	Free	Free	Free	do	None.
Italy	External.	Largely liberalized.	Generally not permitted, with some exceptions.	Credits under 1 year liberalized.	Individual licensing.	Generally not permitted.	Controlled under both banking and exchange control laws.	Liberalized	Liberalized	OECD, EEC.
Japan	do	Individual licensing.	Generally not permitted.	Liberalized	Generally not permitted.	do	Controlled under exchange control laws.	On approved investments permitted after 2 years and controlled via free market before 2 years. Otherwise generally not permitted.	On approved investments permitted after 2 years and controlled via free market before 2 years. Otherwise generally not permitted.	None.
Netherlands	do	Liberalized	Control via free market.	do	Individual licensing.	do	Controlled under both banking and exchange control laws.	Liberalized	Control via free market.	Guilder area.

Portugal	do	Individual licensing.	Switching of existing holdings in OECD permitted. Increases in total holdings generally not permitted.	Individual licensing.	do	do	do	Liberalized for OECD reinvestments made since 1950.	Individual licensing, liberally accorded.	Escudo area, OECD.
Switzerland	Full	Free	Free	Large credits controlled under banking laws.	Large loans controlled under banking laws.	Free	Controlled under banking laws.	Free	Free	None.
United Kingdom.	External.	Individual licensing and control via free market.	Control via free market.	Controlled over 6 months.	Controlled under both banking and exchange control laws.	Generally not permitted.	Controlled under both banking and exchange control laws.	Free on approved investments.	Control via free market.	Sterling area, Uniscan.

[1] Payments to bilateral account countries not listed here are also under special controls.

NOTE.—The notation "liberalized" indicates that prior authorization is required, but is freely given. The notation "control via free market" indicates that transactions are permitted, but that the call on foreign exchange to finance them is restricted by channeling them through a free market, the supply of foreign exchange to which is limited. Tendencies for outflow to increase result in changes in the free market exchange rate rather than in an increased outflow of foreign exchange.

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I. Introduction

This report surveys direct governmental controls employed at present by the major capital exporting countries on the outflow of private capital. Controls on movements of capital to all destinations (other than the Sino-Soviet bloc) are covered, with particular attention to controls affecting receipts by the United States and by less developed countries. Since Government policies toward the export of capital generally vary according to the type of capital flow involved, controls on the following breakdown of international capital movements have been examined:

1. By a resident:
   (*a*) For direct investment.
   (*b*) For portfolio investment, mainly stocks and bonds.
   (*c*) For a loan or credit, either short or long term.
   (*d*) For liquid purposes; e.g. to make a deposit in a foreign bank.
2. By a nonresident:
   (*a*) For the flotation of security issues on the market of the country involved.
   (*b*) For the transfer out of the country of proceeds from the liquidation of direct or portfolio investment belonging to the nonresident.
   (*c*) For the transfer of currency into other currencies when the original currency was received on capital account or is being used to make a capital payment: i.e., the question as to whether a currency is externally convertible on capital as well as on current account.

Since they are of secondary importance, no attempt has been made to cover personal capital movements; for example, life insurance payments, inheritances, dowries, emigrants allowances, or real estate for personal use.

The countries surveyed are those belonging to the Development Assistance Committee (aside from the United States)—Belgium, Canada, France, Germany, Italy, Japan, Netherlands, Portugal, and the United Kingdom—plus Switzerland.

II. Summary of Liberalization of Capital Movements Among OECD Members [1]

The OECD Code of Liberalization of Capital Movements contains two lists, the first listing types of capital movements that members are obliged to liberalize within the OECD area, and the second listing types of capital movements whose liberalization within the OECD area is recommended. Progress toward greater liberalization is made pragmatically and gradually by adding items to the lists. And since the code is adopted unanimously, liberalization by one country is reciprocated through liberalization by the others. There are provisions for nondiscrimination among members,[2] reservations and derogations from the code, and review of performance by members under the code. The controls compre-

[1] Austria, Belgium, Canada, Denmark, France, Germany, Greece, Iceland, Ireland, Italy, Luxembourg, the Netherlands, Norway, Portugal, Spain, Sweden, Switzerland, Turkey, the United Kingdom, and the United States—all countries covered by this study except Japan.

[2] The code permits OECD members to discriminate against each other, and to accord special treatment to countries within their monetary area or within special customs systems to which they belong (see art. 10).

hended by the OECD Code include exchange controls and any other types of controls on either the transaction or the transfer into foreign currency of the funds connected with it.

At present the OECD Code obliges members to free from controls principally the following capital movements to and from other members: (1) direct investments, unless the transaction is considered by a member as "detrimental to its interest," (2) repatriation of direct investments made after July 1, 1950, (3) certain movements of personal capital such as inheritances and dowries, (4) certain limited usages of blocked funds, (5) the physical movement of securities, (6) buying and selling of securities in other member countries without involving new outflows of capital from the member concerned; the repatriation of portfolio capital; the purchase of domestic securities by residents of other members and (7) the granting of commercial credits, e.g. export credits, of 5 years or less.

The OECD Code recommends (1) that repatriation of direct investments made prior to July 1, 1950, be freed from control, (2) that blocked funds be unblocked at least in part, and transfers to other members permitted, (3) that commercial credits of over 5 years and financial credits of over 1 year be freed from control.

Avenues of future progress under constant review in OECD, include the following: (1) encouraging members to remove their reservations and derogations from the code in its present form, (2) shifting items from the recommended to the obligatory parts of the code, (3) adding other items, i.e. additional types of capital movements, to the lists which it is agreed to free from control, and (4) applying measures providing for freedom from control not only to movements of capital among OECD members but to all IMF members, i.e. generally throughout the free world.

III. Summary of Measures To Liberalize Capital Movements Within the European Economic Community

Article 67 of the Treaty of Rome provides that the Six should free capital movements among themselves from restriction progressively and "to the extent necessary for the proper functioning of the Common Market." It is not now clear what degree of freedom for capital movements will in future be considered by EEC members as necessary for the proper functioning of the Common Market. Since the EEC envisages the free right of establishment of firms among members, and the closer coordination of national monetary policies, it is generally expected that liberalization of capital movements within the Community may eventually become far-reaching.

Thus far the EEC has, through the approval of a directive [3] by the EEC Council of Ministers on May 11, 1960, taken the following steps. A list of capital movements has been drawn up and classified into four categories with respect to which different obligations as to exchange controls apply. (Consideration has not yet been given to restrictions outside the field of exchange controls, i.e., other laws, regulations, and fiscal and administrative practices.) Category A covers direct investment and its repatriation, short- and medium-term export credits, and personal capital. Capital movements in category A are to be free of exchange control, and transfers are to be permitted at official exchange rates, or at rates not differing notably or for a long period from official rates. Obligations under this as well as under the other categories are subject to derogation under the general safeguard clauses of the Treaty of Rome.

Category B covers portfolio investment in foreign securities listed on any of the stock exchanges of the Six. Category B transactions are to be free of exchange control, but transfers may be made at an exchange rate differing more widely from the official rate. If transfers are permitted at the official rate, liberalization may be limited transitionally to certain financial firms and to companies purchasing an interest in concerns abroad with a business similar to their own.

Category C covers the flotation of new issues of securities on the domestic capital market by foreign companies, long-term export credits, medium- and long-term financial credits, and dealings in securities not quoted on stock exchanges. For category C transactions, EEC members may maintain or reintroduce exchange restrictions which existed at the time the directive went

[3] Première Directive pour la Mise en Oeuvre de l'Article 67 du Traité.

into effect, and there is no provision concerning the exchange rate at which transfers may take place. The EEC Commission may recommend, but not require, the cancellation of any exchange restrictions retained or reintroduced. In effect, there is no obligation on members to liberalize category C capital movements, but there is an obligation not to become more restrictive than on the effective date of the directive.

Category D covers largely short-term transactions—financial loans and credits, bank deposits, and purchases of money market paper—and all other capital movements not listed elsewhere. Liberalization of this fourth category is optional.

The EEC has made no provisions to liberalize capital movements to nonmember countries, although, in practice, the Six have thus far extended the same treatment to non-EEC members, with some exceptions in the case of Italy.

The extent of liberalization of capital movements among EEC members to date is roughly comparable with that among OECD countries under the OECD Code of Liberalization. The EEC treatment of outflows for purposes of portfolio investment under category B is, however, considerably more liberal. In addition, the stipulation that category A transfers should be at or near official exchange rates is more rigorous. And there is a recommendation, though not a requirement, in the EEC directive that flotations of new issues of foreign securities be freed from exchange controls. The latter recommendation is of limited importance, however, since controls over foreign flotations are generally not exchange controls and are therefore not affected by the recommendation.

IV. Full or External Convertibility on Capital Account

Currencies of the Development Assistance Committee countries and Switzerland are, with limited qualifications, either fully convertible or externally convertible on capital account. Among the countries whose currencies are fully convertible both on current and capital account are Canada, Germany, Switzerland, and the United States. Among those with currencies fully convertible on current account and externally convertible on capital account—with the limited qualifications noted below—may be classed Belgium-Luxembourg,[4] France, Italy, the Netherlands, and the United Kingdom. The Japanese yen and the Portuguese escudo are, in the main, externally convertible on both current and capital account.

The basic characteristic of external convertibility, established by most Western European countries (including all European DAC members) on December 29, 1958, was that any authorized outpayment could be made in hard currency at official exchange rates. It became a matter of indifference to the exchange control authorities in what currency permitted outpayments from the country were effected. Formerly, authorized outpayments to a soft currency country were permitted only in soft currency—i.e. in a currency not transferable into any other currency of the world, but a currency with more limited usefulness.

The Swiss franc was, as of December 1958, already convertible for residents of Switzerland as well as for those nonresidents whose own currencies were convertible. Following the steps taken by the other Western European countries, Switzerland extended the same facilities to them, in effect making the Swiss franc fully convertible for nonresidents as well as residents.

The Japanese payments system also became externally convertible in effect at the same time, since, although the yen was not then used to effect international transactions, Japan settled all authorized outpayments in dollars (or any other convertible or externally convertible currency requested). (Prior to the end of 1958, Japan had been settling in inconvertible sterling with the sterling area and in dollars elsewhere.) The establishment of convertible yen accounts for nonresidents on July 1, 1960, had the effect of permitting the yen to be used as an international currency and of attracting short-term deposits to Japan, since nonresidents could hold yen with the assurance that they were convertible at any time. But Japan had already for some time been settling all authorized outpayments in convertible currency.

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[4] The BLEU system of discouraging outpayments of capital is a bit different in that instead of exchange controls, a less favorable rate of exchange is used as a deterrent: almost no capital outflows are permitted except at free-market rates. Outflows in terms of convertible currencies may be effected via the free market, to any outside country.

For all these countries, external convertibility of the currency applied to permitted capital as well as to permitted current outpayments.[5] That is, a permitted capital outpayment to any country could be made in any currency including a hard currency. External convertibility did not mean, of course, that all outpayments were free of exchange control, either on current or capital account—a characteristic of full rather than of external convertibility.

In certain of these countries with currencies externally convertible on capital account, there is a limited area where nonresident holdings of local currency arising from capital transactions are not freely convertible at official exchange rates either into the currency of the country of the nonresident or into any other currency. In the United Kingdom, Belgium, Japan, Portugal, and the Netherlands, repatriation by nonresidents of the proceeds from the sale of capital investments within the country is to a certain extent subject to limitations of one sort or another—individual licensing, deferment, or conversion only at free market exchange rates.

Where a country with an externally convertible currency had bilateral payments arrangements, external convertibility does not generally apply to receipts of its currency either on capital or current account by residents of partner countries. Payments to and from bilateral account countries are handled by bookkeeping entries throughout the year with end-of-year surpluses or deficits settled according to the agreement, but individual transactions are not settled in convertible currency throughout the year. As of mid-1962 the DAC countries plus Switzerland had in effect bilateral payments agreements, or unilaterally maintained bilateral payments arrangements, with the following countries:

Subject country	Bilateral payments arrangements with—																				
															Sino-Soviet bloc						
	Brazil	Chile	Congo (Léopoldville)	Finland	Greece	Indonesia	Iran	Israel	Korean Republic	Ruanda-Urundi	Somalia	Turkey	U.A.R. (Egyptian region)	Yugoslavia	Bulgaria	Czechoslovakia	East Germany	Hungary	Poland	Rumania	U.S.S.R.
Belgium (Luxembourg)			X							X											X
Canada																					
France															X	X	X	X		X	
Germany																	X				
Italy											X										
Japan									X												
The Netherlands						X															X
Portugal	X	X		X	X			X				X	X			X	X	X	X		
Switzerland					X		X					X	X	X	X	X	X	X	X	X	
United Kingdom																					
United States																					

In brief, where currencies are externally convertible, there are certain limited instances where nonresident accruals of currency are not freely convertible, either on current or capital account. And even the fully convertible currencies are not absolutely free of controls over all foreign currency exchanges. For example, the United States maintains controls on transactions with Communist China and North Korea.

While there are these limited exceptions, it is for the most part true that external convertibility prevails on capital account for Belgium-Luxembourg,

[5] As to whether a transaction is a transaction on capital rather than current account, there are two general types of cases: (1) Where the origin of the funds is a capital transaction, for example from country A to country B, or (2) where the origin is a current transaction, say from country A to country B, but the use is a capital payment to country C (see art. VIII of the IMF Agreement). When currencies were made externally transferable, it would have been difficult for exchange control authorities in country A not to accord transferability privileges in the second type of capital account transactions (i.e., to control the making of a payment to B in the currency of country C) since a nonresident could move first into a fully convertible currency and then proceed to carry out any capital transaction.

France, Italy, Japan, the Netherlands, Portugal and the United Kingdom, and full convertibility for Canada, Germany, Switzerland, and the United States.

On February 15, 1961, certain of these countries—the members of the Inner Six plus the United Kingdom—formally established full convertibility on current account,[6] but remain only externally convertible on capital account. In spite of the fact that Germany did not assume the obligations of article VIII of the IMF agreement before February 1961, Germany has in fact been fully convertible on capital as well as current account since 1959.

The following sections describe the status of capital controls by country.

V. Belgium-Luxembourg

A. GENERAL

All capital flows are free within the Belgium-Luxembourg Economic Union (BLEU). Almost no capital outflows from the BLEU area either by residents or nonresidents are permitted at official exchange rates, but nearly all such transactions are permitted at the free market rate for Belgium or Luxembourg francs. It is necessary to say "nearly all" rather than "all," since there is one area where specific controls operate: this is the floating of foreign issues on the Belgian stock market.

Belgium and Luxembourg now constitute the monetary area. The Belgian Congo and Ruanda-Urundi were at one time part of the monetary area and were treated as residents rather than nonresidents for exchange control purposes; that is, there were no exchange controls on payments to these areas. Following Congo independence, a series of changes was made in this system during 1960, and on August 26, 1960, the Congo and Ruanda-Urundi were made bilateral account countries. For purposes of capital flows, they are now treated as any outside country: capital may be transferred to them at free market rates.

B. THE FREE MARKET

In April 1955, the BLEU created a free market which is the one on which practically all international capital transactions (and a limited number of current operations) are settled. The BLEU authorities viewed this as a necessary measure accompanying greater freedom of capital movements, in view of the inadequacy of their reserves, and the continued movements of "hot money." They regard this market essentially as a device to allow freer capital movements without endangering their exchange reserves in times of stress. They claim that in view of the practical difficulty of distinguishing the type of capital movement involved in any particular transaction, it is preferable to maintain a free market rather than to subject outpayments to the controls which would be necessary for ascertaining their actual nature if they were to be screened with some authorized at official rates and some not permitted.

The free market for foreign exchange, along with the official market, is conducted by authorized banks in Belgium-Luxembourg. Demand for foreign exchange on the free market originates with all residents wishing to export capital from Belgium and Luxembourg, with nonresidents who wish to repatriate capital from Belgium-Luxembourg or who have raised money on the BLEU financial markets for export, or with residents wishing to make certain current payments which are not permitted at the official exchange rate (forward cover for merchandise, gifts and family maintenance payments, and certain travel expenses).

The supply of foreign exchange to the free market derives from receipts of foreign exchange by residents as the result of a capital inflow or of certain current account transactions—interest, profits, dividends, rents, royalties, participation by company branches and agencies in the administrative expenses of parent companies in Belgium-Luxembourg, company sales expenses, certain tourist receipts, or incoming gifts and family maintenance payments and forward cover for merchandise. Nonresidents may also sell foreign exchange on the free market to obtain francs with which to make any of the above sorts of payments in Belgium-Luxembourg, or to speculate on the free market rate. (The francs obtained by a nonresident selling foreign exchange on the free market are set up in special accounts called financial accounts, good only for settlement of the above types of transactions in Belgium-Luxembourg or for reconversion into foreign currency at the free market rate.) Payments for Belgian-Luxembourg exports and all invisi-

[6] Again with certain qualifications that have been accepted by the IMF subject to review.

ble transactions not listed above must be made at the official exchange rate, and receipts by residents of foreign exchange from these transactions must be sold at the official exchange rate. Such receipts of foreign exchange cannot be sold on the free market.

Since residents and nonresidents wishing to export capital[7] are not permitted to do so at the official exchange rate, they are generally willing to pay more francs for foreign exchange on the free market than the official rate. The free market rate for foreign exchange may, therefore, show a premium over the official rate. At the same time, the authorities stand ready to pay in francs the official rate for all offerings by residents or nonresidents of convertible foreign currencies, or externally convertible European currencies. This puts a floor under the free market rate at the level of the official rate, since, at that point, the supply of foreign exchange would leave the free market for the official market.

Occasionally the authorities have sold foreign currencies out of their reserves on the free market to limit the premium at which foreign exchange was selling (i.e., the discount on the franc), but they do not recognize any obligation or guarantee in this respect; that is, there is no obligation to use reserves to support a capital outflow. During the early months of 1959, and again in the summer of 1960 (as a result of speculative movements caused by events in the Congo) the premium on foreign currency in the free market reached substantial proportions. In August 1960, the premium reached 8¼ percent. By December 1960 it had dropped back to 1.26 percent. In April 1961, the franc was again showing a discount of over 3 percent, but by December it was virtually on a par with the official rate.

Thus the BLEU uses the premium on foreign exchange in the free market, rather than exchange licensing, to limit capital outflows should they tend to assume large proportions.

C. DIRECT INVESTMENT ABROAD BY RESIDENTS

Direct investments abroad by residents of the BLEU are free of exchange controls, except that transfer must take place at the free market rate. Despite the existence of a differential at various times, the Belgian authorities say they are unaware of any direct investment prevented by the difference in rates between the free and official market.

D. OTHER KINDS OF INVESTMENT OR CAPITAL OUTFLOW (I.E., LOANS, CREDITS, DEPOSITS IN FOREIGN BANKS BY RESIDENTS, PORTFOLIO INVESTMENTS, ETC.)

The BLEU has no restrictions except the requirement that foreign exchange must be obtained on the free market. Similarly, there is no direct control on loans and credits to nonresidents which do not involve foreign currency; i.e., which are denominated in Belgian or Luxembourg francs; for example, export credits.

E. NONRESIDENT FLOATING OF SECURITIES ISSUES ON THE BELGIAN MARKET

The approval of the Minister of Finance is required for the floating of foreign issues of stocks or bonds on the Brussels Stock Exchange (as well as for the trading of already issued foreign securities). This is a longstanding requirement of the basic Belgian commercial law—not a post-World War II aspect of exchange control (see article 108 of the Code de Commerce). Authorization may be refused for political reasons, because of the tightness of the capital market, or for any other reason.

Stock exchanges in Belgium (Brussels, Antwerp, Liège, and Ghent) are managed by a commission made up of brokers who are members of the exchange and who are elected by the members generally. There is a Government commissioner attached to each exchange. A listing committee scrutinizes all securities, domestic or foreign, for admission on the stock exchange, and the listing of securities is subject to strict regulations. Half the members of the listing committee are chosen by the Minister of Finance from among brokers nominated by the commission of the exchange. Only securities listed in their country of origin may be listed in Belgium.

The capital market is supervised by a Banking Commission (under legislation dating from 1935). To some degree, the functions performed in this respect are

[7] Or to make those current outpayments not permitted at the official rate.

similar to those of the Securities and Exchange Commission in the United States. The Commission is to be notified 2 weeks before the public offering of any stocks or corporate bonds, and a prospectus must be submitted by the issuer, giving extensive information about the nature of the security, the issue price, the purposes of the issue, the interest of the issuing institution in the corporation whose stock is to be offered, etc. The Commission may delay the issue for 3 months if certain conditions are not fulfilled. Moreover, the Commission has the authority to delay the public offering of issues even if the projected issues are unobjectionable and satisfy all legal requirements. The purpose of this authority is to give the Commission powers of control and stabilization over the capital market and to prevent the capital market from becoming unbalanced and overloaded with new issues.

Processing of foreign securities by the Listing Committee and by the Banking Commission is reported by Belgium to be on the same basis as for domestic securities.

The Belgian Government, prior to the independence of the colonies, used to guarantee bond issues floated by the territorial governments of the Congo and Ruanda-Urundi—a special advantage which will not, of course, maintain in future. Otherwise, since the system is one of authorizing each case individually, little can be said as to discrimination for or against the issues of any outside area.

F. CONVERSION BY A NONRESIDENT OF PROCEEDS FROM THE LIQUIDATION OF DIRECT OF PORTFOLIO INVESTMENT

Conversion into foreign currency of francs received by a nonresident from the sale of investments in the BLEU may be made to any country in any foreign currency at the free market exchange rate.

There are two cases where conversion is permitted at the more advantageous official rate. In connection with capital invested in industrial and commercial enterprises, or in long- or medium-term loans, the foreign investor at the time of making the investment may apply for a transfer guarantee from the Belgian-Luxembourg Exchange Institute. The giving of such a guarantee depends on whether the investment is considered to be of value to the Belgian economy, and is accorded only if the incoming investment is itself made at the official exchange rate. This approval system is provided for in the decree law of October 6, 1944, the basic Belgian legislation on foreign exchange controls.

The second case where nonresidents may repatriate capital at the official exchange rate concerns sales of real estate in Belgium and transfer abroad of the proceeds by foreign emigrants.

G. BELGIAN PRACTICES REGARDING CAPITAL OUTFLOWS AND THE OECD CODE AND THE EEC DIRECTIVE

The BLEU's practices regarding capital outpayments are in conformity with the obligations and recommendations of the OECD Code, since the code does not require that members permit capital transactions at official exchange rates.[8] It is less clear whether the free market rate for the Belgian franc will remain over time close enough to the official rate to qualify as coming within the EEC agreement for category A types of capital movements.

With the BLEU's policies on capital outpayments to other EEC and OECD members the same as in the case of outpayments to other countries of the world generally, there is no discriminatory treatment in favor of other EEC or OECD members.

H. RELATIONSHIP TO THE NETHERLANDS UNDER THE BENELUX TREATY

Under the Benelux Treaty of Economic Union which went into effect on November 1, 1960, capital flows are to be completely free among Belgium, the Netherlands, and Luxembourg (article 4). This raises the question as to whether eventually capital flows within the area may take place freely at official exchange rates. However, these clauses of the treaty will be put into effect only gradually, and for the time being there is no change in Belgian practices on capital flows to the Netherlands, which continue to take place on the same basis as flows to all other countries.

[8] Art. 6, in effect, defers to IMF obligations as to exchange rates.

VI. Canada

The export of capital from Canada by residents or nonresidents is free of all foreign exchange or other government restrictions. Foreigners have access to the Canadian capital market on the same terms as Canadians. (Canada is, of course, a substantial net importer rather than an exporter of capital.)

While Canada maintains freedom of capital transactions, it has announced a decision not to adhere to the OECD Code of Liberalization of Capital Movements. Given the large volume of foreign (mostly United States) investments in Canada, which could in adverse circumstances be mobilized in liquid form for transfer abroad, the Canadian Government considers that it must retain freedom of action to intervene if a critical exchange situation should ever arise. In addition, since the matter of new inflows of direct and portfolio investment into Canada is a continuing political issue—for economic reasons as well as because of the element of foreign control over Canadian affairs—the possibility of limitations or disincentives to inflows cannot, perhaps, be ruled out.

The question of the exchange rate was, in the past, also a factor. Prior to May 2, 1962, Canada had a floating rather than a fixed exchange rate. The OECD Code does not require that liberalized capital transfers be made at official or fixed exchange rates; the code permits IMF requirements to be governing for IMF members. As yet the Fund has not determined whether rates for capital transfers fall within the jurisdiction of the Fund.[9] If this situation changed in future, a country with a floating rate might find it difficult to adhere to article 6 of the OECD Code. Since May 2, however, when Canada adopted a fixed exchange rate (with a par value of Can$1.08108=US$1, this particular reason for nonadherence to the code would appear to have disappeared.

VII. France

A. General: Relationship to EEC, OECD, and French Franc Area

While private capital outflows outside the franc area are subject to exchange control, those from France to other parts of the franc area[10] are neither controlled nor recorded. Exchange controls similar to those of France are applied by members of the franc zone to transactions with countries outside the area. It is French policy to give priority to investment in the franc zone, and most private and official aid is directed toward this area. The controls limiting capital flows to franc zone residents are those which are exercised under monetary and financial laws over the flotation of issues on the Paris Bourse and over bank credits to business concerns—controls which apply also to residents of France itself. These controls are directed at maintaining orderly conditions on the capital market and at favoring projects considered to be most useful to the economy, e.g., by increasing export capacity.

While France's exchange control regulations accord with both the EEC directive and the OECD Code of Liberalization of Capital Movements, without reservation, there are no special regulations applying to either of these areas. That is, outside the franc zone, French exchange control regulations are applied on a multilateral, worldwide, nondiscriminatory basis.[11]

Policy re controls and the administration of exchange regulations over capital flows as well as supervision of the flotation of issues and the capital market come under the direction of the Ministry of Finance and Economic Affairs.

All capital outpayments from France take place at the official exchange rate.

The basic French exchange control law is the decree of September 9, 1939, as amended. Control over bank lending and flotations derives from the law of December 2, 1945, establishing the National Credit Council, and law 46-2914 of December 23, 1946, the Finance law.

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[9] The staff has, however, consistently taken the position that the Fund's jurisdiction with respect to multiple rates of exchange applies to all such rates, including special rates for capital transactions.

[10] The French franc area consists of (1) France and Corsica, (2) the overseas departments: Guadeloupe, Guiana, Martinique, Réunion, (3) the overseas territories: Comoro Islands, New Caledonia, French Polynesia, St. Pierre and Miquelon, Wallis Archipelago, and Futuna, (4) the condominium of the New Hebrides, (5) the following independent states: the Republics of Ivory Coast, Dahomey, Upper Volta, Mauritania, Niger, Senegal, Mali, Congo (Brazzaville), Gabon, Chad, the Central African and Malagasy Republics, Algeria, Morocco, Tunisia, Monaco, and the Republics of Togo and Cameroon.

[11] Except, of course, for bilateral account countries: Bulgaria, Czechoslovakia, East Germany, Hungary, and Rumania.

B. DIRECT INVESTMENT ABROAD BY FRENCH RESIDENTS

Direct investment outside the franc zone by French residents remains subject to prior authorization under the exchange control regulations, but the French authorities indicate that in recent years such investment has in fact been liberalized: all applications for the authorization of operations of this kind have been granted.

C. PORTFOLIO INVESTMENT ABROAD BY FRENCH RESIDENTS

Beginning with April 1, 1962,[12] France has freed investments by French residents in foreign securities quoted on foreign stock exchanges. (Purchasing of nonlisted securities is still subject to license and generally permitted after verification of the bona fides of the transaction.) Buying and selling of listed securities may be carried out at the official exchange rate.

D. LENDING ABROAD BY FRENCH RESIDENTS

Commercial credits in francs of up to 5 years in term (related to a transaction in which a resident participates) are freely authorized to all destinations. Many of these credits are, of course, extended by the governmental export credit institution, the Banque Française du Commerce Extérieur.

Financial loans denominated in foreign currency (or convertible francs) are subject to individual licensing under the exchange control regulations. Tight control in this area, particularly for short-term loans, is considered necessary to prevent speculative outflows.

While exchange control is the principal current means of exercising direction over foreign lending, the Bank of France has direct powers of control over bank loans both domestic and foreign under banking legislation. Pursuant to article 1 of the September 29, 1948, Décision de Caracterè Général of the National Credit Council (established by the law of December 2, 1945), Bank authorization required for bank loans in all cases where they would result in raising total credits outstanding by all banks to any one enterprise above a certain figure—currently set at 10 million new francs. The Bank also maintains an audit over lesser credits. These controls were originally established as instruments of general monetary policy. Their existence means, of course, that liberalization of exchange controls alone would still leave a system of direct controls over lending abroad. It also provides a means of control over lending to the franc zone, where exchange controls do not apply.

E. DEPOSITS IN FOREIGN BANKS BY FRENCH RESIDENTS

Capital outflows for purposes of making foreign deposits are strictly controlled and generally are not allowed. Foreign exchange received by residents from exports, invisible transactions and capital transactions must generally be surrendered within a month for francs at the official exchange rate.

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[12] Prior to April 1, France employed a free market system for investment by residents in foreign portfolios to permit trading in foreign securities without necessarily making any net call on foreign exchange supplies. In effect and in general, outflows of foreign exchange for portfolio investment by residents were permitted only to the extent that they were counterbalanced by inflows from other residents who were selling their foreign securities. The demand for foreign exchange from residents wishing to purchase securities abroad, and the supply from residents simultaneously selling foreign securities abroad for foreign currencies, were allowed to balance themselves at a free exchange rate for the franc. The specially designated foreign exchange used in these transactions was referred to as "devises titres". The free market was conducted by the authorized French banks. As with other similar systems, foreign exchange sometimes showed a premium in this market since residents, not allowed foreign exchange at the official rate for investment in foreign portfolios, were often willing to pay a premium for the privilege. However, since holders of foreign exchange from any source could always turn it in at the official rate, the official rate constituted the floor for foreign exchange in the free market. The premium for foreign exchange on the free market in 1960 and 1961 ranged from virtually nothing to 2.5 percent over the par value.

France regarded the free market system as a device for liberalizing security transactions without necessarily engaging the foreign exchange reserves to finance a net outflow of foreign exchange on portfolio investment account. Attempts at net outflow resulted simply in a higher premium rather than in a net loss of foreign exchange, since the authorities were not obliged to support the franc in the free market by supplying additional foreign exchange to it (though they could, of course, support the free market rate if considered desirable).

F. ACCESS TO THE CAPITAL MARKET BY NONRESIDENTS

The Ministry of Finance and the Bank of France have control over the flotation in France of securities issues denominated in foreign currencies (or in francs to be converted into foreign currency), both under the exchange control laws and the banking laws providing for control over credit and monetary conditions. Under banking law—Loi 46–2914 du 23 décembre, 1946, and subsequent regulations—authorization for either domestic or foreign flotations of over 1 million new francs ($200,000) must be accorded by the Direction du Trésor, under the general direction of the Ministry of Finance. In the case of bond issues, operations between $50,000 and $200,000 must also be reported.

Listing on the "official" market of stock exchanges[13] is also subject to advance approval by the Government, in the case of all securities, domestic or foreign. Under the law of May 31, 1916, the quotation of foreign securities in France is subject to authorization by the Ministry of Finance. Such securities must be listed in their country of origin.

In fact, no foreign securities have been floated in France since before World War II. Canvassing in connection with operations on securities issued by foreign companies without the guarantee of the governments concerned is prohibited under a decree of August 8, 1935. The latter limits possibilities of selling foreign shares and bonds, whether new or old issues.

Flotations by members of the franc zone are more common, and France has, on occasion, guaranteed the bond issues of local governments. Foreign exchange is, of course, not involved in issues by franc area residents. Flotations by residents of the franc zone are subject only to the same government controls applying also to residents of France. Under the banking laws, in practice, the Ministry of Finance is now controlling bond issues, but equity issues are rarely refused authorization. The control of bond issues, as to their timing, terms, etc., is obviously of concern to the Government in connection with its own flotations, and is exercised principally to maintain an orderly capital market. For foreign flotations, the exchange regulations rather than banking regulations currently constitute the focal point of control.

G. REPATRIATION OF CAPITAL BY NONRESIDENTS

Since January 21, 1959, the repatriation by nonresidents of all investments in France has been liberalized. Transfer of the proceeds of liquidation may be effected at the official exchange rate. Repatriation of certain types of investment requires no prior authorization. Certain types of investment may be controlled on the way into France—apparently in connection with the matter of foreign control over domestic concerns—and where prior authorization is required for the incoming investment, it is also required at the time of repatriation.

Repatriation of the sales proceeds of direct investments is freely permitted in all cases. A prior authorization is required, but is granted without restriction.

All portfolio investments, loans, and other investments held by nonresidents in France may also be freely repatriated. Operations by nonresidents subject to advance authorization both on the way into France and on the way out are principally the following:

(*a*) Acquisition or sale of securities outside a French stock exchange.
(*b*) Purchase or sale in France of unlisted French corporate stock.
(*c*) Purchase or sale of businesses located in France.

When the incoming investment has been permitted, its repatriation is automatically authorized—that is, while a prior authorization for repatriation is required, it is automatically granted for all bona fide transactions.

VIII. Germany

Germany has no exchange restrictions on outward transfers of private capital. Such transfers at the official exchange rate for direct and portfolio investment, loans and credits, or for bank deposits abroad and other liquid purposes, may be freely carried out by residents, as may be repatriation by nonresidents of the proceeds of liquidation of their investments in Germany. In December 1958 and in the immediately succeeding months, Germany took a series of steps making the deutsche mark convertible for residents as well as nonresidents, and for capital as well as for current payments.

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[13] Outside of Paris, there are lesser exchanges at Bordeaux, Lille, Lyon, Marseilles, Nancy, Nantes, and Toulouse.

Similarly, capital market regulations do not apply to foreign flotations of stocks or bonds on German financial markets. (Flotations of bonds by domestic companies are subject to approval by the Federal Ministry of Economics in cooperation with the relevant Laender authorities.[14] In addition, an informal committee of bankers on which the Bundesbank has an influence, the Kapitalmarktausschuss, regulates the timing of internal bond issues in relation to the state of the capital market.)

Under the law concerning foreign economic relations (Aussenwirtschaftsgesetz) which took effect August 1, 1961, the Government has the authority (art. 22) to restrict capital outflows to safeguard the balance of payments or to protect the German capital market. However, no use has been made of this authorization.[15]

In spite of the relative freedom from controls in Germany, foreign borrowing and the flotation of foreign securities in Germany have been very limited. This may be attributed to a number of factors, including high interest rates and the consequent high cost of borrowing in Germany, the less highly developed stock and bond market as compared with the loan market, and the taxes imposed on securities issues, which further raise the costs of flotations. (There is a securities issue tax—wertpapier steuer—of 2½ percent and a capital market turnover tax—boersen umsatz steuer—of 1¼ percent per thousand at issue and at each subsequent sale. These taxes do not apply to loans, a form of financing more frequently used by domestic German concerns.)

IX. Italy

A. General

Italy restricts capital outflows through the licensing of many types of transactions under the exchange control laws. Until January 2, 1962, foreign exchange losses on capital account were also limited by channeling virtually all capital outflows through a free market; i.e., by not providing foreign exchange at the official rate for such outflows.[16] Since January 2, all authorized outpayments on capital account may take place at the official rate. This change was one among several recent measures gradually liberalizing Italian practice.

[14] Gesetz uber die staatliche Genehmigung der Ausgabe von Inhaber and Orderschuldverschreibnngen; art. 795 of Buergerliches Gesetzbuch (civil code), and Bundesgesetzblatt (Federal Law Gazette) 1954, pt. I, p. 147.

[15] Under the Sept. 1, 1961, provisions for implementing the law governing external economic relations, exports to Communist bloc countries are subject to authorization if some delay in payment is envisaged.

[16] Prior to Jan. 2, 1962, all capital outflows from Italy (with one exception) took place at the free market rate for the Italian lire. (The exception was repatriation by nonresidents of capital investments in Italy if the original incoming investment took place at the official rate and was approved as a productive investment by the Treasury).

Demand for foreign exchange on the free market, if necessary at the cost of a premium, derived from all those wishing to make authorized capital outpayments from Italy not permitted at the official rate. (All current account outpayments are permitted at the official rate). The supply of foreign exchange which Italy permitted to go on the free market was made up of a combination of certain current and virtually all capital inflows—receipts of foreign currency from nonresidents who needed lire for touring, living, or educational expenses in Italy, for paying salaries or wages, for payment of Italian taxes, court costs, or insurance premiums, for making emigrant remittances to Italy, for making portfolio investments in Italy, or for making unapproved direct investments, for buying Italian real estate, and for certain other limited and specified purposes.

(The free market exchange rate could not fall below the official rate since, at worst, nonresidents could obtain lire at the official rate for their expenditures in Italy (or residents who had received foreign banknotes from tourists, etc., could turn them in for lire at the official rate). Foreign exchange on the free market could thus show a premium over the official rate for the lire but not a discount. Italy reports that the free market exchange rate never varied appreciably from parity and was practically the same as rates ruling on the official market; that is, the supply of foreign exchange to the free market was generally adequate to meet the demand for capital outflow from Italy. This demand was, of course, held down by the individual licensing of many capital outpayments under the exchange control regulations.

The free market, called the banknote market in Italy, was conducted by authorized Italian banks, and was set up by Italy under decree laws No. 476 of June 6, 1956, and No. 786 of July 25, 1956, the basic laws on exchange control. As in the case of other countries using free markets for capital outpayments, the free market provided a device permitting at least some liberalization of capital outpayments without risk to the balance of payments and the reserves. In the case of Italy, the maximum amount of foreign exchange at risk because of capital outflows was limited to receipts of incoming capital, tourism, etc., as enumerated above. Attempts at capital outflow in greater volume resulted not in a greater outflow of foreign exchange, but in a rise in the premium for such exchange on the free market with the Government not attempting, if it did not wish to, to support the lire on this market by supplying additional foreign exchange to it.

In addition to exchange controls, under Italian banking law, flotations of stocks or bonds by either residents or nonresidents on the Italian market, denominated in lire or in foreign currency, are generally subject to Government approval.

B. DIRECT INVESTMENT ABROAD BY RESIDENTS OF ITALY

Direct investments abroad are free of exchange control or freely authorized. All corporate bodies in Italy may buy shares or participate in foreign companies, without prior authorization,[17] if the line of business of the companies in which the investment is being made is the same or subsidiary to that of the investing corporation and if the purpose of the investment is to promote the foreign activities of the company making the investment. Direct investments of this sort, which would appear to take in the bulk of direct investments abroad, are thus free of exchange control to all countries of the world without discrimination.

Direct investments abroad in companies with a line of business different from that of the investing corporation in Italy, or where the purpose is not promoting the foreign business of the investing corporation, or direct investments abroad by unincorporated concerns and individuals, are, in the case of investments outside the EEC countries, subject to obtaining prior authorization under the exchange control regulations. Within the EEC area, all these remaining forms of direct investment are free of exchange control. Italy has reported to the OECD[18] that in fact all applications for exchange licenses to make long-term direct investments abroad are granted, so that there is, in effect, no discrimination whether the destination is an EEC country or not.

C. PORTFOLIO INVESTMENT ABROAD BY ITALIAN RESIDENTS

Since the beginning of 1961, Italy has taken certain steps to liberalize to some extent portfolio investment abroad by Italian residents. These changes in the regulations bring them somewhat more into line with the first directive of the EEC. (See category B of that directive.)

On February 26, 1961, an exception was made to the licensing controls over investing in foreign securities, in the case of investment banks, referring in Italy to concerns whose business is investing in securities. Investment banks are now freely permitted to purchase listed securities on any stock exchange in any country. Such purchases may not exceed 20 percent of the capital and reserves of the investment bank making the purchase.

Through two measures adopted on November 28, 1961, and March 7, 1962, Italian corporations other than investment banks are now permitted to purchase listed corporate bonds of companies in all OECD countries (and their monetary areas), provided the line of business in which the investment is made is the same as that of the investing Italian corporation.

Italian residents in general are freely permitted to purchase securities issued by international financial institutions of which Italy is a member.

Otherwise portfolio investment abroad by Italian residents (individuals and companies) is subject to licensing and is permitted only when such investments are considered economically advantageous to Italy. In practice authorization to make such investments is rarely given.

Italian residents with already existing portfolio holdings abroad are not allowed to trade one foreign security for another or to trade these securities to each other—i.e., to engage in trading in the existing pool of holdings abroad in a way which does not entail any foreign exchange outflow.

If residents of Italy sell their portfolio holdings abroad, they are required to repatriate the foreign exchange proceeds for surrender to an authorized bank for lire.

Foreign securities are not quoted on Italian stock exchanges, although this is theoretically possible according to the relevant law of March 20, 1913, (see below under sec. F).

D. LOANS AND CREDITS BY RESIDENTS OF ITALY TO NONRESIDENTS

Loans and credits to nonresidents are subject to exchange control whether foreign exchange is involved or not; e.g., including export credits in lire.

There are certain exceptions to this general situation in the case of commercial credits related to transactions in which an Italian resident participates.

[17] However, documentation must be supplied by the investing concern to the authorized bank for which foreign exchange is being obtained.
[18] OECD: TIR (61) 1/09.

Such commercial credits less than 1 year in term are free of restriction to all countries abroad, and those 1 to 5 years in term are free of restrictions to EEC countries. Italy has entered a reservation to the OECD code, and is not automatically authorizing the medium term credits outside the EEC area.

Otherwise, lending to foreigners is decided on a case-by-case basis by the Bank of Italy and the Exchange Office, with the general criterion of economic advantage for Italy.

E. DEPOSITS IN FOREIGN BANKS BY RESIDENTS OF ITALY

Outpayments for such deposits are subject to exchange control and are generally not permitted. However, shipping and insurance companies, travel and forwarding agencies, and certain concerns supplying related services, may hold operating accounts in foreign currencies up to specified amounts.

Receipts of foreign exchange by exporters and other concerns selling abroad must be surrendered to authorized banks.

F. FLOTATIONS OF SECURITIES ISSUES BY FOREIGNERS ON ITALIAN STOCK EXCHANGES

The Italian markets have not generally been open to foreign issues since the war.[19]

The exchange control regulations restrict the possibility of nonresidents raising funds through flotations in Italy. Securities denominated in foreign currency would come under the regulations on residents investing in foreign portfolios. As noted above, portfolio investment by Italian residents is, with certain exceptions, subject to individual licensing.

A flotation denominated in lire and inconvertible would be of little use to nonresidents of Italy. There are no other countries in the Italian monetary area. This is unlike the situation in the United Kingdom, where a flotation in inconvertible sterling would be useful for the many members of the sterling area.

In addition to exchange control, the Government of Italy exercises control over flotations by either residents or nonresidents under the banking laws—royal law-decree No. 1400 of July 17, 1937 and No. 428 of May 3, 1955. All issues exceeding 500 million lire ($800,000) have to be approved by the Interministerial Credit and Savings Committee, on which are represented the Bank of Italy, the Ministries of Treasury, Industry and Trade, Agriculture, Budget, Foreign Trade, Finance, and Public Works. Issues for lesser amounts must also be approved by the Committee if they are to be quoted on the stock exchanges, but not otherwise.

A request for admission of an issue to an Italian stock market is submitted to the chamber of commerce which operates the market. On new listings, the chamber is guided by advice from the stock brokers committee and the governing board of the stock exchange. The decision of the chamber is dependent also on the prior approval by the Treasury and the Bank of Italy.

If the securities were being floated by a foreign government rather than by a private company, the admission to the stock exchange would have to be granted by a Presidential decree, upon the recommendation of the Ministries of the Treasury and of Foreign Affairs.

Control over securities issues, both domestic and foreign, under the banking laws, is exercised as part of Italy's general monetary and economic policies. In large part because of the need for capital for development within Italy, it has not been the practice to grant authorization to foreign entities to float issues on the Italian exchanges.[20]

G. REPATRIATION OF CAPITAL BY NONRESIDENTS

As of January 2, 1962, repatriation by nonresidents of investments in Italy—direct, portfolio, or personal—has been liberalized on a worldwide, nondiscriminatory basis. Repatriation is permitted at the official rate for the lire. This system replaces the former provisions whereby approved and certain other direct investments could be repatriated at the official rate; and portfolio, as

[19] Among the exceptions, the Inter-American Development Bank this year raised $24 million on the Italian market.

[20] Except to foreign firms with branches in Italy and for use in Italy.

well as unapproved direct investments, could be repatriated—but only on the free market at some discount on the lire.[21]

H. DISCRIMINATION: RELATIONSHIP TO EEC AND OECD

In liberalizing its exchange control regulations to conform with the first directive of the EEC, Italy has, in the main, kept them nondiscriminatory vis-a-vis outside countries. In the case of direct investments, there is some difference, as noted above, between EEC and non-EEC countries in that, for investment in the latter, (*a*) by Italian corporations making an investment abroad in lines of activity different from their business in Italy or for purposes other than promoting their foreign business, and (*b*) by unincorporated firms and individuals, a prior authorization is required from the Exchange Control Office. These two categories of investment would appear to be of secondary importance, and Italy reports that in any case, bona fide direct investments abroad are always authorized.

There is a discriminatory provision in the area of commercial credits, where medium-term credits are free of control to EEC members but not otherwise.

There is also discrimination involved in the limited freeing of portfolio investments within the OECD area. (See section above on portfolio investment.)

For the rest,[22] Italy's exchange control regulations are the same for all outside countries.

Concerning the administration of the regulations under either exchange or capital market controls, while little can be said regarding discrimination in areas where transactions are screened on a case-by-case basis, these areas appear to be limited, including only loans and credits extended by residents of Italy. Otherwise capital outflows appear to fall in three groups—those free of control, those automatically authorized to all destinations, and those not authorized to any destination.

X. JAPAN

A. DIRECT INVESTMENT ABROAD BY RESIDENTS OF JAPAN

All direct as well as all other private investments abroad by residents of Japan are subject to official licensing by the Japanese Ministry of Finance under the exchange control system.[23] In Japan's liberalization program, capital export is to be the last area of exchange control to be liberalized. There is no preference or discrimination in regard to geographic areas of investment. The general overall criterion is that the investment be considered desirable for balance-of-payments reasons. The Government of Japan, in reviewing foreign investment proposals, generally applies two basic criteria: (1) is the investment a sound and profitable one; and (2) will its output compete with Japanese exports, provide a source of needed imports, or promote the expansion of Japanese exports. There are no qualitative tests required participation of local interests, or others. A target for the amount of capital to be made available for export as long-term capital

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[21] Prior to Jan. 2, 1962, the following system was in effect.

The foreign investment law of 1956, designed to encourage capital inflow, provided for an approval system on incoming direct investments. On approved investments, repatriation of any later liquidation (and the payment abroad of current earnings) was guaranteed at official exchange rates. Nonresidents whose investments qualified as productive enterprises could thus transfer abroad, without limitation of time or quantity, proceeds from the liquidation of investments including capital gains, at the official rate.

An application for qualification of an investment project as "productive" was filed with the Ministry of Treasury, which usually rendered decisions within 30 days. On completion of the project, the investor applied to the Treasury again for a finding that his enterprise was in fact productive as originally described. With very rare exceptions, recognition as productive was always granted applicants.

In the case of direct investments which were not approved, including for example, direct investments made before the approval system was introduced, repatriation of capital at the official exchange rate could not exceed the value of the original incoming investment nor could it occur until 2 years after the date on which the investment was made. Earlier repatriation of the original investment, and any capital gain, could be effected at any time at the free-market rate of exchange.

Repatriation of portfolio investments in Italy by nonresidents could be freely effected at the free market rate.

In effect, all repatriation of nonresident capital was freely permitted to all countries of the world without discrimination, at either the free or official exchange rate.

[22] There are certain special provisions for EEC countries in the sphere of personal capital movements, not covered in this report.

[23] Foreign exchange and trade control law (No. 228, Dec. 1, 1949) and the foreign investment law of 1950 (No. 163, May 10, 1950).

is established in each semiannual foreign exchange budget. The figure in the budget for the half year ending March 31, 1961, was $67 million, which covered large allocations for Arabian oil and Usiminas iron and steel in Brazil. Under Japan's new 10-year plan, Japanese direct investments abroad for the development of resources are expected to amount to about $3,500 million in the decade, with a rate of over $550 million in 1970. The plan envisages considerable oversea investment to secure oil supplies as well as other raw materials.

B. PORTFOLIO INVESTMENT ABROAD BY RESIDENTS

Applications by Japanese residents to invest in stocks and bonds abroad, aside from the securities involved in direct investments, are also determined on a case-by-case basis. Such investment is rarely allowed, and never allowed simply for the purpose of obtaining dividends or for speculation. Balance-of-payments effects are considered, for example, whether the investment in a foreign company would result in the promotion of sales of Japanese products. There is no official pooling arrangements within which residents can trade existing holdings of foreign securities.

C. LENDING ABROAD BY RESIDENTS

All private loans and credits to foreigners are subject to official licensing under the exchange control system. This includes loans from a resident to a nonresident whether or not conversion of currency takes place.

The Ministry of Finance has delegated authority to the Ministry of Trade and Industry to administer export credits. Short-term yen credits (less than 1 year) may usually be extended by commercial banks or companies to finance any legitimate export of specified Japanese goods. Other export credits are extended by the Japanese Export-Import Bank, generally for not more than about 7 years, although sometimes the term is extended to 15 years. Such export credit financing is available only for capital goods. However, some exceptions are made in the case of durable consumer goods, notably motorcars, and in the case of tubular goods for the petroleum industry. The limit on Japanese export credit depends on the tightness of the capital market and on capital available to the Government Export-Import Bank,[24] rather than on administrative controls. Under Japan's 10-year plan, long term credits are scheduled in significant amount, to help the underdeveloped countries to obtain capital goods and to enable Japan to increase exports. By 1970, Government and private credits to buyers are expected to be running at an annual rate of $1.5 billion.

Aside from export credits, loans by Japanese residents to nonresidents either in yen or in foreign currency are subject to individual licensing by the Ministry of Finance. Very little of this type of private lending, either on a short- or long-term basis, is permitted.

D. DEPOSITS IN FOREIGN BANKS BY JAPANESE RESIDENTS

Private concerns and individuals are not permitted to convert yen for the purpose of establishing liquid holdings abroad. There is also a surrender requirement for foreign exchange acquired in the normal course of business. Foreign currency acquisitions must be surrendered in 10 days. Exceptions are made for export-import firms and firms engaged in invisible transactions; e.g., banks, shipping companies, and insurance firms. Such firms are allowed to hold foreign exchange abroad in amounts and under conditions prescribed by the control, and designed to facilitate the conduct of their oversea business. Otherwise, and as a rule, no resident (corporation or person) may hold foreign exchange in his own name or deposit money abroad.

E. FLOATING OF SECURITIES ISSUES BY NONRESIDENTS ON THE JAPANESE MARKET

Closely related to resident investment in foreign portfolios, the flotation of securities in Japan by nonresidents is subject to official licensing under the foreign exchange control function of the Ministry of Finance. The inconvertibility of the yen on capital account for all outside areas—and the limited usefulness of the proceeds of a flotation denominated in yen—have operated to eliminate the interest or possibility of foreigners raising funds through issuing securities on Japan's capital market. The Japanese Government has considered the capital market too tight and the balance of payments insufficiently strong to permit outflows for portfolio investment abroad.

[24] The Export-Import Bank accounts for about 70 percent of export credit extended.

F. REPATRIATION OF INVESTMENTS IN JAPAN BY NONRESIDENTS

The foreign investment law of 1950 authorizes the Japanese Government to guarantee the repatriation of capital (and remittance of earnings) according to a definite schedule after a stipulated waiting period on approved investments, either direct or portfolio. The administration was given discretion to withhold approval if it did not appear that the investment in question would contribute either to the improvement of Japan's balance-of-payments position or to the development of essential industries or public enterprises.

As of July 21, 1959, a system of conditional approvals was introduced under which the remittance of principal (and earnings) on approved investments is guaranteed, subject to the condition that Japan can temporarily defer such remittances for balance-of-payments reasons. Since 1959, about half of approvals accorded have been of the conditional type.

Approval direct and portfolio investments by nonresidents in Japan can be repatriated in full after they have been held for 2 years. (This period of deferment has been progressively shortened in recent years.)

Difficulty in obtaining approval may develop due to, among other reasons, the proportion of foreign ownership involved in the case. In already existing firms—i.e., for investment via the stock market in already issued stocks—approval is not accorded where the result would be foreign equity participation of over 10 percent in public utilities and natural resource industries, or over 15 percent in other industries. Approvals may be accorded where foreign ownership is at a higher level in the case of new plants and firms or their expansion—i.e., in the case of direct investments involving new issues of stock. (There have been three approvals of U.S. investments in the last 4 years where the U.S. ownership ratio was as high as 50 percent.)

Because of difficulty in obtaining approval for repatriation, some foreign firms have made yen investments on an unapproved basis, in which case a separate application must be made each time the investor wishes to convert capital (or earnings) into foreign exchange for remittance abroad. Approval in these cases is rarely given. (All investments in Japan dating from before 1950—the date of the investment law—are also, of course, unapproved. However, in this case Japan permits certain securities to be repatriated.)

In order to liberalize repatriation possibilities on approved investments before the 2-year waiting period has expired, Japan established a pooling arrangement as of May 1, 1961. Foreign investors are now able to sell their holdings in Japan, but not for convertible yen and not at official exchange rates. A new security yen has been established, the free-market rate for which will depend on the existence of other foreign buyers willing to invest in Japan. (This system is similar to that used in the United Kingdom with security sterling, and in other European countries.) From the point of view of the individual foreign investor, repatriation is permitted, though perhaps at some sacrifice in the rate of exchange, while from the point of view of Japan, no net outpayment of foreign exchange for repatriation purposes is involved.

Japan's regulations on the repatriation of foreign capital affect principally the United States, since U.S. concerns and individuals bulk largest among foreign investors in Japan.

XI. Netherlands

A. GENERAL

Direct controls in the Netherlands over capital outflows stem from the exchange control regulations issued under the Foreign Exchange Decree of 1945, as amended, and also from the banking laws according the Ministry of Finance and the Netherlands Bank general control over credit, i.e., over internal monetary policy. The Netherlands Bank also administers exchange controls in the field of capital.

All authorized capital outflows take place at the official exchange rate with the exception of transfers in connection with investment in securities. Transactions in foreign exchange related to trading in securities have been separated from all other foreign exchange transactions so that such trading will not necessarily make any net call on the Netherlands' general supplies of foreign exchange: outflows on securities account are permitted to the extent they are paid for by inflows, with a free market rate for the guilder equating the two.

B. DIRECT INVESTMENT ABROAD BY NETHERLANDS RESIDENTS

While direct investments abroad are still subject to individual licensing under the exchange control regulations, the Netherlands has officially stated that such investment is in fact fully liberalized.[25] Any authorization required is granted.

C. PORTFOLIO INVESTMENT ABROAD BY NETHERLANDS RESIDENTS

Investment in foreign securities by Dutch residents is subject to exchange control. The authorities rarely allot any net supply of foreign exchange for this purpose, partially since it would not be Dutch policy to support the free market rate in time of stress, and partially since, in fact, inflows have recently been exceeding outflows on portfolio investment account.

Under general license, residents are allowed to purchase foreign securities[26] provided the purchase is made with foreign exchange obtained on the free market. Operations in foreign exchange by Dutch residents connected with buying and selling foreign securities, and by nonresidents buying and selling Dutch securities, have been merged in a single free market, i.e., a market in which the government does not intervene, if it does not wish to, to influence the rate of exchange involved in the transactions. Demand for foreign exchange on this market derives from residents wishing to make portfolio investments abroad, and from nonresidents wishing to sell their Dutch securities and repatriate the proceeds. (See below.) The supply of foreign exchange for the free market depends on other residents wishing to sell their foreign portfolio holdings and turn the proceeds into guilders, and on nonresidents wishing to purchase guilders in order to obtain Dutch securities. In brief, there can be a net increment in Netherlands holdings of foreign securities if the necessary foreign exchange is supplied in general by nonresidents simultaneously increasing their holdings of Dutch securities.

Since residents are not permitted to obtain foreign exchange at the official rate for investment in securities abroad, they may be willing to pay a premium for foreign exchange on the free market; that is, to sell guilders at a discount. The free market rate for foreign exchange may thus show a premium but not a discount as compared with the official rate, since holders of foreign exchange may—at worst from their point of view—sell it at the official rate.

The free market in foreign exchange related to securities transactions is conducted by the same authorized banks and exchange dealers also handling foreign exchange for transactions outside the field of securities at the official rate.

This system is similar to that in the United Kingdom, except that the authorities have connected the market among residents buying and selling foreign securities, and the market among nonresidents trading in Dutch securities, so that there is a single free market rate for foreign exchange used in securities transactions.

The authorities intervened in the free market to lower the premium, i.e., to support the guilder, in November 1959 and in November 1960. That is, at those times the authorities did make a call on their general foreign exchange supplies to permit a greater volume of outflow on portfolio investment account than would otherwise have been possible. Otherwise, the free market rate has not differed from the official rate by more than 1 percent, which indicates that in general, supplies of foreign exchange on the free market have been adequate to meet the demand of those residents wishing to buy foreign securities. The Netherlands authorities have indicated that in normal circumstances they are prepared to support the guilder on the free market if there is more than a slight discount below the official rate. The Netherlands stresses, however, that the free market system is maintained so that, in a time of stress with substantial capital outflows, the guilder would be allowed to depreciate on the free market to provide a balance between incoming and outgoing securities payments, and the reserves would not be drawn upon to support the rate and finance the capital outflow. The system is designed as a capital control, which would become highly effective at any time capital outflows for the purchase of securities tended to exceed inflows: the premium on foreign exchange would then discourage outflows.

[25] OEEC: TIC(61)1/03.

[26] Foreign securities purchased by residents are limited to those listed on stock exchanges. The actual securities are not held by resident owners but by the authorized banks, who issue certificates to the owners.

D. LENDING ABROAD BY RESIDENTS

In the field of commercial credits (related to a transaction in which a resident participates) e.g., export credits denominated in guilders, the Netherlands has taken no reservation to the OECD Code[27] which requires free authorization of such credits with terms up to and including 5 years. (The OECD Code does not require liberalization in the 1- to 5-year category if countries consider controls in this area necessary for reasons of internal monetary policy and where similar controls apply to both residents and nonresidents, but this would not seem an excepting provision currently applicable in the Netherlands.)

There are general licenses freeing small loans from control. In July 1960 general licenses were issued permitting residents to lend money to nonresidents in amounts not exceeding 10,000 guilders (about $2,600) per calendar year to the same nonresident; and also permitting residents to extend mortgage loans to nonresidents in connection with sales of real estate, providing the loan does not exceed 50 percent of the sales price of the real estate.

All financial loans of more substantial size remain more rigidly under exchange control.

The Netherlands Bank (which is under the direction of the Ministry of Finance) has the power to operate direct controls over lending not only under the Foreign Exchange Decree of 1945, as amended, but also under the legislation giving the bank control over credit, article 9 of the Bank Act of 1948 and later legislation expanding on this article, including the 1956 act for the supervision of the credit system. For foreign lending, it is the exchange controls rather than any regulations under banking legislation that are currently operative. Regarding domestic loans, formal licensing under banking legislation has been discontinued, and policy is effectuated rather by general monetary measures plus informal discussion between the Government and the banks in the case of particular large loans that might possibly put a strain on the credit system.

E. DEPOSITS IN FOREIGN BANKS BY NETHERLANDS RESIDENTS

Exchange controls are operative to prevent outflows by residents for the purpose of holding foreign currencies in foreign banks.

While foreign currency earnings do not in a nominal sense have to be surrended in the Netherlands, the difference between Dutch regulations in this respect and those of other countries with surrender requirements is not substantial. Payments from nonresidents must be received in accordance with prescription of currency requirements and may then be held in special "foreign currency accounts" in authorized banks in the Netherlands. Any use of these funds is subject to the exchange control regulations.

F. FLOATING OF ISSUES ON THE CAPITAL MARKET BY NONRESIDENTS

Direct control under banking law (see above under "Lending") of public issues on the stock exchanges, whether domestic or foreign, has been discontinued. However, under a "gentlemen's agreement," all such issues in amounts of over 10 million guilders ($2.6 million) are cleared in advance with the Netherlands Bank, which is likely to raise objections only if the flotations present problems in connection with prospective large Netherlands Government bond issues.

Netherlands Bank approval is also required under exchange control law for foreign issues the proceeds of which are to be paid abroad in foreign currency.

The Netherlands stock exchanges (Amsterdam and Rotterdam) were wholly closed to foreign flotations from 1955 until May 1, 1961, given domestic needs for capital, the tightness of money, and other factors. In April 1961, the Netherlands Bank announced that it would begin to grant licenses for foreign issues, at least for foreign bonds, on the Dutch capital market. The Bank's announcement emphasized that licenses would be granted only on a limited and gradual scale. In 1961, foreign bond flotations aggregating 577 million guilders ($160 million) were authorized. Late in 1961 consideration of the possibility of permitting additional flotations was deferred pending absorption of the Netherlands Government's own 300 million guilder bond issue of August 4. In April of 1962 the Netherlands Bank announced that licenses would be issued for some 150 million guilders ($41 million) in foreign bonds in the period to October, with further possibilities to be assessed later.

[27] The EEC directive also requires such liberalization, at least among EEC members.

G. REPATRIATION OF INVESTMENTS IN THE NETHERLANDS BY NONRESIDENTS

Repatriation of direct investments by nonresidents is liberalized, and proceeds of liquidation may be transferred abroad freely at official exchange rates.

Repatriation of portfolio investments is handled through the free market arrangement covering inflows as well as outflows of both resident and nonresident capital on portfolio account.[28] That is, nonresidents may sell their Dutch securities for guilders and repatriate the proceeds at the free market rate of exchange so long as other nonresidents are at the same time offering to buy Dutch securities and supplying foreign exchange for the guilders necessary to make the purchase, or so long as Dutch residents are reducing their holdings of foreign securities (see above under Portfolio Investment Abroad).

As with similar free market arrangements in other countries, this arrangement permits trading in securities, including repatriation by nonresidents, without necessarily drawing on the Netherlands' general supplies of foreign exchange. An attempted large outflow in time of stress would be reflected in a rise of the premium rather than in an actual large loss of foreign exchange. The premium has for some time past been very small, since there has been considerable interest abroad in Dutch securities, particularly Royal Dutch Shell. The flow of funds on portfolio account has therefore been inward into the Netherlands rather than outward.

H. DISCRIMINATION: RELATIONSHIP TO EEC, OECD, BENELUX, AND OVERSEA DEPENDENCIES

As mentioned in connection with Belgium, no steps have yet been taken to implement the provisions concerning the unified capital market, comprehended in the Benelux treaty of economic union. At this time, therefore, there are no special provisions in the regulations re the BLEU area.

Netherlands exchange controls apply to outflows from the metropole to the dependencies—the Netherlands Antilles, New Guinea, and Surinam—in contrast with the systems of other monetary areas. It is quite clear, however, that in the application of controls, preferential treatment is extended to these areas. The Netherlands guarantees from time to time bond issues of the provincial governments, and extends a certain amount of official grants and loans to these areas for both current and capital expenses. (All controls discriminate against Indonesia, since there has not yet been a settlement of economic and political differences with Indonesia.)

The Netherlands has no special regulations for the EEC and OECD areas.

As noted above, for direct investment and its repatriation, and short- and medium-term commercial credits, authorization are freely granted for all destinations. Trading in securities is also conducted on a worldwide basis within certain limitations. The principal fields where individual licensing and administrative discretion now operate in the Netherlands are those of financial loans by credit institutions and flotations of stocks and bonds on the stock exchanges.

XII. PORTUGAL

A. GENERAL

All forms of capital outflow from the Portuguese monetary area are subject to control, though certain transfers from metropolitan Portugal to other OECD countries are automatically authorized, since, subject to important limitations, Portugal, as an OECD member, has alined its practice with the OECD Code of Liberalization of Capital Movements.

There are no special arrangements on capital flows to other EFTA members, since the EFTA agreement does not cover capital movements.

Control is exercised by the Inspectorate General of Credit and Insurance, a division of the Ministry of Finance, in consultation with the Bank of Portugal as to monetary and foreign exchange policies. Special confirmation by the Ministry of Finance is required on all transactions exceeding 10 million escudos (about $350,000). All capital outpayments are made at the official exchange rate; there are no multiple exchange rate practices in effect and no blocked accounts. Revised regulations governing capital transfers were published in

[28] Redemption of securities, however, takes place at official rates of exchange.

Portugal's Official Gazette of June 29, 1960, November 7, 1960, and September 19, 1961.

Portugal considers controls on outward movements of capital to be necessary (1) to permit the Government to prevent outflows which might cause a strain on the balance of payments, and (2) to permit the retention of capital considered to be necessary in Portugal for economic development purposes or to relieve general tightness in capital markets. Following the recent disturbances in Portuguese Angola, there have been attempts at capital flight from Portugal. The Ministry of Finance issued a warning on April 20, 1960, against illegal transfers and stressed that the controls would be strictly enforced.

B. THE PORTUGUESE MONETARY AREA

The escudo area covers metropolitan Portugal (including the Azores and the Madeira Islands), the Cape Verde Islands, Portuguese Guinea, São João, Baptista de Adjuda, the islands of São Tomé and Principe, Angola, Mozambique, Macao, and Portuguese Timor. (The population of the metropole is roughly 9 million and of the oversea territories roughly 12 million.)

Current account payments from Portugal to the oversea territories may be made freely, but those on capital account are subject to authorization. While thus subject to adminisrative discretion, capital flows from metropolitan Portugal to the rest of the escudo area are generally authorized more freely than those to the rest of the world. Portugal has stated that constitutional provisions specifically provide for the progressive freeing of capital account transactions between the metropole and the oversea provinces. Uniform controls on outpayments from the escudo area to the rest of the world are applied throughout the area.

C. OUTPAYMENTS BY RESIDENTS FOR DIRECT OR PORTFOLIO INVESTMENT ABROAD, LOANS TO FOREIGNERS, OR DEPOSITS IN FOREIGN BANKS

For all such transfers out of Portuguese monetary area, licensing of each individual transaction is required.

Loans and credits to nonresidents are subject to exchange control whether made in escudos or in foreign currency, i.e., whether foreign exchange is involved or not.

Trading on Portuguese stock exchanges in foreign securities is not permitted since foreign securities were delisted from the exchanges during World War II and none have been admitted to the exchange since that time. For listing on the exchanges of either domestic or foreign securities, approval must be obtained from the Government. Securities of corporations in Portuguese oversea provinces are listed.

For special arrangements applying to OECD members in the case of direct and portfolio investments, and commercial credits, see below.

D. ACCESS TO CAPITAL MARKETS IN PORTUGAL BY NONRESIDENTS

Stock exchanges exist in Lisbon and Oporto, but their listings are limited and the amount of business transacted is small.

The flotation in Portugal of new issues of stocks or bonds of foreign companies or governments is controlled under the same regulations and processes applying to other international capital movements; i.e., individual licensing by the Directorate-General of the Ministry of Finance, in conjunction with the Bank of Portugal. (See Official Gazette of June 29, 1960, rule II, secs. 5 and 6.)

Under Portugal's current 6-year development plan, the Government has promulgated decrees for the issuance of development bonds, which qualify for the guarantees, privileges, and exemptions normal to Government securities. A significant part of the capital from these development bonds is to be employed specifically for investment in Angola, Mozambique, and other Portuguese colonies. Over the 6-year period, roughly $175 million in public and private Portuguese capital is programed for expenditure in the colonies. In other words, Portuguese oversea territories enjoy privileged access to Portuguese capital, but nevertheless under control.

E. REPATRIATION OF CAPITAL BY NONRESIDENTS

Transfer into foreign currency of the escudo proceeds of the sale of either direct or portfolio investments in Portugal owned by nonresidents requires authorization by the Inspectorate-General of Credit and Insurance and the Bank of Portugal, plus special confirmation by the Minister of Finance if the amount involved is over 10 million escudos.

In the case of repatriation of direct investments by other OECD members, such authorization is automatically given if the investment in question was originally made by import of capital into Portugal. (See below.)

In the case of repatriation of portfolio investment, the Portuguese authorities have indicated that no restrictions on outward transfers are in fact applied.[29]

F. CONTROLS ON CAPITAL FLOWS TO OTHER OECD MEMBERS

Since Portugal's conformance with the aims of the OECD code is limited—that is, since a number of capital flows of the sort coming under the code are subject to individual license when the destination is another OECD member as well as when the destination is any other country outside the escudo area—there is little discrimination involved in Portugal's system as between OECD members and nonmembers.

While Portugal's system of controls on capital transfers to other OECD countries is in conformity with the OECD code, this does not necessarily involve any discrimination in favor of other OECD members in the matter of permitting capital to flow out freely for purposes of making direct investment in OECD countries but not in other countries of the world. Portugal does not in fact permit its residents to make direct investments freely in other OECD countries. Its notification to the OECD indicates that such capital outflows will be authorized only if the capital is not considered necessary at home for Portugal's own economic development. It is to be noted that list 1 of annex A of the code obliges members to authorize direct investment flows only if such flows are not considered detrimental to the interest of the country concerned. In addition, countries such as Portugal could, if the need arose, invoke other permissive clauses of the code—article 7, which provides that members need not take all the liberalization steps of the code if their economic and financial situation justifies such a course; or article 14, which provides for special regard for underdeveloped member countries.

Repatriation of direct investments made in Portugal since 1950 by residents of OECD countries is freely permitted, including capital gains (providing the original investment was made with imported capital). Authorization by the Inspectorate-General for Credit and Insurance is required in these cases merely to establish the legality and bona fides of the outpayment. Since repatriation of direct investments by residents of non-OECD countries is subject to exchange control and may not be permitted, this is an area—a limited one—where discrimination against non-OECD members may exist.

Portugal also freely permits its residents to buy and sell foreign securities in other OECD countries, provided they use capital already held abroad in an OECD country and not legally required to be repatriated to Portugal—that is, provided no outflow of foreign exchange from Portugal is involved. Since this freedom is limited to purchases and sales in other OECD members (and therefore limits the number of countries receiving capital covered by such transactions to OECD countries) a further element of discrimination, as compared with non-OECD members, may be involved. However, the importance of this discrimination is again limited, since only capital already held abroad is concerned.

Portugal has entered a reservation to the provisions of the OECD code concerning the freedom supposed to be accorded to residents of OECD members to liquidate their portfolio investments in Portugal and to transfer the proceeds of the liquidation out of Portugal. In this area, therefore, controls remain operative for residents of OECD members as well as for nonmembers. (As noted above, however, administration of the regulations is reported to be liberal.)

A similar situation applies in the case of commercial credits; there is little discrimination between OECD and non-OECD members since Portugal has entered a reservation and is not according freedom in commercial credits of over 1 and under 5 years' duration to OECD countries as required by the code The Portuguese reservation applies to all credits granted by credit institutions. It is possible, therefore, that in the limited areas of (*a*) credits of 1 year and less in term granted by any source, and (*b*) credits of up to 5 years' duration

[29] OECD: c(62)24 (Feb. 26, 1962), p. 24.

granted by exporting firms, there is no control for other OECD members, but that controls are operative for non-OECD members. The volume of credits of this sort is not likely to be large, however.

XIII. Switzerland

A. General

The Swiss franc is free of exchange control; i.e., is convertible for both residents and nonresidents, on both capital and current account, except in the case of 11 bilateral account countries[30] largely in the Soviet bloc. With bilateral account countries, outpayments of capital are free of exchange control while outpayments for current account items covered in the bilateral agreements are controlled.

While capital outflows are free of exchange control, Switzerland exercises other forms of control over certain types of capital movements to all outside countries. In connection with monetary and general economic policy and under the laws regulating banking and credit institutions (Loi Fédérale sur les Banques et les Caisses d'Épargnes, Nov. 8, 1934) foreign lending and the flotation of foreign securities on the Swiss market are controlled by the Swiss National Bank. Swiss attitudes and official actions limiting the outflow of capital in varying degree from time to time, reflect official policies toward keeping interest rates low, retaining capital in Switzerland for domestic use, insuring a satisfactory level of internal economic activity, plus maintaining an orderly capital market and Switzerland's position as an important world financial center. While Switzerland maintains a largely open and hard currency capital market, it is a relatively small market compared with potential demand upon it if this demand were completely uncontrolled. The queue of foreign borrowers is always a long one.

B. Direct and portfolio investments and short-term capital outpayments by residents, and repatriation of capital by nonresidents

The Swiss permit free outward movement of private resident capital for direct investment, for acquisition of foreign securities (although admission of foreign securities to Swiss stock exchanges must be authorized by the Swiss National Bank), for liquid purposes such as the purchase of short-term paper or to make a deposit in a foreign bank. There is, moreover, no restriction on the repatriation of capital by a nonresident.

C. Lending abroad by residents

All bank loans or credits to foreigners of 12 months or longer and amounting to Sw Fr10 million ($2.3 million) or more, require approval of the Swiss National Bank under banking law (see above). The law also gives the National Bank administrative discretion to require smaller loans and credits to be submitted for approval if at any time conditions in the capital markets and general economic and monetary policies make such a course desirable.

Since the law providing for Swiss National Bank control of these matters covers only banks and financial institutions, loans and credits extended to residents of foreign countries by Switzerland's nonfinancial business corporations or by individuals are not subject to control, though the Government's advice may, of course, be sought on such lending.

D. Floating of foreign issues of securities on the Swiss market

All foreign placements in Switzerland of share or bond issues amounting to Sw Fr10 million or more must have the approval of the Swiss National Bank. As with lending, the Bank has discretion to require that smaller flotations also be approved.

The practice of the authorities in 1961 appeared to be to allow two foreign issues a month, with these issues usually restricted to a maximum of around $15 million. Generally, bond flotations, and not flotations of stocks for new money, predominated among approved flotations. These practices change fre-

[30] Bulgaria, Czechoslovakia, East Germany, Greece, Hungary, Iran, Poland, Rumania, Turkey, U.A.R. (Egypt), and Yugoslavia.

quently, however, depending upon the state of the Swiss capital market. In early 1962, there appears to have been a slowing down of flotations.

For 2 years prior to August 1958 the Swiss market for new issues of stocks and bonds, as well as for financial loans from banks, was completely closed by the Swiss National Bank to foreign borrowers. And, at the end of 1958, Switzerland imposed an informal but effective ban on new flotations and borrowing in the Swiss market by Common Market countries, in protest against trade discrimination by the EEC countries against Switzerland. This ban, promulgated by the Swiss Federal Council through the Swiss National Bank, was never popular with the private banks, and was lifted in early 1961, partly because domestic liquidity had become high and Switzerland wished to encourage capital outflow.

E. DISCRIMINATION

Since Switzerland operates relatively few Government controls in the field of capital movements,[31] has no oversea monetary area, and since the only regional arrangement, including provisions on capital flows to which Switzerland belongs, is the OECD, the extent of possible discrimination is small.

In the field of securities flotations and bank lending, since the larger transactions remain subject to individual authorization, discrimination is, of course, possible, as the experience of the Inner Six demonstrates.

F. RELATIONSHIP TO OECD CODE OF LIBERALIZATION OF CAPITAL MOVEMENTS

Switzerland, as a member of the OECD, has adhered to the code without reservation, since Swiss practices are in general considerably more liberal than those as yet required by the code.

The only question which arises in this connection concerns commercial credits. The OECD code obliges members to free from restriction commercial credits of a term 5 years or less. In Switzerland, such credits of a term 1 year or more and over Sw Fr10 million in value remain controlled. It may be that Switzerland considers its retention of this control as coming within the code's provision that restrictions in this field may be employed if considered necessary for reasons of monetary policy and provided similar restrictions apply to like credits between residents.

XIV. United Kingdom

A. GENERAL

The United Kingdom maintains a full set of exchange controls on outpayments of capital, with the major exception of outflows to the rest of the sterling area, which are free of this type of control. While licensed transactions take place, of course, at the official exchange rate, a system of multiple free market exchange rates is used in connection with measures which lend some flexibility to certain of the controls on capital flows. There are two free market rates for sterling—the premium on foreign exchange for resident dealings in foreign securities and certain direct investments (investment dollars), and the security sterling rate for dealings in nonresident holdings of sterling securities, repatriation of which is blocked.[32] (See below.)

Exchange control is administered by the Bank of England and authorized commercial banks on behalf of the United Kingdom Treasury under the Exchange Control Act (1947).

The United Kingdom also controls lending and the flotation of securities through the Capital Issues Committee operating under the Borrowing (Control and Guarantees) Act of 1946 and various ancillary Treasury orders. This control functions as part of general monetary policy. Up until February 5, 1959, the Capital Issues Committee controlled domestic as well as foreign lending and flotations. Since that date, domestic lending and flotations have been exempt from control. It should be noted that this form of control applies to sterling area members as well as to other foreign countries.

The United Kingdom considers the balance-of-payments position too problematical, sterling commitments too far flung, and the ratio of reserves to outstanding sterling balances still at too modest a figure, to permit a general liberalization of controls on capital movements for the time being.

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[31] Aside from the controls over bank lending and issues of securities.

[32] A connection which dealers had worked out between these two markets was severed by the United Kingdom's regulations, effective July 4, 1957. See London D-93, July 10, 1957.

B. DIRECT INVESTMENTS ABROAD BY UNITED KINGDOM RESIDENTS

Each transfer by a resident of funds for direct investment in a nonsterling country is subject to individual licensing and is decided on its merits. Prior to mid-1961 the United Kingdom indicated that licensing was liberal for bona fide direct investments, in which the investor was to take an active part normally with a controlling interest. Applications for such investments were refused only if they were considered to be detrimental to the national interest in that they promised no benefit to the economy through such means as the fostering of exports, the development of "knowhow," or the making available of raw materials. Transactions under approved licenses took place at the official exchange rate. (Regarding Uniscan and OECD areas see below.)

However, on July 25, 1961, the United Kingdom announced a change in its policies concerning direct investments. Because of the then-current balance-of-payments difficulties, all projects for such investment outside the sterling area were stringently screened. To be permitted, direct investments outside the sterling area were required to show a favorable effect on the United Kingdom balance-of-payments in the short term.

On May 17, 1962, the United Kingdom announced a relaxation of controls over direct investments outside the sterling area, reverting in large measure to the situation which had prevailed in the period immediately preceding July 1961, that is, licenses are in future to be granted for bona fide direct investments in which the investor is taking an active part, generally with a controlling interest; however, the newly permitted investments are to be financed not by conversion of sterling at the official exchange rate but by borrowing abroad or by purchasing foreign exchange on the switch dollar market, formerly used only for resident dealings in foreign securities; that is the newly permitted transactions are to result in no current increase in the overall demand for foreign exchange. This demand is either deferred to the future insofar as projects are financed by borrowing, or is to be met with foreign exchange from the pool of such exchange already available for transactions in quoted foreign securities (see below), and with no increase in this pool. Foreign exchanges at the official rate will continue to be available only for those direct investments which meet the stricter criteria imposed after July 1961.

C. PORTFOLIO INVESTMENT ABROAD IN NONSTERLING SECURITIES BY UNITED KINGDOM RESIDENTS

Such investment is subject to licensing, and the United Kingdom does not normally allot any foreign exchange for this purpose. Little net increase in the existing level of resident holdings of foreign securities is thus possible.

Residents are, however, allowed to sell their existing holdings to each other, or to sell existing holdings of one foreign security for another.[33] Up until recently, the regulations required that if the security sold was a United States or Canadian security, the securities purchased with the proceeds had to be United States or Canadian securities quoted on a recognized stock exchange (in effect, a discrimination in favor of dollar securities). As of May 17, 1962, the distinction between dollar and nondollar securities was eliminated.

This trading among residents in foreign securities gives rise to a free market rate for the foreign exchange used in such transactions. (The free market is conducted by authorized United Kingdom banks and exchange dealers). The foreign exchange good for purchasing foreign securities is supplied by United Kingdom residents selling their foreign securities abroad for foreign currency, for example in New York for dollars. The demand for such exchange comes from other residents wishing to purchase foreign securities, and willing to pay a premium for foreign exchange usable for this purpose since the United Kingdom will not make foreign exchange at the official rate available for such investment. Beginning with May 17, 1962, demand for foreign exchange for making direct investments abroad which do not meet the criteria justifying the provision of foreign exchange at the official rate, will also be added to the free market. The official rate puts a floor under the free market rate since, if nothing better offers, holders of foreign exchange good for purchasing foreign securities can turn it in for sterling at the official rate.

[33] Existing holdings, that is the "pool" of dollar securities, were indicated in the Radcliffe report to amount to about $4 billion.

The free market or switch dollar rate has exhibited substantial fluctuations. In July 1961, when the British balance of payments showed increasing difficulties, the premium for purchases of dollar securities went to 6¾ percent. By the end of the year it had fallen back again to under 1 percent, rising to some extent once more in early 1962.

With increasing demand for continental securities, and with the U.S. balance of payments showing difficulties, the exchange rate for purchasing nondollar securities began to diverge from that for dollar securities in April 1961. Between April 1961 and May 1962, when the regulations differentiating between dollar and nondollar securities were altered, there were thus two switch foreign exchange rates for sterling. The premium for purchase of continental securities went to a maximum of 10¼ percent in July 1961. Just prior to amalgamation of the two markets on May 17, 1962, the premium was 2¾ percent for dollar securities and 5½ percent for nondollar securities. On May 18 the combined premium stood at 4 to 4⅜ percent for switch (or "investment") dollars.

Prior to 1957, United Kingdom residents were allowed to purchase foreign securities freely not only from each other but also from other members of the sterling area. However, since Kuwait was not strictly controlling exchange and the importation of fresh supplies of foreign securities, it provided an avenue whereby foreign exchange was flowing out for portfolio investment. Since July 4, 1957, United Kingdom residents have been required to obtain permission from the Treasury to acquire foreign currency securities from residents of other parts of the sterling area. At the time of the closing of the Kuwait gap in 1957, the dollar premium exceeded 15 percent, indicating speculation against the pound.

D. LOANS AND CREDITS BY UNITED KINGDOM RESIDENTS TO NONRESIDENTS

Exchange control covers the extension of loans and credits except for commercial credits of 6 months or less and certain other short-term banking facilities—overnight loans to foreign bank customers, preshipment finance facilities and mail credit facilities. The freedom in connection with commercial credits of 6 months or less applies to credits connected with trade into or out of the sterling area or between third countries.

The United Kingdom has indicated that applications for exchange licenses for loans and credits are liberally approved for commercial or industrial purposes. The United Kingdom's notification to the OECD [34] would indicate that controls on commercial credits with terms between 6 months and 5 years operate restrictively only in the case of those extended by credit institutions, those extended by other firms being licensed automatically. Moreover the United Kingdom has reported to DAC that exchange control over export credit on capital goods is not applied restrictively insofar as the volume of credit is concerned (though apparently the term of credits approved may be limited).

In addition to exchange control, there is control exercised by the Capital Issues Committee over loans. All borrowing by nonresidents of the United Kingdom in sums of over 50,000 pounds is subject to this form of control. (See below regarding access to the London market.)

E. DEPOSITS IN FOREIGN BANKS BY UNITED KINGDOM RESIDENTS

Foreign exchange is not usually granted to residents to make deposits in nonsterling countries.

Permission is granted for resident commercial, industrial, and financial organizations to maintain current bank accounts abroad if they have frequently to make payments in the country where the bank account is held.

Authorized security depositories may hold sums arising from the sale or redemption abroad of foreign currency securities for up to 6 months, pending reinvestment. (See above regarding trading in foreign portfolio holdings.)

[34] See OEEC C(60)235.

F. ACCESS TO THE LONDON MARKET BY NONRESIDENTS

Flotations of issues of stocks or bonds by foreign private concerns or governments in amounts of more than 50,000 pounds require the consent of the Capital Issues Committee. This control has been used to influence the timing of large issues and as one element among the several means the Government has to influence general monetary conditions in the United Kingdom—including the regulation of credit, interest rate policy, etc. Instructions to the Capital Issues Committee have been relaxed or tightened from time to time depending on the need for a tight money policy. Since 1959 borrowing and flotations by residents of the United Kingdom itself, for use within the United Kingdom, have been free of this type of control. The control remains applicable, however, to the rest of the sterling area and all other countries.

In the postwar period, oversea issues have averaged roughly 15 percent of the total sum raised by new issues on the market. Oversea issues have been almost exclusively for governments in the oversea sterling area, that is, the funds raised by oversea borrowers in London have been sterling funds rather than convertible foreign exchange.

G. REPATRIATION BY NONRESIDENTS OF THEIR INVESTMENTS IN THE UNITED KINGDOM

All repatriations are freely permitted to the sterling area and Uniscan members (see below). Otherwise only certain types of repatriation are permitted. In the case of direct investments, repatriation is permitted of investments made since January 1, 1950, if at the time the original investment was made, it was approved by the exchange control authorities. In the case of nonresident holdings of sterling securities, repatriation is generally not permitted except in the case of redemption payments made in accordance with the original terms of issue of the security; e.g., bonds when due.

Otherwise sterling obtained by nonresidents from sales of their investments in the United Kingdom is not convertible into foreign currency, but is credited to blocked accounts. The United Kingdom allots no foreign exchange to permit the transfer of these funds abroad. Blocked sterling may be used by nonresidents to invest in portfolio holdings in the sterling area,[35] or can be sold to other nonresidents who may wish to invest in sterling securities, that is, a repatriation by one nonresident must be matched by an incoming investment by another nonresident, so that there is no net use of foreign exchange involved for the United Kingdom. Since holders of blocked sterling are not permitted to transfer into foreign currency at official rates, they are generally willing to sell such sterling at a discount. This sterling, good only for purchases of sterling securities, is known as security sterling and the rate at which it is traded to other nonresidents as the security sterling rate. This rate[36] has in recent years remained within 2 percent of the official rate. Security sterling is traded on free markets outside the sterling area, notably in New York and Zurich.

H. REGIONAL ARRANGEMENTS: THE STERLING AREA, UNISCAN, OECD

The various regions to which the United Kingdom is party and which have relevance to controls on capital flows are Uniscan, the OECD, and, of course, the sterling area. (As noted above, the EFTA contains no provisions on capital movements, in effect, deferring decisions on these matters to OECD).

1. *Uniscan.*—As one of the arrangements under the January 30, 1950, Uniscan declaration of the United Kingdom, Norway, Sweden, and Denmark, capital flows within this area are somewhat freer than they are vis-a-vis most other countries of the world. (Transactions involving Uniscan members remain under control, but when application is made for a license, it may be automatically authorized or considered more liberally). The United Kingdom permits residents of Uniscan countries to repatriate any capital they may wish from the United Kingdom at the official exchange rate. They may also switch their holdings from one category of United Kingdom asset to another. Concerning credit, the United Kingdom indicated its willingness "to extend both the period and the type of

[35] If the security purchased is a bond or other evidence of debt, it must have at least 5 years to run before maturity.
[36] Computed at the official closing rate for the day.

credits for economic purposes which may be granted to residents of the other three countries." And with reference to investments by United Kingdom residents in Denmark, Norway, and Sweden the agreement was that the Government would "look sympathetically at proposals for investment in the other three countries, particularly where such investments take the form of setting up productive enterprises."

Concerning the matter of discrimination, it is clear that the Uniscan arrangements, in the limited areas of repatriation and switching, are more liberal than those applied to other nonresidents of the sterling area. Regarding credits and investments by United Kingdom residents in Scandinavia, the operation of the agreement is a matter of administrative discretion, and it is not apparent whether preferential treatment is, in fact, accorded to Uniscan members.

2. *The OECD.*—The United Kingdom has not seen its way to implementing a number of provisions of the OECD code, and has entered reservations to the code mainly in connection with commercial credits, the repatriation of portfolio investment in the United Kingdom held by residents of member countries, the usage of blocked funds, and the repatriation of direct investments made in the United Kingdom prior to January 1, 1950. (The United Kingdom has a number of reservations also to the provisions of the code regarding personal capital, which, as being of secondary importance, has not been covered in this study.)

Regarding most commercial credits 5 years and under in term, where the code provides for liberalization, the United Kingdom maintains control of all credits of over 6 months extended by credit institutions.

The United Kingdom also does not permit OECD members to repatriate their security holdings in the United Kingdom except for residents of Ireland and Iceland as sterling area members and of Denmark, Norway, and Sweden as Uniscan members.

Concerning the repatriation of direct investments in the United Kingdom, the British permit repatriation only if the original investment was approved for this purpose by the exchange control authorities at the time it was made. (Again sterling area and Uniscan countries are exceptions.)

Blocked sterling funds belonging to residents of OECD members are permitted by the United Kingdom to be used only for investment in sterling securities, whereas the OECD code required a somewhat broader usage to be permitted.

In the facility United Kingdom residents have to trade in foreign securities provided no outflow of foreign exchange is involved, the United Kingdom's practice has been in conformity with the code. Except for the period between July 25, 1961, and May 17, 1962, United Kingdom practice in connection with direct investment abroad has also been in conformance with the code. While direct British investments in other OECD countries remain subject to authorization, the United Kingdom reports that they are liberally licensed (and in 1960 amounted to 40 million pounds).

On the subject of possible discrimination in favor of OECD members and against nonmembers, the United Kingdom, where it has removed controls, has removed them on a worldwide basis rather than vis-a-vis OECD members alone. Looked at from another point of view, since the code was adopted the United Kingdom has not liberalized capital controls markedly either vis-a-vis members or nonmembers, but has rather taken a number of reservations to the code. Where controls remain, and applications are decided on a case-by-case basis, judgments as to possible discrimination between OECD members and nonmembers are, of course, difficult to form.

3. *The sterling area.*—For the sterling area,[37] as noted above, capital flows from the United Kingdom are free of all exchange controls, but the Capital Issues Committee maintains control of loans and securities issues of substantial size. (Hong Kong's position is exceptional: exchange controls do operate regarding payments to Hong Kong.)

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[37] The sterling area is currently made up of Australia, Burma, Ceylon, Cyprus, Ghana, Iceland, India, the Irish Republic, the Hashemite Kingdom of Jordan, the State of Kuwait, Libya, the Federation of Malaya, New Zealand, Nigeria, Pakistan, the Federation of Rhodesia and Nyasaland, Sierra Leone, the State of Singapore, South Africa, South-West Africa, Tanganyika, and western Samoa, together with all British colonies, protectorates, protected states, and trust territories.

It has, of course, been United Kingdom policy since World War II to encourage capital outflow, to the extent permitted by the balance-of-payments position, in order to reconstitute United Kingdom investments abroad, many of which had to be liquidated during the war, and to contribute to economic development particularly in the Commonwealth and sterling area. Private long-term investment abroad has averaged roughly 300 ($850) million pounds per year over the last 8 years, exclusive of reinvestment earnings estimated to be in the order of magnitude of 200 million pounds annually. Over half of the United Kingdom's new private investments overseas have in recent years been in the sterling area. Government assistance for oversea development adds another 100 million pounds per year, almost all within the Commonwealth and sterling area.

Senator PROXMIRE. It seems to me this might be a very interesting amendment to the tax bill to provide the kind of tax provisions he is suggesting.

Chairman DOUGLAS. Thank you, gentlemen, very much indeed.

Mr. MITCHELL. I enjoyed being here.

(Whereupon, at 4:05 p.m., the committee recessed, subject to the call of the Chair.)

JANUARY 1963 ECONOMIC REPORT OF THE PRESIDENT

MONDAY, FEBRUARY 4, 1963

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

The committee met at 10:05 a.m., pursuant to recess, in room 1202, New Senate Office Building, Senator Paul H. Douglas (chairman of the committee) presiding.

Present: Senators Douglas, Proxmire, Pell, Miller, and Jordan of Idaho; Representatives Reuss, Curtis, Kilburn, and Widnall,

Also present: Representative Don H. Clausen of California, James W. Knowles, executive director; John R. Stark, clerk; Roy E. Moor, and Donald A. Webster, economists.

Chairman DOUGLAS. The committee will come to order.

I am very happy to welcome an old friend in Dr. Gerhard Colm this morning. He has had a most distinguished career both in Germany and in this country. In Germany he got a Ph. D. from the University of Frieburg in the Black Forest, and an honorary degree from Frankfurt. He was an economist with the Federal Statistical Bureau in Germany, a professor and deputy director of the Research Institute in World Economics at the University of Kiel, and he came to this country, I think, in 1933, and was professor and dean at the new school for social research. Then in Washington he has had a very distinguished career, first in Government with the Department of Commerce, the Bureau of the Budget, the Council of Economic Advisers, and then in private organizations, as chief economist of the National Planning Association, and a lecturer and visiting professor at many universities.

He has been on many missions for the Federal Government, including the military government in Germany, and I believe you leave tomorrow, Dr. Colm, as member of the special U.S. economic mission to the United Nations.

You have been a fine citizen of this country, and we feel it a great honor that you are going to testify before us this morning.

Will you proceed in your own way.

STATEMENT OF GERHARD COLM, CHIEF ECONOMIST, NATIONAL PLANNING ASSOCIATION

Mr. COLM. I thank you very much, Mr. Chairman. It is, indeed, a very great honor for me to appear before the joint committee.

I feel a great responsibility at this particular juncture. It seems to me that what Congress will do may influence the welfare of millions of our citizens and will influence the position the United States has in the effort of building a peaceful world. So I talk with a great deal of feeling of responsibility at this particular time.

I am speaking as an individual, not on behalf of the National Planning Association, but I must say that I would not be able to say what I think I can submit to this committee were it not for the studies made by my associates at the National Planning Association; much of what I can say is based on their work.

Mr. Chairman, I have a prepared statement which I think is in your hands, and, if agreeable with you, I will submit it for your use as you see fit—for the record or the wastebasket, as you prefer; I would like to talk extemporaneously, just trying to hit the highlights, in order to leave as much time as possible for your questioning.

Chairman DOUGLAS. Your statement will be printed as part of the record as submitted.

(The complete prepared statement of Gerhard Colm, chief economist, National Planning Association, follows:)

INTRODUCTION

I am grateful to the chairman and the committee for this opportunity to discuss some of the economic problems which are ahead for this Nation. I feel a great responsibility because I know that the actions of the Congress, to which this committee will give advice, will greatly influence the fate of many millions of citizens and, to some extent, will influence also the position of the United States as a world economic power and its relations with its friends and its opponents abroad. I am speaking strictly as an individual and do not necessarily express the views of the National Planning Association, although much of what I have to say is based on studies made at the NPA.

The crucial approach provided in the Employment Act is as valid for the Nation's economic problems today as it was when adopted by the Congress in 1946. The Employment Act requested the President, in the Economic Report, to discuss and, by implication, the Joint Economic Committee to consider the following three questions: (1) What are the goals to be achieved with respect to employment, production, and purchasing power in order to accomplish the objectives in the act? (2) What is the foreseeable development of employment, production, and purchasing power assuming that no major changes will take place in policies? (3) If there is a discrepancy between the goals and what is likely to happen under existing policies, what change in policies would be recommended in order to achieve the goals? In a very oversimplified manner, I have illustrated in the appended chart alternative total production estimates as an attempted answer to these three questions. (Data underlying the chart appear in appendix table I.)

The lines on the chart do not represent forecasts but are the assumed consequences of forces making for sustained economic growth under various assumptions. They neglect possible cyclical movements which, at a particular time, could lift economic activity above the line or let it drop below. In my testimony before the Ways and Means Committee early last summer I said that I did not see convincing evidence of an imminent recession but advocated a vigorous and comprehensive program in support of economic growth. This is still my conviction today. However, I also believe that a policy of strengthening long-term forces of growth is the best method for reducing the always existing possibility of a recession. In my present testimony and in presenting this particular chart I focus on what I like to call sustainable factors of economic growth.

I. THE GOAL

Line I of the chart presents that increase in production of goods and services in constant prices which would be necessary to approximate full employment. Actually, in accord with recent practice, the estimates imply 4-percent unemployment as compatible with full employment. I realize that this is only an interim goal; however, we all know that in a period of rapid technological development, friction in the labor market will be somewhat higher than with a lesser degree of technological advance. Furthermore, this rate of growth not only permits full employment, as defined, but also full employment of a growing labor force working under conditions of rising productivity. Bringing unemployment lastingly below the 4-percent target would probably depend on the success of public and private programs designed to increase the occupational and geographical mobility of labor. Besides the urban and rural redevelopment programs and the training programs, a more effective interstate employment service would be essential for this purpose.

The dimensions of the task that unemployment, underemployment, labor force growth, and rising productivity impose upon us can be vividly shown. The accompanying tabulation summarizes the job opportunities which would have to be created by the end of 1963 in order to achieve a 4-percent unemployment rate as well as to meet other "full-employment conditions," such as permitting reentry into the labor force of those who have withdrawn because they could not find work, and reducing involuntary part-time work.

Job needs for full employment, end of 1963

	Millions
(*a*) Reduction of recent unemployment rate (5.6 percent) to 4 percent	1.1
(*b*) Reentry into labor force of those who have withdrawn for lack of job opportunities	.8
(*c*) Job needs to absorb normal annual net labor force additions	1.2
(*d*) Replacement jobs needed to offset rising productivity	1.5
(*e*) Full-time equivalent job needs of those working part time for economic reasons	1.0
Total job requirements to reach 4-percent unemployment by end of 1963	5.6

NOTE.—Lines (*a*), (*b*), and (*c*), totaling 3.1 million, from Economic Report, pp. 38–39; line (*d*) computed on assumption of 2-percent advance in output per employee; line 3 computed on basis of figures on part-time employment, Economic Report, p. 198, with a slight additional allowance for part-time farmworkers.

Somebody may ask why we figure on a continuing relatively high rate of productivity growth even though that appears to aggravate the problem of creating enough additional employment opportunities. I believe, in this matter, we have no choice. Technological advance and rising productivity are a necessity for the American economy for various reasons. Among them is the need to meet our international commitments. This necessitates a continuing high export surplus achieved by maintaining and improving the competitiveness of our products, particularly in the technologically advanced categories of industry, where we have always had a comparative advantage over other countries. This goal, of course, is not directly spelled out in the Employment Act but is covered in the phrase that the policies under the act should be pursued in accord with the other obligations. I also think that a fair degree of price stability is implied in the Employment Act. In any case, that has been the interpretation by the various Presidents and joint committees as reflected in their Economic Reports ever since the year 1947.

Line I thus represents a continuing rate of growth of around 4 percent per year which is slightly below the goal recommended by the President and, by the way, also slightly below the goals mutually agreed upon by the Atlantic community countries in the OECD. Personally, I believe that the 4 percent ought to be a minimum goal, because only a steadily and satisfactorily growing economy can bear the burden of heavy defense, space exploration, and other programs, in addition to maintaining satisfactory increases in the standard of living, particularly for people of the lower income brackets, without imposing an undue tax burden on the population as a whole.

Nevertheless, under present circumstances, and considering the job requirements outlined in the above table, I could not recommend that reaching our full potential, say, within 12 months or less is a practical goal. Reaching the full-employment production line within a 12-month period would require an expansion of real GNP of about 10 percent. The monetary and fiscal policy measures required for reaching this goal within a short time would have to be of a magnitude which might interfere with our other goals—particularly the stability of the price level—without resorting to control measures which would be justified only under emergency conditions that do not now exist. Therefore, I have indicated on the chart line II, reflecting that course of development putting us back on the path toward full-employment production in 1963, but which would reach the full-employment track only in the calendar year 1963.

This line II represents what I would regard as a feasible target even though achieving even that modest goal in a sustainable manner would not be easy.

II. THE OUTLOOK FOR PRODUCTION UNDER EXISTING POLICIES

Line III on the chart gives us an estimate of what might happen if presently existing policies were continued. Perhaps I should not call it an estimate, but rather an assumption. Line III represents a 3-percent rate of growth on the average for the next 3 years starting from the 1962 level.

In this projection is implied a continuation of the existing tax structure, but considering, of course, the increase in social security contributions which have become effective in January. No new expenditure programs of the Federal Government are assumed. When I speak of no new programs, I do assume some increase in Federal Government expenditures, because some increase results from several programs already adopted by the Congress. However, this projection does not assume the initiation of new programs or expansion of programs beyond present authorizations. It also assumes continuation of recent business attitudes with respect to new investments, and also of State and local government expenditure programs. The 3-percent growth rate is probably the most optimistic assumption under a do-nothing policy. I am by no means sure that with a do-nothing policy, a 3-percent rate of growth even for 1963 is assured. Furthermore, it is highly probable that a severe recession sometime during the 3-year period would be most likely. On these assumptions, then, the gap between full-employment production (line I) and projected production under present policies (line III) would widen.

The previous tabulation (p. 747) indicated that about 5.6 million job opportunities would have to be created to meet the full employment conditions by the end of 1963. The gap between the full-employment line and the 3-percent growth line is translated, in the following tabulation, into the corresponding shortfall of job opportunities:

	Millions
Total job requirements to reach 4-percent unemployment by end 1963	5.6
3 percent GNP growth rate will permit:	
Replacement of jobs lost through productivity advance	1.5
And add new jobs	0.7
Total	2.2
Difference equals excess unemployment	3.4
Plus 4-percent unemployment	3.0
Equals total jobseekers, end 1963	6.4
Less concealed unemployment (lines b plus e, table, p. 747)	1.8
Equals unemployment, conventionally defined, or unemployment rate of 6.3 percent	4.6

Thus line III is seen to imply an unemployment rate—in the usual definition—of 6.3 percent by the end of 1963.

III. THE OUTLOOK UNDER THE PRESIDENT'S PROGRAM

A. The economic effects of the proposed tax reduction and tax reform

I come now to the most difficult, and certainly the most controversial, part of my presentation; namely, the appraisal of the economic effects of the program which the President has submitted to the Congress in the state of the Union message, the budget for 1964, and the Economic Report now under consideration by this committee. Much of the language of these documents suggests that the main—if not the only—policy measure designed to bring us back toward the full-employment path is the proposed tax reduction and tax reform. I will not here discuss the merits of the tax proposals in detail. I take only the proposals in their general features and try to appraise the impact they would have on economic development.

In my evaluation, I have generally followed the so-called multiplier analysis. This considers the effect which a reduction, for example, of the individual income tax has on the disposable income of individuals, and the effect which an increase in disposable income is, in turn, likely to have on consumer expenditures. This increase in consumer expenditures, in turn, has an impact on total production, which would result in increasing payrolls and profits, thereby again affecting disposable income and consumer expenditures. I estimate that a $1 tax reduction on individual incomes, widely distributed up and down the income pyramid, would probably result in about a $2 addition to the gross national product within 1 year.

With respect to the corporate tax, the case is more complicated. As corporations in general are now rather liquid, the increase in available funds would hardly make a very big difference immediately, particularly for the larger corporations. However, a decrease in tax liabilities might increase the profit incentive for undertaking marginal business investments. Nevertheless, for a period where we still have much underutilization of factories and relatively ample availability of corporate funds, I do not believe that the increase in available corporate funds and the increase in profit expectations would have a great immediate effect on investment. The effect will, however, increase over a longer period of time, when increasing consumer demand and production result in a higher rate of operation, and conditions become more favorable for substantial investment in new plant and equipment. Therefore, a very substantial effect on investment activities may occur in the future. This is what the economist would call, not a "multiplier," but the "acceleration" effect of a tax reduction.

However, this analysis omits one consideration. We should not exclude the possibility of an anticipatory effect of tax reduction. It might be that official consideration of a tax reduction has a certain intangible effect on the climate that affects consumer and business attitudes. Though recognizing this possibility, I see no way of translating it into a specific dollar estimate.

The President's proposal would have only a limited direct effect for the year 1963 because only that part of the income tax which is deducted at the source would result—after about 1 month's delay—in some immediate increase in disposable income. For the other parts of the individual income tax, it is possible that some individuals may reduce their advance payments, but it is likely that most of the reduction would result in larger refunds in 1964. With a multiplier of 2, the assumed individual income tax reduction effective during the last 5 months of calendar 1963, would provide, in effect, an increase in the rate of operation of the economy for 1963 as a whole of about $3 billion. For the combined 2-year period 1964–65, total net income tax reductions might contribute roughly $30 billion.

B. Proposals for expenditure programs

Even though the emphasis of the Presidential messages was on tax reduction as a means for increasing the rate of growth, the proposed increase in expenditures is also likely to have a significant impact. The estimated increase in expenditures for defense and space programs is $4.3 billion. However, the most immediate economic impact would not be the expenditures in these areas—that is, the payment of bills—but the orders and the arrangements made by business to get ready for production—purchase of raw materials, for example. It may even by that we have already had some effect of these increases in defense procurement. Correspondingly, some orders to be placed in 1963 will become expenditures in subsequent years. Under the present program some flattening out in the increase of defense programs appears to be contemplated. If that should be the case, we might have to apply a Government expenditure multiplier to somewhat less than the full amount of the estimated increase in defense expenditures. The opposite is done with respect to the space program which still will continue to rise. This consideration does not apply, of course, to the increase in military pay and other current expenditures. Considering the distribution of the Government debt, it is not likely that the multiplier effect for the increase in interest payments is as high as for other Government expenditures or for tax reduction.

The President's state of the Union message and the budget message have emphasized that proposed total expenditures for programs other than defense, space, and the debt service show no increase, but, rather, a small decline over the current fiscal year. This is borne out by the budget figures. However, if we consider the economic impact of these "other" programs, it would be a great error to assume that they have no positive effect on the economic outlook.

For quite a number of programs, moderate increases are proposed, which have been made possible within the limits of the general expenditure policy by declines in a number of other programs. For example, the estimated reduction in the postal deficit by about $250 million permits an increase in other expenditures of an equal amount within the budget limitation. Economically it is likely that the positive effect on employment and production of the program increases will be larger than the negative effect of the postal rate increase.

Other ways by which it was possible to increase programs under the rule include, e.g., the proposed shift of repayments of rural electrification loans (about $150 million) from miscellaneous receipts to funds available for new loans; the proposed replacement of direct loans by loan insurance or guarantees (as in the case of rural housing); and an increase in the sale of assets by the Export-Import Bank and the Commodity Credit Corporation which again makes funds for new loans available without increase in net outlays as recorded in the budget. Here, the negative economic effect of absorbing funds by the sale of assets is probably less than the positive effect of expanding new loans.

These measures are in line with the President's statement in the state of the Union message that he has attempted to substitute private credit for public credit. However, from the economic point of view, this substitution makes little difference if we assume that, without Government guarantee or insurance, private funds would not have been forthcoming for these specific purposes.

Appendix tables II and IIA present, for major programs, the net increase or decline shown in the budget summary, the gross increase in these programs, and the methods by which a reduction in the budget estimates is brought about. The aggregate increase in the gross expenditures in these programs is estimated at $2.4 billion (excluding trust funds). Considering the stronger positive effect of the program increases, I would guess that for an estimate of the economic impact a net increase of $1.5 billion in the programs outside the national security-space-debt service area should be considered for the fiscal year 1964. All told, the increase in expenditure programs above those implied in our 3-percent growth curve might explain $2 billion of total output for the calendar year 1963 as a whole, and around $20 billion for the years 1964–65 combined. Together with the roughly $30 billion contribution to output accounted for by income tax reduction, the dual impact represents approximately 5 percent of GNP.

Line IV of the chart now presents an estimate of the increase in total production of goods and services in constant prices which would result both from tax reduction and all major expenditure programs inside and outside the defense-space field. (In the chart, fiscal year estimates had to be converted to a calendar-year basis. The estimates for calendar 1964, and especially 1965, are admittedly of a very tentative nature.) Very uncertain is the evaluation of the negative economic effects of the increase in postal rates, sale of Government assets, and other measures offsetting the increase in expenditure and loan programs. Nevertheless, I do not believe that the order of magnitude in these estimates can be far off the mark.

The estimates reflected in line IV suggest that the tax program and the action programs proposed for consideration and implementation in the President's messages alone would lift economic activities significantly above the level of line III, representing no new policies, but would not bring us back to the full-employment track by 1965; and it might still leave us with around 5.5 percent unemployment by the end of 1963, corresponding to an output rate of perhaps $590 billion.

IV. WHAT COULD BRING US BACK TO THE FULL-EMPLOYMENT PATH?

Would a larger tax cut, perhaps, be advisable in order to reach the objective? Here, we consider a question on the borderline of economics and political judgment. I would personally favor a larger tax cut for the first year than that proposed by the President. I believe that a tax cut, phased over 3 years, will have a continuing negative influence on the willingness of the Government to engage in highly needed new programs. Therefore, the proposed tax reduction might have a much smaller net positive effect considering its negative influence on programs than has been assumed. I am in favor of a substantial tax cut as early as legislation can be approved in 1963 because it is the only kind of action which can be taken without too much delay.

The tax cut would be most effective if accompanied by an appropriate monetary policy. But the question still remains as to whether, and to what extent, a growth-supporting monetary policy is limited by considerations of short-run capital movements and the balance of payments. In reconciliation between domestic and international requirements, a policy has been pursued in recent years of preventing long-term interest rates from rising (or even supporting a slight decline) during the recovery phase of the current cycle while permitting short-term rates to rise.

This policy marked an important departure from past practice and was, I believe, a move in the right direction. Experience to date could encourage the monetary authorities to go further in the policy of lowering the long-term rate of interest, particularly since it is one of the advantages of monetary policy that it can be reversed if necessary.

As a matter of fact, the budget recommendations imply a policy of holding or even lowering the long-term rate of interest. Otherwise, it would not appear realistic that about $1.25 to $1.5 billion of Government loans could be sold to the public or switched to private financing as proposed in the budget without capital losses.

I recognize that there is no certainty in this field, but I believe that a somewhat bolder monetary policy in support of economic growth would, in the long run, not necessarily interfere with the need to improve the balance-of-payments situation. The latter objective can best be promoted if (*a*) domestic and foreign capital is attracted by an expanding American economy and (*b*) the competitiveness of American industry is maintained and improved by technological advances without corresponding cost and price increases. A restrictive monetary policy may, in the longer run, aggravate, rather than remedy, balance-of-payments difficulties.

Besides tax and monetary policies, there are extremely urgent programs of high priority which are essential for economic growth—but not only for economic growth. There are most serious deficiencies in the fields of education, health, research for civilian purposes, urban and rural renewal, mass transportation, and others. In each of these areas, some progress is planned under programs for the next few years. However, it seems to me that the effectiveness of these programs in relation to economic growth is underemphasized in relation to the emphasis given to the tax program. Not all of these programs would be reflected wholly in additional Government expenditures. With some Government initiative, the way could be paved for large and profitable additional outlays by private enterprise. Indeed, many of these Government outlays—for example, urban renewal—could most effectively be made through quasi-public authorities and by private funds which would not be reflected in direct budgetary expenditures.

At present, the Federal Government considers urban renewal plans submitted by communities for possible financial support. In my opinion, the Federal Government should take the initiative in providing assistance, cooperation, and leadership in the formulation and execution of a truly comprehensive urban development program.[1] There is a tremendous need for private investment in urban redevelopment, but Government leadership is required to open up the opportunities for private investors. It has been estimated that $1 spent under Government leadership may stimulate $2½ to $3 of private investment. Some experts give an even higher ratio for private investment. Government leadership is also necessary in order to develop sound programs for mass transportation.

These activities are not overlooked in the President's program. However, their possible role in a long-term program for promoting economic growth is not emphasized. The President's Economic Report does not mention urban renewal in the discussion of economic growth. Only in the Council's report is there a brief reference to this important topic in connection with the work of the Cabinet Committee on Economic Growth. Actually, I believe that a program of urban renewal and mass transportation could, over a number of years, stimulate private investments more than the proposed reduction in corporate taxes. This is not meant to be an argument against tax reduction but rather a comment on the relative emphasis of various approaches which need to be combined for effective use of our productive resources and for economic growth.

The promotion of technological advances outside military and space fields is another important step toward accelerated economic growth and improved international competitiveness. The Economic Report fully recognizes the significance of this subject, but I must ask whether this recognition is fully reflected

[1] See "The Scope and Financing of Urban Renewal and Development," a statement by the business committee of the National Planning Association, Washington, D.C., June 1962.

in the President's program. We find in the appropriation requests for the Commerce Department $7.4 million for these specified purposes for fiscal 1964. This is indeed a very modest beginning for a very big task. However, I agree that at this stage what is most needed is not a big appropriation. Imaginative leadership is needed in order to assure that the progress which is made in research and technology in the military/space field may have the greatest possible spillover into nonmilitary fields.

I believe advances could and should be made in three directions. First, Government agencies responsible for research and development in the national defense field should, in their own evaluation of R. & D. consider the best way in which advances could be made available for more general use. Activities for this purpose are undertaken by the Atomic Energy Commission, and NASA has initiated efforts in a similar direction. I do not believe that many such efforts are being considered in the military field proper.[2] Second, efforts should be made to prevent contractors from bottling up research results which were financed by the Government and which could find use in nondefense fields. Third, even where there is no intentional holding back of information, most corporations (with the possible exception of a few very large ones) are not equipped to pick out from the flood of reports on technical advances those which really could be of use for them. The report of the Council of Economic Advisers emphasizes that a large part of industry lacks the capacity to utilize the opportunities which are now implicit in the advances of science and of the sophisticated science-based technologies. The Department of Commerce, quite properly, has undertaken to remedy that fact. Its program, however, is but the most modest of beginnings. The capacity of industry to make use of new scientific data and knowledge should not be thought of in isolation. Rather the research from which information is, or could be forthcoming, and industry's capacity to comprehend and to utilize that research information, and the work of all intermediary agents, should be thought of and developed as a system.

This problem of channeling appropriate results of military space R. & D. into civilian applications is a subject on which the National Planning Association has undertaken a special project, under the direction of Dr. Robert Solo, which I hope will result in a publication later this year. (A preliminary report on the findings of this project has been published in a recent article by Dr. Solo under the title "Gearing Military R. & D. to Economic Growth" in the Harvard Business Review, November–December 1962.)

In this conection, it is worth noticing that the United States has sponsored—and sometimes helped finance—establishment of productivity centers designed to promote technological and managerial advances in many free world countries, both developed and underdeveloped, but none in the United States. In the President's Economic Report and the Council's annual report, full recognition is given to the need for promoting civilian technology. I feel, however, that the implementation of these suggestions in the President's program is inadequate.

In all these fields; urban redevelopment, mass transportation, R. & D., and so forth, it takes a considerable period of planning and preparation before programs can become truly effective. That is the reason why I agree with the emphasis for the immediate future on tax reduction and monetary policy. But if we postpone the preparation and development of these other constructive programs too long, then we may have to carry tax reduction for support of economic growth so far that it may result in a misallocation of resources between private spending and these very productive public and semipublic programs of high national priority.

I fully understand that it may be difficult to obtain political support simultaneously for various approaches in support of economic growth. I do not question the political wisdom of dealing with one aspect of a complex growth program after the other. This approach leads, however, to the temptation of claiming too much for that item in the program which is pushed at a particular time. This happened with respect to investment incentives last year and seems to be happening to tax reduction and tax reform this year. I agree that tax reduction should have highest priority now; but it should also be recognized that continuing tax reduction alone and by itself will not result in the best allocation of resources in accord with national needs, will not get us back to the

[2] See the "Report to the President on Government Contracting for Research and Development," prepared by the Bureau of the Budget and referred to the Senate Committee on Government Operations, 87th Cong., 2d sess., Document No. 94 (May 17, 1962).

full-employment track by 1965, and will not lead to a sustained and satisfactory rate of growth unless supported increasingly by those other constructive programs to which I have referred. And we cannot wait until future years to intitiate these programs. If we do not push the preparation of them now with utmost vigor, they will not be ready at a time when tax reduction has exhausted its effectiveness.

I hope, therefore, that this committee will endorse the proposal for an early and substantial tax reduction this year but will also point out the need for bolder Government initiative and leadership in such programs as urban renewal and technological advancement. Let me repeat: these programs do not necessarily imply very large increases in budgetary expenditures. Nonetheless, they are likely to result in substantial and long-lasting increases in private investments. Considering the impact of such programs on economic activities, they would not be likely to result in increased Federal deficits.

Computations suggest that, with substantial tax reduction now and a substantial increase in these other constructive public and private programs and consequent capital investments in subsequent years, we can attain the goal of full and sustained employment in the course of a 2- to 3-year period. And, I believe that, given the general structure of our economy, the financial resources, the skills of management and technology, and the expected results of the labor-training program, the objective of a rate of growth of 4 percent or better is a realistic target.

V. PRICE AND COST STABILITY

At the present time, the outlook for reasonable stability in prices and costs is quite good, particularly relative to developments in some competing foreign countries. However, I do not think we have any reason for complacency. I agree with the analysis in the Economic Report that the budget deficits which are envisaged are not likely to create excess demand. Our idle capacity in human and material resources is, in general, so large that a substantial increase in demand and production is possible without straining our overall resources even though there may occur some bottlenecks in specific cases. Nevertheless, if we step up the pace of expansion, as I hope we will, the old problem of a price-wage or wage-price spiral might again reappear even before we have excess demand. In case excess demand should occur, monetary and credit policy would be most effective to counteract it. However, a new price-cost push would probably induce the monetary authorities to put on the brakes prematurely.

Therefore, we should be prepared to deal with price and cost-push problems in other ways than by use of restrictive monetary policies which, of necessity, would slow down the rate of growth. As I have already had an opportunity to discuss this subject before this committee, I need only note briefly that I do not have in mind price and wage controls or any other compulsory measures. What I would recommend is an approach similar to the proposals made by Congressman Reuss a few years ago when he suggested the creation of special price-wage analysis boards for key industries. These boards could also look into the productivity problems of their industries. While the general guidelines for wage policy announced by the Council of Economic Advisers are very useful, we need more specific formulations for key industries. This could be one of the tasks of these boards. Such an approach does not imply compulsion; it relies on the so-called "jawbone" method, but it would put a few teeth into the jaw. I believe that the best time for establishing such a mechanism is before we experience a possible new period of "market power" inflation.

In closing, let me repeat what I said at the beginning: I believe this is a very crucial time for getting us back on the path toward full employment, price stability, and improved international competitiveness. This is a task which not only greatly concerns the welfare of the American people, but also would give support to the role that America has to play in helping to build a peaceful world.

This committee has a great responsibility in advising the Congress on all these matters of monetary, fiscal, and economic policy related to economic growth and stability. I understand that once again there are deliberations in the Congress for making the legislative machinery of the Federal Government in this area more effective. I hope that the Congress will also take a look at the experience of the Joint Economic Committee over the last 16 years. I believe that the effectiveness of the Joint Economic Committee in dealing with, and analyzing, the tasks of economic policy and in making constructive proposals has surpassed the expectations which were held in 1946 when the Employment

Act was passed. However, I wonder whether the direct legislative impact of the committee's deliberations could not be strengthened. It would be one of the possible steps in that direction if the Congress were to adopt, as a customary procedure, a practice that has already been followed on occasion. Would it not be quite natural for the legislative and appropriation committees, when considering legislation or appropriations which greatly affect economic and fiscal conditions, to hear as one of the first witnesses a representative of the Joint Economic Committee, or, if necessary, representatives of the majority and minority views held within the Joint Economic Committee? This procedure would be one way of assuring that the results of the committee's studies and deliberations would be brought specifically to the attention of the members of the legislative and appropriation committees.

I have two articles in Challenge magazine dealing with this problem and it may contain a few paragraphs of interest to the committee. May I offer them to the chairman if he should want to have them included in the record? I thank you very much.

(The tables, chart, and articles referred to follow:)

Appendix

TABLE I.—*Past and projected GNP under alternative assumptions (in billions of 1962 dollars)*

	Actuals	I: Full employment growth potential	II: Target	III: 3 percent growth	IV: Estimated impact of administration proposals
1957	478	478			
1958	471	497			
1959	503	517			
1960	516	537			
1961	526	558			
1962	554	580			
1963		603	580	570	575
1964		627	616	587	610
1965		650	650	605	638

TABLE II.—*Federal expenditures (administrative budget) by functions (except defense, space, and debt service) in millions of dollars*

Expenditures function	Estimated expenditures		Adjustment [1]	Estimated expenditures after adjustment	
	For fiscal year 1964	Change from fiscal year 1963		For fiscal year 1964	Change from fiscal year 1963
International	2,679	−195	+523	3,202	+328
Agriculture	5,696	−1,035	+1,300	6,996	+265
Natural resources	2,503	+123	+50	2,553	+173
Commerce and transportation	3,388	+63	+249	3,637	+312
Housing and community development	276	−149	+329	605	+180
Health, labor, and welfare	5,613	+698		5,613	+698
Education	1,537	+166	+150	1,687	+316
Veterans	5,484	−61		5,484	−61
General	2,195	+154		2,195	+154
Total	29,371	−236	+2,601	31,972	+2,365

[1] Explained in table IIA. The table presents major adjustments and does not reflect a complete reconciliation between the net estimates of the budget and the gross increases in program estimates.

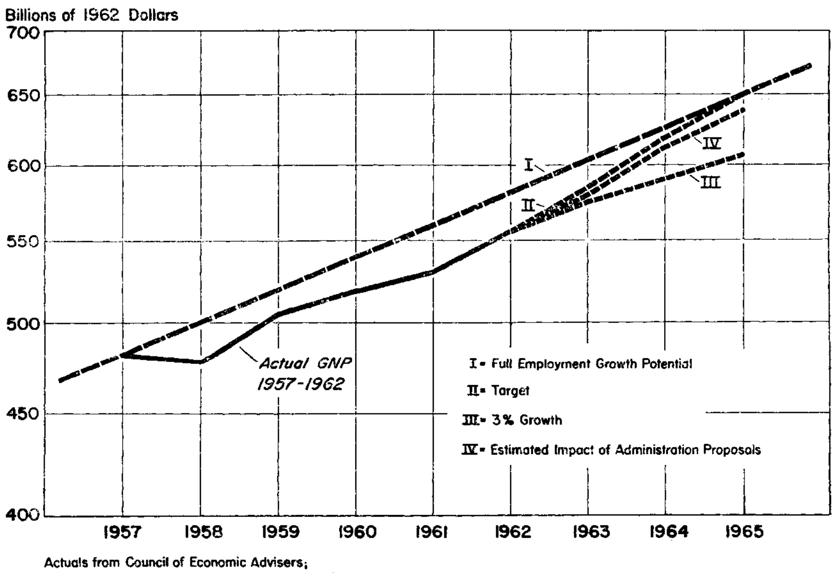
TABLE IIA.—*Details of adjustments—Administrative budget expenditures*[1] *(changes 1963–64)*

[In millions of dollars]

International:		
Loan, U.N. (nonrecurrent)	100	
Export-Import Bank private financing (sale of assets)	423	
		523
Agriculture:		
Increase in cotton sales by CCC (largely depending on domestic subsidy legislation)	700	
CCC loans to be sold to private banks	300	
Rural electrification revolving fund adjustment	150	
Guarantees replacing direct farm housing loans	150	
		1,300
Natural resources: TVA private bond financing		50
Commerce and transportation: Post office rate increase adjustments		249
Housing and community development:		
Increase in Federal Savings and Loan Insurance Corporation	14	
FHA and FNMA loans switch to private financing	315	
		329
Education: Shifting college housing loans to private financing (sale of college housing bonds)		150
Total		2,601

[1] See footnote to table II.

PAST AND PROJECTED GNP UNDER ALTERNATIVE ASSUMPTIONS



Actuals from Council of Economic Advisers;
Projections prepared by National Planning Association.

[From Challenge magazine, November 1962, pp. 11 through 14, vol. XI, No. 2; Institute of Economic Affairs, New York University, 1962]

EMPLOYMENT ACT OF 1946—GOVERNMENT'S ROLE IN A FREE ECONOMY

(By Gerhard Colm)

Is the machinery established under the Employment Act of 1946 adequate to cope with our present-day economic problems? Gerhard Colm, chief economist of the National Planning Association and one of the Employment Act's nameless authors, assesses our experience with the act and suggests some changes to bring it up to date.

It is almost a cliche to call the Employment Act of 1946 a milestone in the development of the Government's responsibilities in the economic sphere.

The act, and similar statutes adopted in other democratic countries, was an expression of the people's determination that appropriate Government policies would be used to avert depressions and unemployment. It was, in a way, an expression of confidence that a satisfactory economic performance could be accomplished within the framework of a free society; not through a policy of laissez-faire, but through deliberate economic and fiscal measures.

The U.S. Government—as well as every other government of modern times—was, of necessity, concerned with such matters as agriculture, industry, transportation, foreign trade, finance, and labor relations long before there was an Employment Act. But the act marked a new era in that it proclaimed Government concern with the performance of the economy as a whole.

Since the American Government is so organized that regional and local interests find effective expression both in the legislative and executive branches, the Employment Act established machinery in the two branches—the Joint Economic Committee and the Council of Economic Advisers—to articulate the Government's concern with the performance of the economy as a whole. The duty of the Executive to submit an annual economic report to Congress and the duty of the Joint Economic Committee to evaluate these reports provided the link between the two.

Both the Council of Economic Advisers and the Joint Economic Committee are advisory agencies. The Committee has no responsibility for drafting any specific legislation, and the Council has no operating functions. While the act did not prescribe any specific policies to accomplish its stated goal of promoting "maximum employment, production, and purchasing power," it is clear from the legislative deliberations that preceded its passage that fiscal and monetary policies were regarded as the main instruments for achieving the act's purpose.

Since 1947 was the economy's first year of operation under the Employment Act, we can now look back on 15 years' experience with it under the aegis of both political parties. Has this performance fulfilled the expectations of the act's framers? What lessons can we learn from our experience thus far?

The passage of the Employment Act of 1946 was largely motivated by the Nation's concern that post-World War II demobilization might cause the economy to revert to the depressed condition which prevailed during the 1930's. While no such depression has taken place during the last 15 years, nobody would claim that the avoidance of a serious depression can be attributed solely to Government policy under the Employment Act. As a matter of fact, the United States was faced with economic problems in the postwar years that were quite different from those expected by the act's framers.

The first problem economic policy makers had to face was inflation, which abated in 1949 but was resumed with the beginning of the Korean war. This period came to an end in 1952. Government policies certainly mitigated the inflation through a variety of measures recommended by the President in his annual economic reports. In the switch from a proposed tax reduction in 1950 to tax increases in response to the Korean war, the Joint Economic Committee played a decisive role. In general, it is probably fair to say that the machinery of the Employment Act proved helpful in the fight against inflation without claiming anything like a perfect record.

The problem of inflation, however, did not end with the Korean war. It continued in the form of a "creeping" price rise. The economic reports of the President and those of the Joint Economic Committee between 1952–62 greatly contributed to a better understanding of the difference between a price rise stemming from excess demand on the one hand and one resulting from the exercise of "market power" by business and unions on the other. However, only in exceptional cases did Government action go beyond admonishments to business and labor to exercise self-restraint in price and wage policy. The principal exception was President Kennedy's action last spring to prevent a steel price increase.

The Council of Economic Advisers, for its part, has developed general guidelines for a noninflationary wage policy, but there is no machinery to implement them. Proposals have been made that fact-finding committees should look into the price, productivity, and labor cost situation of key industries. Yet even such apparently moderate proposals have been suspected as being steps in the direction of price and wage control. Both business and labor believe they can pursue their own interests better by "free" collective bargaining and "free" price policy than by injection of the "public interest" represented by Government as a third party in price and wage determination.

Yet the increasing talk about the public interest in such matters has undoubtedly had some restraining effect on business and union attitudes. Nevertheless, there remains the task of finding an acceptable structure within which prices and wages can be determined without jeopardizing the public interest.

A second characteristic of the postwar period were the frequent—but short-lived—recessions. As far as recessions are concerned, the machinery created under the Employment Act must serve first as a "storm warning system" and secondly as an instrument to formulate countermeasures.

Encouraged by the Council and the Joint Committee, tools for business cycle diagnosis have been greatly improved—first by the monthly publication of Economic Indicators and, most recently, by the monthly publication of Business Cycle Development. The latter publication organizes statistical data in an attempt to construct a kind of economic barometer.

Spectacular advances have also been made in sample surveys of businessmen's plans to invest, as well as the buying intentions of consumers. In addition, electronic computers have been used for quickly processing available statistical information.

Still the record of the Council as a storm-warning agency is far from perfect. Failures in diagnosis can be partly explained by the problem of politics. President Truman fought his 1948 campaign on an anti-inflation platform. It took some time until the Council found the indications of an approaching recession in 1949 clear enough to change the advice it was giving the President. Another example is the denial by the Chairman of the Council during the presidential campaign of 1960 that a recession was in the making when many economists thought that available economic indicators did not permit any other interpretation.

Not all failures in diagnosis, however, can be blamed on politics. In the summer of 1962 some observers of the leading indicators believed that a recession was imminent while others believed that a period of slow expansion might be followed by a new rise of economic activity in 1963. Thus, despite all the technical advancements in the diagnosis of the business cycle, economic forecasts remain statements about probabilities. Actions on the basis of forecasts therefore inevitably run the risk that the forecast was in error. Evaluating the possible harm by not acting in time on the one hand, or by acting prematurely on the basis of an uncertain forecast on the other, always requires a mixture of economic and political judgment.

There is no question that the current political debate about the need for antirecession policies is based on a quality of economic intelligence which is far superior to anything available 15 years ago. But this is still no guarantee that the right decisions will be made.

Not only have we improved our ability to predict recessions: we are much better at combating them, too. The use of variable financial terms for residential construction and home improvements has been particularly successful. Statistical analyses suggest that deliberate Government policies have made at least some contribution to mitigating recessions and promoting recoveries.

During the entire postwar period the desirability of using temporary but substantial tax cuts as an antirecession device was continually discussed. In order to use this device without the delay involved in legislative deliberations, it was proposed that the President be authorized to cut taxes up to a specific amount if the economic indicators demonstrate a need to bolster sagging purchasing power.

While there is no inclination in Congress even to consider such a delegation of authority to the President, the idea that tax reduction and the deliberate creation of deficits should be used as an appropriate antirecession tool is gaining acceptance. In recent discussions before congressional committees this principle was hardly contested. The questions under debate were rather:

> Is it certain that a recession is imminent, or is it possible to wait until a tax cut can be worked out in conjunction with tax reform?
>
> Should tax reduction be associated with an increase in expenditures or with a reduction in expenditures? Those who believe that Government expenditures are too high argued for expenditure reduction without considering that such action would counteract the economic effect of tax reduction.
>
> Should the deficit be financed entirely by corporate and individual saving, or should the banking system play its part through action by the Federal Reserve System?

While at the time of this writing no immediate tax reduction has been recommended by the President or adopted by Congress, the debate again shows the advances in thinking about antirecession policies which have been made during the last 15 years. However, it is happening at a time when it is increasingly clear that the frequent recessions are but an expression of a more deeply rooted problem—inadequate economic growth. When President Kennedy appointed Walter Heller as Chairman of the Council of Economic Advisers, he emphasized that growth was his major economic concern. This concern was reflected in some parts of the Economic Report of January 1962. But, in the final analysis, the available information on the factors which make for growth and the existing obstacles in their path have not been used as a springboard for proposing a comprehensive program of action.

The recent statement by the President that he does not intend to recommend an immediate tax cut probably reflects his opinion that such legislation would be supported by Congress and the public only if adopted in the case of a clearly visible recession. The American public, however, has not yet accepted the idea of a tax cut as one element in a comprehensive program designed to stimulate economic growth and combat chronic unemployment.

In any case, a policy of domestic economic expansion is complicated by our balance-of-payments deficit. Many people feel that the fiscal and monetary measures needed to insure full employment and a high rate of growth would at the same time aggravate the balance-of-payments problem. My personal view is that a policy of domestic economic expansion would not in the long run hurt our payments position.

Here, then, is a major unresolved problem which is one of the reasons why the administration's economic policies sometimes seem hesitant and wavering. Under the Employment Act, it is the job of the Council of Economic Advisers and of the Joint Economic Committee to help resolve such policy dilemmas. In this regard the machinery created under the act has not fulfilled its purpose.

Proposals have repeatedly been made to add to the Employment Act the objectives of price stability, economic growth, and a balanced payments position. Actually, however, the act has always been interpreted to include these objectives which are completely compatible with its language and spirit. Therefore, I cannot see any particular reason to specifically add them. The main difficulty is that the Government has not been able to work out a policy which would place these various goals in proper perspective. Such a policy would integrate programs to promote price stability, full employment, and an international payments balance with an all-embracing approach to balanced economic growth.

The Council of Economic Advisers has given advice in this direction, and I am sure that the President has recognized its soundness. There is, however, no unanimity within the administration on the relative importance of the various goals and of the monetary and fiscal policies needed to accomplish them. The Council can only advise the President on its own views and inform him of the conflicting views which exist. The Council cannot be expected to coordinate its own ideas with those of the Treasury, the Federal Reserve System, and private interest groups unless the President adopts a particular policy.

It appears to be the President's judgment that the time is not ripe for obtaining needed political support for such a comprehensive policy of balanced economic growth in his own official family (including the Chairman of the Federal Reserve Board), in Congress, and in the various interest groups in the private sector. On the other hand, the political forces which might support such a policy cannot be mobilized unless the President provides determined leadership.

Consequently, hesitation in formulating and adopting a comprehensive program for economic growth cannot be regarded as a failure in the machinery established by the Employment Act. Nevertheless, improvements in institutional and statistical devices could be used to highlight the need for such a program.

Under the Employment Act the President in his Economic Report must present estimates of the levels of employment, production, and purchasing power necessary to achieve the act's goals. President Eisenhower and his Council have been criticized inside and outside Congress for their failure to live up to this provision. The report of January 1962—President Kennedy's first—was a big step forward, but further progress is still needed.

I believe that national economic projections, both long-term and intermediate, would help to demonstrate the potential levels that could be attained in key sectors of the economy if we attain full employment and utilize all the available technological possibilities. These projections would also indicate the investment required for technological advances and additional productive capacity.

Such national economic budgets require coordinated projections of economic data and projections of Federal, State, and local transactions. These budgets would provide useful tools for the economic evaluation of various long-term Government programs. They could also serve as guides for tax and debt management policy. They would help businessmen to determine potential markets for their products and the feasibility of expanding capacity. Projections of this kind are now provided by private research organizations. But their usefulness for long-term business planning would be greatly enhanced if the business community could rely on the Government to contribute to a program of balanced economic growth through appropriate fiscal and monetary policies.

Congress recently appropriated funds for a study of the problem of economic growth under the direction of the Council of Economic Advisers. Thus the proposed development of a medium- and long-range national economic budget requires no radical innovation but only a further development of programs which have already been initiated. There is no doubt, however, that a great educational effort is needed before national economic budgets are accepted as the tool for the formulation of long-range economic policies.

On the legislative side, a substantial improvement is needed if the Joint Economic Committee is to live up to the role which was envisaged for it under the Employment Act. It was created (*a*) to appraise the economic reports of the President, (*b*) to conduct economic studies of its own, and (*c*) to advise the Congress on legislation needed to accomplish the purposes of the Employment Act.

The committee has regularly issued appraisals of the President's economic reports and has conducted very valuable studies of relevant topics. It has held hearings which gave academic and research economists, and representatives of business and labor, an opportunity to discuss current economic issues. Some of the reports have become valuable material for teaching and have helped to bridge the gap between an academic and a more practical approach to economic policy. In all these respects the joint committee has made valuable contributions which have probably exceeded the expectations of the framers of the 1946 act. The joint committee has, however, been much less successful in giving legislative advice to its congressional colleagues.

At present, the joint committee has an impact on legislation mainly through the fact that its members are also members of other committees which consider legislation related to the economy. Actually, the joint committee has been most successful as a kind of postgraduate training ground for legislators. Some of the outstanding speeches on economic matters in the Senate and House have been made by members of the committee, and there is no doubt that its existence has raised the level of economic sophistication in Congress.

I believe, however, that a more regular channel should be provided to bring the joint committee's advice to the attention of the Congress as a whole. The fact that reports by the joint committee are made available to other Members of Congress hardly assures that much attention is paid to them. It would be desirable if other committees which are considering legislation affecting the economy would hear representatives of the Joint Economic Committee to obtain their views (if necessary, majority and minority views) before legislation is framed. If a committee's proposal is not in accord with the views expressed by the Joint Economic Committee, this conflict should be officially reported to the Congress. As far as I know, the joint committee has presented its views only in exceptional cases, such as the Korean war tax program, or in relatively minor problems, such as those involving appropriations for certain statistical programs.

It is significant that the House Committee on Ways and Means held its own hearings before those of the Joint Economic Committee on the economic outlook in July–August 1962 when the question of an immediate tax reduction was being considered. It is obvious that the joint committee has not yet been successful in obtaining recognition from the other committees as the source of advice on legislation affecting the economy.

The interest of busy legislators can only be assured if they know that the committee's work has a tangible impact on legislation. Consequently, if the joint committee were required to present its views on all legislation and appropriations affecting the economy, it would be more nearly playing the role assigned to it under the Employment Act.

Our 15 years' experience with the Employment Act has definitely proven the importance of this basic legislation, particularly as a means for dramatizing national concern with the economy as a whole. The machinery created under the act has assisted the President in policy formulation and has made him less dependent on Cabinet members who naturally tend to give advice from the point of view of their respective departments. The Joint Economic Committee has been most effective as an educational enterprise in the broadest definition of the term. It has been less effective in directly giving advice on economic and fiscal legislation.

The United States is engaged in a great venture to prove that an economy with free institutions can be adapted to the needs of the space age. But success in this venture requires deliberate Government policies. While the experience of the past 15 years has been encouraging, improvements in the machinery and more boldness in policy formulation and implementation are needed if we are to meet the great economic and social challenge of our time.

[Reprinted from Challenge, February 1963]

MEETING THE CHALLENGES OF THE SIXTIES—NEW LOOK FOR THE EMPLOYMENT ACT

(By Bertram M. Gross)

As one of the principal draftsmen of the Employment Act of 1946 and a former Executive Secretary of the Council of Economic Advisers (which the act created), Bertram M. Gross has long been interested in improving the Employment Act's machinery to keep pace with our rapidly changing economy. Here he outlines five strategic principles "which, if imaginatively applied, may open up new vistas in the administration of the Employment Act." Mr. Gross, professor of administration at Syracuse University, is now a visiting professor at the Harvard Graduate School of Business Administration, giving the Leatherbee lectures on administrative theory and practice.

The Employment Act of 1946 was enacted after a sharp conflict between organized groups holding divergent views on the role of government in a free society.

Rather than being a mere compromise, the act was a constructive integration of opposing interests and viewpoints. In part, this integration was the fruit of the wisdom and flexibility evidenced by both proponents and critics of the legislation. More fundamentally, it was made possible by widespread memories of the great depression of the 1930's.

From deep-rooted fears that with the end of war it might happen again emerged a common purposefulness that it shall not happen again. This sense of negative common purposefulness made it possible, after all the heated debate, to obtain bipartisan agreement on the act's positive provisions:

Its historic policy of promoting "maximum employment, production, and purchasing power."

Its specification of the President's responsibility for regularly transmitting to Congress an economic program to achieve "needed levels of employment, production, and purchasing power."

Creation of the Council of Economic Advisers as one of the agencies to assist the President in his administration of the act.

Creation of the congressional Joint Committee on the Economic Report to facilitate congressional consideration of the economic program as a whole.

Within the area of deepest consensus, the purposes of the act have already been achieved. There has been no mass unemployment in the United States as a whole. More important, there is good reason for confidence that there never will be. Our cultural values, institutional arrangements, managerial abilities, and techincal skills are fully adequate to prevent or quickly curtail any major economic crisis.

But American success in avoiding another great depression is beclouded by our sustained failure to attain a healthy rate and composition of economic growth. Instead of enjoying maximum or optimum employment, we have suffered from overall unemployment of about 5.5 percent since the end of the Korean war. To this must be added a substantial increase in time lost through involuntary part-time work and other forms of underemployment.

Instead of an annual increase in gross national product (GNP) of 4 to 5 percent, the minimum required for maximum production, we have been inching ahead at little more than 2 percent per year. This small growth rate has been overdependent on defense expenditures and on the supercharged marketing of consumption goods that are not really needed and are shoddily made or designed for planned obsolescence. The failure to use our productive potential has meant an accrued loss of untold billions in GNP. In more specific terms, it has meant that—

Our education system has failed to keep pace with national needs.

Scientific research and development, apart from defense and space, have lagged far behind potential.

Cultural and artistic activities have been starved for lack of resources.

We have been unable to provide sufficient assistance to developing nations.

We have lost the tremendous advantages that could have been obtained from more investment in the renovation of obsolete plant and equipment, transportation facilities, and rundown urban areas.

Above all, there is now no rational basis for confidence—on the part of business, labor, farmers, consumers, political parties, government, or foreign nations—that there will be sustained economic growth in America. Rather, leaders and decisionmakers in all of these fields have come to expect recurrent recessions and sustained underemployment of both machinery and labor. On the basis of this expectation, many managers establish prices consistent with the high costs of low utilization of capacity. Many union leaders and workers resist technological changes which, in the absence of genuine economic expansion, threaten larger scale unemployment. Thus the expectation itself becomes something of a "self-fulfilling prophecy," reinforcing the existing tendencies toward economic "crawl and fall."

This situation would be quite different if bold general statements were enough to promote healthy economic growth. Thus the 1960 Democratic Party platform stated that "our economy can and must grow at an average rate of 5 percent annually. * * * We pledge ourselves to policies that will achieve this goal without inflation." This pledge was repeated in Candidate Kennedy's insistent affirmations that "we must move ahead in the 1960's." In his Economic Report of January 1962 the President and his able Council of Economic Advisers stated their overall goals for economic growth: a reduction of unemployment to 4 percent of the labor force by 1963 and an annual increase in GNP of at least 4½ percent for the 1960's as a whole.

But the specific programs presented to Congress fell far short of what would have been needed to start the economy in this direction. One reason was that the more ambitious programs recommended by the Council would unquestionably have been rejected by the Congress. The President was more interested in feasible action than in building a record of Presidential wisdom and congressional recalcitrance. As it was, large parts of his less-than-full employment program were wrecked by congressional opposition.

More recently, considerable attention has been focused on stimulating the economy through a one-shot or two-shot tax reduction. This could have an exhilarating effect similar in many ways to another big increase in defense or space expenditures. But it would be a temporary stimulant only. Not even its most ardent proponents would claim that by itself it will produce widespread confidence in sustained growth.

As a consequence, a reevaluation of the Employment Act is desperately needed. In particular, we must consider some of the institutional requirements for economic growth that are certainly as important as the various economic policies appropriate to a particular period of time.

To start the reevaluation process in motion, I shall put forth five strategic principles which, if imaginatively applied, may open new vistas in the administration of the Employment Act:

Sustained economic growth requires the promotion of common purposefulness among the private and public organizations with the power to affect economic behavior.

Common purposefulness requires widespread and sustained participation in the development of growth objectives.

Growth objectives are meaningful only if narrowed down to specific sectors of economic behavior.

Growth programs should take into account the side effects of healthy growth.

More research is needed on the nature of growth processes.

These principles are derived from the new advances in the behavioral sciences since 1946, and from the ideas on democratic planning emerging in the practice of many Western countries and in the minds of many thoughtful Americans.

Promotion of common purposefulness

"Management by objectives" is the most significant idea in modern-day public and business administration. This means that the key task of leaders is to develop a sense of common purposefulness among people with different interests and responsibilities. When people are personally committed to some general objectives, successful performance can be obtained with widely dispersed initiative and flexibility. Within such a framework the inevitable and desirable conflicts on other matters can be more readily resolved through compromise or integration.

Yet in devising programs of economic growth the promotion of common objectives is rarely itself regarded as an objective. Economists tend to focus on technical matters and the preparation of documents which may enhance their professional standing. They are more dedicated to convincing a President or Prime Minister to accept their objectives as his own than in helping him to promote common purposefulness among key sectors of society.

Widespread participation in purpose formation

Another basic idea in modern administrative thought is that common purposes can best be developed by genuine and continuous personal participation. Objectives are genuinely shared only when people have had a part in their formation and adjustment. Plans and programs are truly meaningful only when prepared with the help of the very organizations and institutions that will themselves be involved in carrying them out.

Yet there is a dangerous tendency among Government economists and liberal critics of Government to think of economic growth in terms of a program developed by the President in his capacity as Chief Executive, presented to Congress as his program and forcefully carried to the people by all the modern instruments of communication. While this approach has certain things to commend it, it is an oversimplified and potentially dangerous concept of Presidential leadership in economic affairs.

One of its defects is overpersonalization. The President and his advisers become the spokesmen for "his" program. Cabinet members by this example are encouraged to present "their" programs. In a society built upon a tremendous dispersion of economic power, this is no way to develop a widespread sense of "we" and "ours." In France, in contrast, despite the intensely personal leadership of President de Gaulle on other matters, economic planning is depersonalized. The French economic plan is never identified with De Gaulle, the commisariat du plan, or even with the Government as a whole. It is rather the collective product of all who have participated in its formulation.

In the United States the first requirement of a more vigorous growth program is more active participation by the Joint Economic Committee. A small step in this direction has been the constructive approach taken by the present Council of Economic Advisers toward testimony before the committee. In addition, more attention should be given to ways in which the committee, with support by the Council, can take the lead in conducting special inquiries of the type that can only be handled properly by a congressional committee.

Above all, the committee should present to the Senate and the House every year, after considering the Economic Report, a concurrent resolution setting forth long-term goals of economic growth. Only in this way will it be able to discharge its major function: to help the Congress focus on the major objectives of economic growth rather than be confined entirely to rulemaking on segmental issues.

Something of this sort was contemplated when the Employment Act was still being considered in Congress. In fact, the bill which passed the Senate by a heavy bipartisan majority provided that the joint committee would submit a resolution setting forth a "general policy" with respect to the President's economic program. This provision was subsequently dropped—not as a matter of principle, but merely because it became evident that a resolution on general policy would not be feasible. If the earlier provision had been limited to long-range growth objectives, it would probably have been enacted. This earlier error should now be corrected by an amendment to the Employment Act allowing the joint committee to report such a resolution to the floor without referral to any legislative committee.

The Employment Act already authorizes the Council to establish committees and consult broadly with representatives of industry, agriculture, labor, consumers, State and local governments, and others (sec. 4(e)). Thus far, however, such committees have been mainly used to discuss the immediate economic outlook or specific measures of Government action. They have never been viewed as instruments for sustained work in developing common purposefulness on growth objectives. In part, this failure stems from the narrow idea that such a committee or commission must either make decisions on specific Government policies or advise the President or Council on Government policy.

A way should be found to escape this oversimplified "either/or" approach to relations between the top agencies of the executive branch and the key power centers outside of Government. Surely it is possible to develop consultative arrangements to formulate common purposes on economic growth.

Specific as well as overall objectives

Such macroeconomic goals as a 4½-percent annual growth rate, a $700 billion GNP, 70 million jobs, are not in themselves objectives that can be attained through the actions of specific groups. The function of these objectives is to help such groups formulate their own goals. They are particularly helpful to Government—and indeed have been largely developed as an instrument of Government fiscal policy.

But such goals cannot be very helpful to private business—or helpful enough to government—unless they are developed for specific sectors. Only then can they play a role in market analysis and investment budgeting.

It would probably be a mistake to set up committees covering all sectors of the American economy. It would be wiser to initiate a more modest and experimental approach in a few sectors where long-range expansion is of strategic importance. For this purpose, priority might be given to sectors in which public activity or regulation plays an important role—such as education, power, transportation, and construction. Particular attention should be given to the primary metals sector. Both in 1952 under Truman and in 1962 under Kennedy the Government's disputes with the steel industry were centered on wages and prices without concerted attention to the major factor in steel costs: the level of steel output. Is it too much to hope that future wage-price disputes may be viewed in the more rational framework of fuller utilization of capacity? If so, it will be easier for collective bargaining to operate without public intervention.

Probably the highest priority should be given to education. Here planning by local school boards and State departments of education is seriously handicapped by the lack of a national forum and a national perspective. Yet the sharp controversies on Federal aid and racial integration seem to have distracted attention from equally important matters. The Council of Economic Advisers and the U.S. Office of Education could make a major contribution to local and State school planning by working with educational institutions to establish machinery for the collaborative development of national educational goals.

In this connection, let me say a word in criticism of the old idea of a "shelf of public works." This idea is based on the limited assumption that the advance preparation of plans and blueprints would be enough to provide for their utilization in a time of recession.

The only effective way to stimulate more employment through public works, however, is through projects that people need and actively want. The best "shelf" is the one that people are already trying to reach for—even before its wares are needed to counteract the business cycle. Widespread participation in developing growth goals will itself be a major factor in the organization and promotion of demand in both the public and private sectors.

Coping with the side effects of healthy growth

When we began giving economic aid to other countries, we often made the mistake of thinking of economic growth as a painless process. More recently, we have been learning that in underdeveloped countries growth invariably creates a wave of social change.

At home, however, the proponents of economic expansion, in their enthusiasm, often make the mistake of ignoring or understating the uncomfortable side effects. Here, as in any other society, even the healthy and unforced variety of growth may cause serious instability. This is a form of instability we must learn to live with, cope with, and control or tolerate. Otherwise, we may be forced to live with stagnation as the price of stability.

Let us frankly face the fact that sustained economic growth means sustained inflationary pressures. We must also realize that it means more rapid replacement of obsolete machinery, skills, procedures, organizations, and managers. These inevitable costs of progress are indeed small in comparison with the greater costs of continued "crawl and fall." They can be rendered still smaller through institutional innovation and flexibility.

Research on growth processes

One of the most dynamic factors in American industry during the past decade has been the tripling of scientific research and development. In appraising the growth prospects of any individual corporation, investors now invariably take a look at its research and development program. As the Council of Economic Advisers said in its 1962 report, "there is a positive correlation between research effort and productivity growth."

The Employment Act clearly authorizes the council to initiate intensive research on the processes of economic growth. Yet every council since the act was first passed has limited its research almost entirely to the compilation and interpretation of economic trends. No council has directed its attention to either pure or applied research in the more fundamental social processes that lie behind the economic trends.

The members of the present Council are fully aware that economic growth is not something that can be properly understood by relying on the traditional concepts of economics alone. They realize that all the behavioral sciences have a contribution to make. They should therefore take the leadership in bringing the best scientific minds of the country together in considering the research needs on the economic, social, psychological, institutional, and administrative aspects of economic growth. At some universities suggestive beginnings have already been made in the analysis of economic growth in underdeveloped countries. Such analyses will become richer when the United States and other highly industrialized countries are put under the scalpel.

Improved understanding can also be obtained by a greater willingness to learn from others. We should abandon the myopic, one-way street concept of technical assistance which sends American "experts" on economic development to many other countries and seems to rule out the idea that we too may have something to learn from foreign experts. We should be humble enough to ask experts from other countries, particularly those that have been more creative and successful in their growth programs, to study our problems and give us advice. If the Council or the Joint Committee were to undertake such efforts with France, West Germany, Japan, and Holland, the immediate payoff in improved public relations would be tremendous. The gains in wisdom obtained, if enough American effort were invested in the undertaking, could be even greater.

The ideas herein presented in oversimplified form are more difficult than they may appear. Their successful development and application would themselves require considerable participation by many people and organizations. They would require some profound changes in attitudes and working methods on the part of the Council of Economic Advisers and many other agencies.

Above all, they would require time. This is no area for 90-day wonders or 2-year miracles. It is rather a field for the slow processes of human learning and institutional adaptation, as organizations gain mutual confidence in their ability to find common purposefulness amid the welter and delightful disorder of a pluralistic society.

The task of the President, the Council, and the Joint Economic Committee is slowly and surely to build—and pass on to their successors—a stronger institutional foundation for carrying out the objectives of the Employment Act.

Chairman DOUGLAS. You may proceed in your own way.

Mr. COLM. Mr. Chairman, may I now proceed to this chart?

Chairman DOUGLAS. Yes, indeed.

Mr. COLM. Mr. Chairman, the Employment Act provided that the Economic Report should center around three basic concepts; correspondingly, by implication, I think this committee will be interested in three basic concepts; Namely, (1) What is the economic objective we are trying to achieve with the help of economic and fiscal policies? (2) What is likely to happen in the foreseeable future if we proceed with present policies and with existing attitudes of business, consumers, labor, and so on? And (3) if it does not appear that, with present policies and attitudes, we would achieve our objective, what is the legislative and administrative program that would help to bridge the gap between what is likely to happen under existing policies and what is desirable?

Mr. Chairman, I will organize my remarks around these three concepts, and to facilitate, I have provided a chart which gives some kind of projection for each of these concepts. The chart is appended to the prepared testimony, but I think it may be more visible in this larger form.

First, what is our objective? Well, on this chart, line No. I depicts what might be regarded as our objective. Conforming with recent practice, this line implies a 4 percent unemployment, and that rate of growth which would be needed in order to maintain not more than 4 percent unemployment, absorb the increase in the labor force, and permit a satisfactory growth in productivity.

I would like to say with all possible emphasis that I am not satisfied with a 4-percent rate of unemployment. I think we should do better than that. However, as my discussion will be largely concerned with general policies—fiscal and monetary—I might state that I do not believe that with general policies we can achieve a rate of growth sufficient to get us below that level in a highly dynamic economy.

If we want to go below that, we have to rely on other measures. Some of them are underway: For example, redevelopment for depressed areas, urban growth, the Public Works Acceleration Act, the very ambitious training program which Congress has approved and which is in its initial stages.

I would also like to mention at this point that I think in order to get below 4-percent unemployment something needs to be done with the employment service. That is a footnote, Mr. Chairman. I was greatly impressed when I had the opportunity recently to discuss with a great authority in this field, a leading Swedish expert, Mr. Kellgren, this question. He has prepared a report for the Secretary of Labor in which he stated that he has been visiting many employment offices. He found that, except for professionals, nurses, and a few other categories, our employment offices were strictly limited to meeting supply and demand in a narrowly defined community; and without going to the supervisor, placement people could not even make a telephone call to the next town, even though they thought there might be a job opportunity.

Representative CURTIS. What was the name of that gentleman?

Mr. COLM. Kellgren. K-e-l-l-g-r-e-n.

He has presented a report to the Secretary of Labor on this problem.

Well, this line describing our objectives, Mr. Chairman, in my opinion, presents a minimum of what should be done in order to comply with the objectives of the Employment Act. The line represents a 4-percent rate of growth per year which, again, in my opinion, is a minimum. Actually, I would want a 4.2 rate of growth, but my staff put it at 4 percent; they are so much more conservative than I am. So this is a 4-percent rate of growth. I will accept it if it is the understanding that is a minimum as to what we should do.

Mr. Chairman, I do not think that it would be feasible—we are now at the end of the solid line, about $30 billion below the full employment line. I do not think it would be feasible to reach our objective within a very short period of time.

In my testimony you will find the details of how many job opportunities would have to be created if we want to reach this line within a 12-month period. This, in my opinion, would require a monetary and fiscal policy which might go beyond what is consistent with other objectives, such as price stability and so on.

Therefore, I have drawn here line No. II, which I regard as a realistic target. Again, I think it is a modest target. It reaches the full employment line within a 2-to-3-year period—sometime in 1965. But line II would put us back on the track toward full employment in 1963, even though we would be gradually achieving full employment only in 1965.

I might emphasize that this chart, and most of what I have to say, is addressed to what I like to call the sustainable forces of growth rather than cyclical variations.

It might well be that we can hit the full employment line before 1965 if we get into a boom. But then I wonder whether that would be really sustainable. It might also be that we will stay far below if we get into a recession. What the lines represent therefore is what I would call the sustainable forces of growth, and this is what my remarks are primarily addressed to.

Now, in contrast with this target line, you find here line No. III, which represents the best I could estimate might happen under a, let us call it, do-nothing policy. Under a do-nothing policy——

Senator PROXMIRE. That is line III?

Mr. COLM. The lower line.

Representative CURTIS. You mean "do nothing" by Government?

Mr. COLM. Yes.

Representative CURTIS. Yes.

Mr. COLM. What I mean here is that the Government will do everything that is now on the statute books, including authorizations. The line does, for instance, include continuation of increases in expenditures of State and local governments, and also that increase in Federal Government expenditures which is already implied in actions taken by Congress in previous sessions. But it does not consider, let us say, any tax reduction or tax revision, and it does not consider any change in existing programs or the adoption of new programs.

Line III represents a 3-percent rate of growth from the present level, and, as I say, I think it is the most optimistic line I could draw. Actually, I believe, if we would not adopt any new policies, we would not proceed at a 3-percent rate of growth from this level, but might instead get into a recession sooner or later.

Now, you find here line No. IV. That is my estimate of what might happen if the administration's program is adopted. This line IV is my estimate of the economic impact of the administration's program. You can see right away it is far above line No. III but it does not hit what I call a reasonable target. In evaluating the administration's program, I will deal first with the tax problem, and here I must say I enter this with some trepidation—the analysis of the tax problem—because from what I can gather through the press and through some glimpses of statements at previous hearings last week, you got into quite a discussion as to how to estimate the impact of the tax reduction. I very much hesitate to confess that I have been using a primary consumer multiplier of 2. I hesitate to say it because it may appear almost as if I am in collusion with other experts who use the same figure.

I can only claim that I think I have published that figure before others did, so perhaps they have copies it from me.

Anyway, the primary multiplier used for tax reduction is 2, and, as I know this has been widely discussed here, the primary consumption multiplier is the first step. After that, demand increases. Production goes up. We get into a higher rate of operation. The second force is activiated, which we call the "accelerator." That refers to the point where investments really begin to respond to the increased demand, and this, by the way, is the whole essence of the program as I understand it: to create an incentive for business to invest in response to an expanded demand, and in expectation of profitability.

Now, again, I emphasize I am not in collusion with the staff of the Joint Economic Committee. I had my testimony worked out before I heard that Senator Douglas had somebody working on that who came out with a multiplier of 4, including the effect on investment. I come out with a multiplier of 3.5. That is composed of, during the calendar year 1963, a total effect of the tax measure of $3 billion; in the calendar year 1964 and 1965, combined, of $30 billion; then a spillover into 1966 because the multiplier has not exhausted its effectiveness in those 2 years, of $2 billion, giving me an aggregate effect of $35 billion divided by a $10 billion net deduction, which gives me a total multiplier of 3.5.

I admit the figure of 3.5 is not in my testimony. The day after I read the discussion, I computed our figure. I did not assume a 3.5 multiplier; but we made estimates as to the impact on various types of investments, and that is how we came out.

I have another qualification. I used tax reduction, very broadly considered, in the effect I tried to evaluate. The tax reform measure, in itself, also would have an economic effect. But I have not evaluated that. I know there are some special advantages for low-income people by the proposed new handling of the standard deduction, providing a minimum. There are other effects created by the 5-percent floor for deductions. I have not evaluated that, and I am sure, with a refinement, one might come out with slightly different figures, but I would say they are within the margin of error; it would not be billions; it may be a few hundred millions.

Now the expenditure increases in the administration's program—$4.3 billion in defense and space—must be considered. I do not believe the increase in the debt service will have much of a stimulating effect on business, so we have $4.3 billion.

I have some qualifications in my testimony which I will skip because they are rather technical.

Now, the President said that in all areas except defense, space, and debt service, expenditures would not increase, but show a small reduction. I looked into that a little bit, and this is a formula which does not exhaust the full situation. Actually we found, by going only through major programs, an actual increase in programs in areas outside space, defense, and debt service of $2.4 billion.

You will find that calculation in table II–A where it is explained.

Now, these increases totaling $2.4 billion are offset by such actions as the proposed increase in postal rates, sale of assets, FNMA and Eximbank actions, and so on; and in one case a switch—in the case of

Rural Electrification, repayment previously accounted for under "Miscellaneous receipts," is in this budget put back into funds available for new loans, and it is stated that legislation would be proposed to permit that switch. But, whatever it is, it is not offset through some of the increases in various programs.

After we had made these estimates—with a very small staff, just going through the budget and claiming only that we covered major programs, I saw that the new Budget Director, Kermit Gordon, presented a somewhat higher figure. If the committee should be interested, Mr. Wagner of my staff has tried to make a reconciliation showing the difference as to why Mr. Gordon comes to about $3 billion where I had $2.4. There are a few items which may be in or out.

If the committee wishes, it is just one table which might be of help to the staff when they try to reconcile my table with the table presented by Kermit Gordon.

Representative REUSS. Do you have that table here, Mr. Colm?

Mr. COLM. Yes.

Representative REUSS. If there is no objection, I think this would be helpful, and we will ask that you file it with the committee.

(The table referred to follows:)

COMPARISON OF MR. GORDON'S VERSUS NPA ESTIMATES OF EXPENDITURE DECREASES IN 1964[1]

GC approach: We take total budget expenditures as given in the message (including all increases) and analyze the larger expenditure decreases by function to determine whether they represent a true decrease in program expenditures.

	Billions
BOB expenditure decreases (Mr. Gordon's table)	−$3.4
NPA decreases:	
	−2.6
Veterans (same as budget)	−.1
Total	−2.7
Difference	−.7

Detailed differences

	Millions
Postal rates: Differences of $250,000,000 accounted for by our disregarding proposed new increase in parcel post rates amounting to $127,000,000 plus expected volume increases	−$250
Farm price supports: Our figures were checked with the Department and and we were informed a decrease in cotton inventories are estimated at around $700,000,000; all other commodities resulting in an approximate standoff. This accounts for difference of $200,000,000	−200
Other built-in decreases: $150,000,000 accounted for by different treatment of college housing loans. (See below.) Balance consists of a multiplicity of minor items	[2] −600
Substitution of private for public credit: $150,000,000 of this difference accounted for by different treatment of college housing loans (See above.) Balance represents $50,000,000 TVA financing (private) and our different estimates	[3] +400
Other decreases: $150,000,000 consists of change in treatment of rural electrification loans, balance consists of a number of smaller items	[4] −300
Net difference	−800

Residual difference: Approximately $100,000,000 due to rounding.

[1] Mr. K. Gordon's testimony, table 2; Mr. G. Colm's testimony, table 2B.
[2] Net−$450,000,000.
[3] Net+$250,000,000.
[4] Net−$150,000,000.

Mr. COLM. Yes.

Well, let me say on the expenditure side, we come to something like, in 1963, a $2 billion increase above this No. III line. Now, this does not account for the whole effect of expenditure increases, because even our "do nothing" line has an increase in Federal expenditures; namely, those which are the result of previous action, and the $2 billion are only those which would have to be added to this line on account of new programs.

For the year 1964 and 1965 combined, I get $20 billion; thus there is a $30 billion increase in GNP through the tax measure and $20 billion for these 2 years as a consequence of assumed expenditure measures.

If I combine the two—to get an evaluation of the program as a whole—I come to a figure in 1963 of $5 billion in additional GNP, and for the year 1964–65 combined, one of $50 billion as a result of the program of the administration, including the primary multiplier combined with the acceleration effect, and the multiplier effect of the acceleration effect.

Mr. Chairman, while you were out, I presented an aggregate multiplier figure of 3.5. I know you are interested in that figure, which is a little lower than the figure of your staff, which was reached without collusion.

Chairman DOUGLAS. You reached a multiplier figure of 3.5, total multiplier?

Mr. COLM. For the primary consumption multiplier—I admitted that I had the same figure; for years I have been using a figure of 2; but, combining the primary consumption multiplier with the effect on investment and the feedback of investment on consumption, I reached a figure of 3.5.

Chairman DOUGLAS. We reached a figure, you know, of 4.0, approximately.

Mr. COLM. Yes.

Chairman DOUGLAS. So we are rather close. And you did not consult with Dr. Moor at all?

Mr. COLM. Only after I had my figure.

Chairman DOUGLAS. That is very good.

And Dr. Moor, you did not consult with him?

Mr. MOOR. Only after I reached my figure.

Mr. COLM. I might say something which is not in my testimony but in my worksheets. The total increase in GNP to 1965 is distributed in the following way:

On consumption I get a $19 billion increase due to the program of the administration; on investment of 25; on Government expenditures of $6 billion.

Mr. Chairman, while you were out, I described this, the "do nothing" line, as including those expenditure increases which are due to previous actions of Congress, which, unless rescinded, would go ahead, even if there were no program.

The difference between the "do nothing" policy and the administration policy would be about 5 percent of the 1964–65 GNP, which is a very substantial, a very significant increase, and would lead us quite a way toward our objective, but would not quite reach that objective.

As a matter of fact, under the "do nothing" policy, I get—and "do nothing" is an optimistic assumption which rules out recession or any other disturbance—we would reach unemployment, as conventionally defined, of 7 percent. Under the administration's program we would come here to about 4.5 percent, but we would not come to the desired 4 percent, in my opinion.

Mr. Chairman, I would like to take a few minutes, having presented the results of our analysis, to state what I think about it, what could be done, in my opinion. This will be, I hope, constructive criticism.

First, let me say I do agree with the tax cut. The reasons for it have been so widely discussed that I do not want to go into it now, though I have a suspicion that members of the committee may ask questions about that.

I do believe that the earliest and largest feasible tax cut would be desirable. I would have a larger tax cut in 1963, if we could have it, than the one proposed by the administration. I do not go into strategy, on which I am not an expert, but, as a layman and newspaper reader, I have in my own mind some doubt that a one-package proposal will give us the earliest possible tax cut, and whether a two-package deal might not be more expedient—that is, a tax reduction in 1963 combined with further tax reduction and reform in 1964 and 1965. I think it is important that we get away from this "do nothing" line and on the track toward full employment as early as possible. But this is a tactical matter on which I have no strong conviction. On the chance that Congress will pass a package in a short time, I would be most happy and most surprised.

If I had one criticism, it is the exclusive—the almost exclusive—emphasis on the tax measure, which we have in the various official expressions from the administration. I know it is said to be a demand of political prudence to push one thing at one time and leave other things for the future. This may be true. I have no judgment on that, at least not as an expert.

However, that leads to the temptation that, in pushing it through, the effect of one measure is exaggerated. I think we had that last year, when the administration pressed for the investment tax credit, and I heard statements that this would put us back on more accelerated growth. Of course, I was for it; I am happy it was passed by Congress. In a whole, comprehensive program where demand and incentive expands, it could play a highly incentive role, but I think, taking it as a whole, too much was claimed.

In a similar way, I think, now, the exclusive emphasis on tax reform and tax reduction may put too little emphasis on other constructive measures which, I think, are of equal importance for the longer run.

I agree, tax reduction is something that can be done fast, if Congress is willing to do it, and that it has a very quick effect. Other measures that I am talking about—urban renewal, promotion of civilian technology—these measures require much more preparation. And unless these measures are pushed now with the utmost vigor, they will not be available in sufficient size, by the time the tax reduction has exhausted its effectiveness, to lift the rate of growth.

In my opinion, the support of economic growth, Mr. Chairman, as nobody knows better than you do, is a very complex matter. Economic growth in our economic system affects consumers, business, technological advances, the labor force, changes in training, and all that.

This wide area cannot be covered by just one measure. It requires a complex approach, irrespective of whether politics suggests that you push one thing and then wait another year before pushing another thing.

Now, I would like to mention very briefly three fields which, in my opinion, would supplement the effectiveness of the tax measure:

First, monetary policy. I think much of the effectiveness of the tax measure depends on the monetary policy to be pursued at the same time. I am not a particular expert in that field, but I have watched what has been done during the last year—the so-called Operation Twist—and I think it is encouraging that, partly under the prompting of Congress, the Federal Reserve has adopted a policy of not permitting long-term interest to rise, even in a period of a modest recovery. Possibly, there has even been an inching down of the long-term rate of interest, depending on whether you want to look at new issues——

Chairman DOUGLAS. About one-fifth of 1 percent?

Mr. COLM. Yes.

At the same time, short-term interest rates have been going up. That was done, as you know, because of the consideration of the international situation. I think, due to the excellent work which has been done in this field in cooperation with foreign countries, we should now be in a position in which a somewhat bolder monetary support of economic growth could be undertaken without undue risk. I say "without undue risk." Nobody can ever be entirely certain, but, after all, the monetary device has one advantage: That if the policy proves wrong, one can reverse it. I would be in favor of a bolder support of economic growth, and certainly I feel a little uneasy about the newspaper reports that some tightening has occurred in the last few months, and more tightening is allegedly contemplated for the future.

The second point concerns urban renewal and mass transportation. Mr. Chairman, in the whole Economic Report—and I may have overlooked something—I found only one brief reference in the President's Report that urban renewal is one of the things in which some increase is contemplated, and only one reference in the Council's Report where they list all the measures which are under consideration by the Cabinet Committee on Economic Growth.

In all the recommendations and analysis of economic growth, I do not find this item at all. Personally, I think that this is a matter of high national priority which should be pushed in its own right and on its own merit, and I think that the progress which is being made is too slow. If I understand it correctly, the Government is ready to support plans which a community brings in, if the plan is acceptable. But we know that the economic units in the communities and the political units do not coincide, and there is, as we know, even in Washington—in this area—much conflict; without a more aggressive leadership, I do not think we will make the progress which is needed for this particular area, as well as to come up with something in 2 or 3 years which really gives support to our economic growth.

This field is particularly attractive also because, for one thing, only small Government expenditures reflected in the budget would be involved. Most of them could be undertaken by authorities—not in order to hide anything, but just to do it in the most expedient way. These authorities should be financed by private funds, perhaps with some Government guarantee or other support. Of course, the issue, in large cases, should be coordinated with the Treasury debt-management policy.

Also, we know that there is no other area where we have such leverage for private investment. I am talking, here, on the basis of a special study made by NPA in this field. The NPA estimates are that $1 billion spent by Government authorities would create $2.5 to $3 billion in opportunities for private investments.

I noticed that other experts, for instance, Dr. Dyckman, puts this relationship as 1 to 7. We think, based on the limited experience of Pittsburgh and some other cities, that is an exaggerated ratio. We put it only as 1 to 2.5 to 3. But let me say that in the long run this one program could provide more stimulus to private business investment than the whole revision of the corporate tax. This is no argument against the revision of the corporate tax. I am in favor of that, but it is an argument criticizing the underplaying of these constructive programs in the present program of the administration.

Third, one very brief word on civilian technology.

Mr. Chairman, I think there is in the economic report an admirable discussion of this subject, and a brief summary in the President's program that is also very consistent and to the point. However, the implementation of this huge program is very, very small. There is a supplemental bill in the Department of Commerce of something like $1 million, and for next year, $7 million, and there is in the tax bill an allowance of $50 million for treating investment in research equipment in the same way as the tax bill now permits for current research expenditures.

But much needs to be done here, and can be done, which does not involve great expenditures, but does involve a little imagination and leadership.

We have three problems:

First, the agencies which are administering the Government's more than $10 billion share of this $15 billion R. & D. program. At the Atomic Energy Commission, there is well underway—at least there is a division for civilian application, and whatever work is done, the organization is there.

In NASA a great effort is being made to get something similar underway, but I think they are still seeking how to do it. They are still searching for an answer.

In the military, I do not find anything, really, in this direction, and I recommend to your attention the so-called Bell report, which was submitted to a congressional committee, dealing with this subject matter. I have the exact citation in my testimony.

Second, we have the problem that many of the procurement agencies are bottling up research findings, partly for their own use in case a "catastrophe" should happen: Disarmament. Do not leave out the quote. But, in part, it is a fact that these procurement agencies have a job to do in weapons development, and the byproducts often do not find proper attention, even though they could be used for civilian use. So we have a bottling up.

Third, we have a big problem of receiving and utilizing R. & D. defense research findings in the civilian sector of the economy. As you know, research is done in a few corporations—I mean the percentage of the R. & D. is highly concentrated, and smaller or even middle-sized companies have very great difficulties even finding out what is going on, in spite of a very effective, but very small, office in the Department of Commerce, which is designed to disseminate some of the findings, but is truly inadequate.

There is a deeper reason. One has found that, really, for evaluating R. & D. research, those who are best equipped are those who do active research. It is not just a passive thing. Anyway, I am here touching on a big problem which I think requires more than appropriations; it requires quite a bit of thinking. What I am saying, by the way, is based on a special study underway at NPA which will be published as a book during this year with the support of the National Science Foundation.

I refer, in my testimony to a preliminary finding, which was published in the Harvard Business Review in the November-December issue of last year.

Mr. Chairman, I mentioned these programs, not because I expect any effect from them in 1963. I expect an effect in 1964, 1965, and 1966. But we do not want to get into the situation where we want tax reduction and gain a tax reduction to support the economy while there are very needed other programs lacking support. The danger is that the emphasis on tax reduction dampens the enthusiasm—the willingness of Congress—to give support to these programs, even though what I am asking is not just an increase in expenditures. Sole emphasis on tax policy would also get a misallocation of resources, because, while the tax reduction frees certain resources—and I am glad it does—it does not support directly these essential purposes.

Mr. Chairman, I have in my prepared testimony a section on the price-wage problem. The committee is familiar—at least one member of the committee is familiar—with my views on that, because I have strongly supported an amendment proposed a few years ago by Congressman Reuss. I think that perhaps there is a somewhat different emphasis today. Today the President, through the Council, has issued guidelines for wage and price policy, which, by and large, are very good. But they do not help too much in a specific situation. I think we should have specific efforts, spelling out for key industries, what these guidelines really mean: guidelines that would imbrace not only price-wage, but would add price-wage-productivity, considerations.

Unless we do something in that area, Mr. Chairman, I am afraid that, as we again get, as I hope we will, on the path toward full employment, we may again get some price rises which are not due to excessive demand, and the Federal Reserve, using their money rates, will feel they ought to step on the brake while we are still short of the situation where that stepping on the brake should become necessary.

Mr. Chairman, in conclusion, I again want to express my gratitude that I had this opportunity to present my views to the committee. I recently had an opportunity—I was asked—to write an article in connection with the 15-year anniversary of the Employment Act. By some mistake it was gotten out too late, but, anyway, the article was published, and I said there, with full conviction, that, in my opinion, the Joint Economic Committee has exceeded in its performance the effectiveness—the expectations—that the framers of the law held in the years 1945 and 1946; and I was sitting right with the congressional committee at that time working day and night on it, and I know what the expectations were.

It has exceeded expectations in the whole lifting of the level of sophistication in economic discussion. In one respect, with full frankness, the committee has not fulfilled these expectations. That is in the effect the Committee's considerations have directly on the work of the legislative committees, and, except where, as is true in some cases, there is an overlapping membership between this committee and other committees, or where members of this committee have made speeches on the floors of the Senate or House; I think from the tone—from the caliber—of the speeches, one always knows whether the person is or is not a member of this committee.

I did not mean to give you a grade "A" for performance. What I meant to suggest is that some procedures could be adopted which, in my opinion, would not make any radical change from the past, and still increase the effectiveness of the voice of this committee.

Mr. Colm. I thank you very much.

Chairman Douglas. Thank you, Dr. Colm.

I will ask Senator Proxmire to proceed with questions.

Senator Proxmire. Dr. Colm, it is most encouraging to have a witness come before us and stress the importance of monetary policy and the importance of dovetailing monetary policy, working in harness with fiscal policy.

I assume from what you have told us, although you did not spell it out in detail, that, if we should follow a restrictive monetary policy, that is, if interest rates should rise, if the money supply should not be expanded to keep pace, to some extent, with the increased growth of gross national product, that the consequences of the President's fiscal policy would be that much less expansionary.

In other words, that unemployment would be that much greater, recovery would be that much slower; is that correct?

Mr. Colm. That is correct, Senator.

I would say that with a neutral monetary policy, these policies would not remain ineffective. Let us say we have increase in programs entirely financed by taxes; you still get a positive effect. But unless supported by an appropriate monetary policy, the effect is small. It could be much larger if the policy is supported by an appropriate monetary policy.

Senator Proxmire. Last week one of the leading papers in Washington reported that the administration planned to increase savings bond interest at the end of this year, or in early 1964, from 3.75 to 4 percent, and that they anticipated a rise in interest rate as a consequence of the President's tax reduction program and the expansionary results of it.

Would you not feel that a rise in interest rates this soon, in view of the modesty of the tax cut this year, and even the modesty of the tax cut through fiscal 1964, would be an indication of a monetary policy that was more restrictive than is warranted under present circumstances?

Mr. Colm. Yes, Senator, I do.

Senator PROXMIRE. Now, I notice that you indicate on page 12, when you discuss monetary policy, page 12 of your statement, you say:

> The budget recommendations imply a policy of holding or even lowering long-term rates of interest. Otherwise, it would not appear realistic that about $1.25 to $1.5 billion of Government loans could be sold to the public or switched to private financing as proposed in the budget without capital losses.

That is a very neat observation and very interesting. I hope that the administration made that assumption. Frankly I doubt it, in view of the testimony of the Secretary of the Treasury here, who seemed to support the observations I read from the Washington Star, indicating an interest rise in 1963 and 1964. Both he and the Chairman of the Federal Reserve Board, I felt, implied that a rise in the interest rate would be good news, indicating, in their judgment, that the economy is expanding. But I take it you feel a rise in interest rates might be appropriate, but it would have to come after the economy has expanded considerably, and perhaps as late as 1965 or 1966.

Mr. COLM. I see in the immediate future nothing in the economic outlook—either domestic or international—which suggests to me the desirability of an increase in interest rates.

Senator PROXMIRE. Now, you have a "do nothing" lineup here, No. III, and I want to make sure I understand that. That means that there would be no increase in spending over 1963 budget; that is, the budget that we completed last year?

Mr. COLM. Senator Proxmire, that is a misunderstanding. Line No. III in the chart does imply some increase in Federal Government expenditures: namely, those which follow from action taken in the past. We have the following situation. Congress—and this is, of course, sometimes a frustration for Congress—Congress can act by appropriations which gives the authority to obligate money, and the expenditures come perhaps 2 or 3 years later for long-term projects. So some increase in expenditures is already implied in the action taken by Congress in previous years.

A "do nothing" policy only assumes that no new programs or expanded programs would be adopted by the Congress.

Senator PROXMIRE. In other words, you assume there is no increase, for example, in the space program. The President has recommended a 75 percent step-up in that program, and you assume that there would be no increase?

Mr. COLM. Yes.

Senator PROXMIRE. Or you assume that there would be no increase in the Defense budget?

Mr. COLM. Yes, there is an increase in Defense.

Senator PROXMIRE. But you would assume that the Congress would not honor the $2 billion increase which the President is requesting in his budget this year, is that correct?

Mr. COLM. For fiscal year 1964, Senator, I would say, except for the pay increase, most of the increases are the result of actions taken by Congress last year or in previous years. They are included.

I would not get a 3 percent rise in output unless I would have some increase in Federal, State and local expenditures.

Senator PROXMIRE. All right.

Now, you talk about a 3.5 multiplier, and this astonishes me, because you assume a very modest multiplier as a result of increases in consumer demand of 2.

Mr. COLM. Yes. May I interrupt, Senator?

Senator PROXMIRE. Yes.

Mr. COLM. I called it the primary effect of consumption.

Senator PROXMIRE. Yes, that is accurate, of 2. Now, I do not want to misinterpret the remarks of Mr. Paridiso, who is a very competent economist. I understood him to say he also took 2 as the primary multiplier, and to indicate because of the fact that we already have an excess of plant facilities, and that the primary multiplier would not result in much of an accelerating influence, that is, increase in investment, he assumes something like a 2.25 percent total multiplier.

What is missing?

Why is there this vast difference between two very competent economists, since the multiplier is so vitally important in determining what is going to develop in economic stimulus from a tax cut.

Mr. COLM. Senator, may I ask for which year Mr. Paridiso made the estimate?

Senator PROXMIRE. I think perhaps that is the answer. I think his estimate was for the calendar year.

Mr. COLM. For calendar 1963? I neglected the acceleration effect for the calendar year 1963. I have it only for 1964 and 1965.

Senator PROXMIRE. I would assume that Mr. Paridiso would mean calendar year 1964. Obviously, for calendar 1963, the effect of the tax cut would be very small, because it is only in the last few months that it would be of value.

Mr. COLM. My estimates make no allowance for the acceleration effect in the calendar year 1963. I have the whole effect in 1964 and 1965.

Senator PROXMIRE. I am puzzled by your statement where you say:

> All told, the increase in expenditure programs above those implied in our 3 percent growth curve might explain $2 billion in total output for the calendar year 1963 as a whole in discussing the President's proposals and around $20 billion for the year 1964–65 combined.

Why is it this big? I am amazed that you make this assumption that it is going to have this effect.

Do you anticipate a very large increase in fiscal 1965 in the Budget? Do you anticipate the President is going to ask for an increase?

Mr. COLM. No, sir, I do not.

Senator PROXMIRE. Then why does it jump tenfold?

Mr. COLM. It is the same thing we were just discussing. For the calendar year 1963, I have no acceleration effect, but I include the full acceleration effect, which means an overall factor of 3.5, for the years 1964–66.

Senator PROXMIRE. I see. The complication on this multiplier is that the timing has to be very explicit and very clearly understood. Otherwise, you get enormous variations.

Mr. COLM. Yes.

Senator PROXMIRE. 2, 2.25, 3, 3.5, 4, depending on how long a period. Is it not also true, however, with a multiplier, that it is based on all kinds of assumptions, the propensity to save and to spend; that, as time increases, the validity of the multiplier tends to diminish?

That is, we have to make estimates on what effect this tax cut is going to have 2 years from now. It is awfully hard to tell.

Mr. COLM. Senator, the propensity to consume and save are really minor factors. The big factor determining how income gets translated into consumer spending are the so-called leakages. The big leakages are in the corporate area, and in the tax area; these factors—making the multiplier of 2—are much more important than the propensity to consume. You see, if it were only the propensity to consume, of which Kahn spoke in 1931 when he developed this concept, it was a very simple, mathematical computation. He used the multiplier to consume, let us say, of eight-tenths; then he got a multiplier of 5. But we know today that there are other factors which are much more important.

With all due modesty and with respect—or impertinence, you might say—with respect to the economic profession, I have considerable confidence that we are not entirely off the mark when we talk of a primary consumer multiplier of 2. Where our profession is much less advanced is in the analysis of the whole motivations and responses of business with respect to investment.

When we come to the acceleration effect, I think we are on more uncertain ground. But this uncertainty, Senator, should not lead to the conclusion that, if it is uncertain, let us dismiss it.

Of one thing we are certain: That here is a big factor operating, whether it is 3.5 or 4 or 3.3, I do not know. I come out with 3.5, and it could be wrong also. But it is a significant factor.

As we come to a higher rate of operation, we get more modernization and expansion in plant and equipment—we know this is a big factor. So, even though I admit as an economist that our knowledge is by no means adequate, we know the direction in which it works, and we know about the approximate size; but we cannot—and we should not—claim too much by way of precision.

Senator PROXMIRE. My time is up.

Chairman DOUGLAS. Congressman Curtis?

Representative CURTIS. Thank you, Mr. Chairman.

I was interested to learn that this is the Appropriations Committee room and observe that this is hardly an example of starving the public sector in our affluent society.

I understand you are of the macro-economic school, and I am of the micro-economic school. I only recently have these distinctions become prevalent. Frankly, I am disturbed that economists can divide into such neat categories. I do not believe that either the macro-economists or the micro-economists look at economics as a black and white issue. It must be studied in both ways.

In terms of these macro-economic statistics, what is your estimate of the Federal debt if this millennium of full employment and full use of our economic capacity were reached?

Mr. COLM. Mr. Curtis, first let me say there is no alternative between "micro" and "macro." There could not be any economics that does not consider both, I claim only that "macro" embraces "micro."

Representative CURTIS. That is right, but these are terms that are often oversimplified. I do not think that those who talk in macro terms, or the aggregates, disregard the components, any more than those who emphasize the components fail to consider the aggregates.

It cannot be reduced to an oversimplification.

Of course, I am interested in the aggregates that have been presented.

As I understand the President's theory, it deals more in aggregates than components.

Assuming these aggregates of past and projected GNP figures, employment rates for full employment, and the growth rate, what is your estimate of the Federal debt? According to these theories, we are going to have continued deficits. In fact, the argument is used that if we do not enact these proposed policies, the deficit will be even greater. If you reach this point, which you say needs to be projected to around 1965, what would be the Federal debt at that point?

How much deficit must we have in order to get that?

Incidentally, as I read the President's presentation in both his budget message and economic report, even if we reached full employment, we would still have a deficit.

Mr. COLM. Yes.

Congressman Curtis, I have no figure at hand as to what the debt might be in 1965. I made some estimates which were published in our little monthly, Looking Ahead, in December, before I knew the President's program and the budget, which shows that with the tax reduction which I there assumed, which was about $8 billion—I had a somewhat smaller program—the fiscal year 1964 budget deficit would be somewhat larger with the tax cut than now. That means within the fiscal year 1964, the regeneration of the economy would not entirely offset the reduction in revenue. But already in fiscal year 1965, the budget deficit would be only one-half under a tax-cut program—and some of the other programs which I mentioned—only one-half of what it would be under my "do nothing" policy.

Representative CURTIS. Yes; I understand how you relate it but I want to follow your theory and find out what the debt will be. I think we will have to raise the debt ceiling, if the President is successful in his program, to around $320 billion at the end of this year.

These are all projections for the future, but I want to discuss the debt. When we reach this millennium of full employment and a full utilization of our economic capacity, what will be our debt? If you have that figure, and I wish some of the macroeconomists would figure it out, what would be the theory in regard to debt? Should it be paid off? Do we want to maintain a certain size debt? Is that economically desirable? What will be the interest payment on that debt, and what economic impact will it have?

You see, Dr. Colm, all the witnesses who have followed the same philosophy you do fail to prepare any discussion of the problems of debt management, and what the economic impact would be from financing $11.9 billion deficit.

Maybe that economic impact would be insignificant. At least it should be discussed. At no point in your paper today have you discussed the economic implications of managing the Federal debt as it is, the additional $11 billion deficit, and any projected deficits in this theory until we reach a balanced budget.

I guess you hope to have a balanced budget, or is the balanced budget theory completely out of date? It used to be that it would be balanced from the deficits of the recessions in the periods of the peaks, but that theory is out the window now, according to those who first presented it. Now we say the budget is to be balanced somewhere in the distant future when we attain full utilization of our capacity. For this reason, I direct these questions to you.

Mr. COLM. Congressman, your criticism that I have not mentioned this in my prepared testimony is entirely valid. I have been concerned with the problem and have published articles on that problem very frequently, so I would like to respond to your question.

There are two problems. One is the financing of the current deficit, which you mention, but I think it is not the primary focus of your question. It is the future debt.

Representative CURTIS. Plus the debt, if we adopted these policies——

Mr. COLM. Yes.

Representative CURTIS. Plus the additional deficit expected in fiscal 1964.

Mr. COLM. Yes.

Representative CURTIS. Inasmuch as you talk in long-term programs, I would expect this ingredient to be put into it.

Mr. COLM. Yes.

Congressman Curtis, you asked me, do I think that the debt will ever be paid off? My honest answer is I do not think so. We will have periods where the debt will be reduced, but I think the main problem is—as it has always been in the history of indebtedness—that the debt has been reduced in its relative weight because the economy rose by more than the debt.

Representative CURTIS. Do you mean it has that right now?

Mr. COLM. Well, we have had the phenomenon—we have a much smaller debt burden today than we had at the end of the war.

Representative CURTIS. Well certainly, that is no basis for consolation. We knew we were going to finance a major war through borrowing on the future. I would be much happier if those who are relaxed about this debt would relate it to periods of an economy based on peace.

There it is no similar figure. In fact, the debt is considerably higher than any peacetime period of the past.

Mr. COLM. I would be greatly disturbed, Mr. Curtis, if our figures would suggest an increase in the debt or an increase in the debt service larger than the revenue which would be derived from the growing economy.

Actually, the percentage of the interest in relation to whatever measure you take, national income, taxable income, gross national product—this relationship is getting smaller and smaller, even though the absolute size of the debt may be rising; and, in my opinion, it is continuing to rise.

What do you mean by "burden"—what is "burden"? It means it would be a burden if we have to increase tax rates in order to remain solvent, in order to pay our debt charges. But you have to think that a $10 billion increase in the GNP means at least $2.5 billion more in Federal revenue. The Council even says $3 billion, but my figure is a little lower, $2.5 billion, or something like that.

Now, certainly, it would be greatly disturbing if the debt charges would increase so that they would absorb a larger portion of Federal revenues, of the increase in Federal revenue. In my opinion, even with the most conservative estimates for the economic effects of any Government program, and the most conservative estimates for what business is doing in modernization and expansion, I can only see a future reduction in the burden of the debt and the debt service.

This statement, to my mind, is entirely compatible with the opinion that the debt, which is now somewhat above $300 billion, will go to $310 billion and may go further. You have the same in any business enterprise.

Representative CURTIS. My time is up, so I will have to come back on this, Dr. Colm. But the subject is on the record now, and I wish the Kennedy administration spokesmen would devote some attention to it. It needs discussion and debate.

If they really want a national debt, let us discuss the very thing that we were just beginning to talk about.

Mr. COLM. Mr. Curtis, I must respond in one respect. I am not an administration spokesman.

Representative CURTIS. No, I know you are not. But you support the administration's economic theories, which I disagree with, and I would like to debate them.

Mr. COLM. Yes.

Representative CURTIS. However, to this very day, neither an administration spokesman nor one supporting their theories, has come in with a prepared statement discussing the problems in debt management. That is true to this point. When I have interrogated the witnesses, they have improvised and thought of it only for the moment.

Chairman DOUGLAS. Congressman Reuss?

Representative REUSS. Thank you, Mr. Chairman.

We are always grateful to you, Dr. Colm, for the very thoughtful contributions you make to our committee hearings. I am glad you did not confine yourself to remarks about economics, but got into political science a little bit with your point that the Joint Economic Committee's recommendations ought to be more effective than they are. And you suggest, as a means of achieving that end, a witness or witnesses representing the Joint Economic Committee appear from time to time before the appropriate legislative committee to present views of the Joint Economic Committee.

Surely, there could not be a better year to do that than this year, when, for the first time in our economic history, a tax cut is being contemplated almost entirely for its effect on growth and unemployment.

The difficulty I have with the proposition is inherent in the makeup of this committee and, for example, that of the House Ways and Means Committee, which will consider, starting this week, the tax legislation. My hunch is that the report of the Joint Committee this March 1, 1963, will disclose the kinds of split personality which are evident in the questioning from the bench here during the last week and a half.

For example, I think most of the Democrats will espouse the theory that it makes sense to cut our tax rates on a permanent basis in order to prevent the tax take from arresting our economy before it gets to something like full employment. But I anticipate that there will be some dissent on the Democratic side to that proposition.

I think most of the Republicans will take the view that a tax cut will increase the deficit and that anything which increases the overall deficit should not be undertaken. But I think there will be some dissent on this from the Republican side.

My point is simply this: If the Joint Economic Committee tries to present its voice on the matter, it is likely to represent not a simple melody, but a Bach fugue with much counterpoint going on.

I am wondering, therefore, whether you have any specific thoughts on the presentation of the Joint Economic Committee's views on what is certainly the No. 1 economic question of the year: Shall there be a tax cut for growth-stimulating purposes?

Mr. COLM. Congressman Reuss, it is a big question. I wish that the Joint Economic Committee would go on record recommending the tax cut as one measure which could be made effective, Congress willing, within a relatively short time.

But I also wish that the Joint Economic Committee would, at the same time, say that this emphasis on the tax cut and tax reform should not lead away from the other constructive programs which are needed if the purpose of sustained economic growth is to be accomplished.

Now, this, in essence, fits in with what I have been suggesting—that the Joint Economic Committee may appear as a witness either in one voice or two or in four voices—we have now learned there are four parties in Congress—is not entirely new. I think two times the Joint Economic Committee has taken a hand. One was when Senator Taft appeared before an Appropriations Committee, speaking for the committee as a whole in favor of certain statistical programs, and I know this committee has been bipartisan in its support of statistical programs; this may be a minor thing, but it is a precedent, anyway—also more recently than in the case of Senator Taft. That was the time of the Korean war when Senator O'Mahoney, on behalf of the committee, intervened in the tax bill which was just pending at that time.

My recommendation—meant for the year 1963—it was an article written for the 15th anniversary of the Employment Act. I would be very happy if the article written for the 20th anniversary by me, or by somebody else, would say that something has been accomplished.

Representative REUSS. I think that is a very useful suggestion.

One more question on the tax cut. Is the effect of the tax cuts of different sizes purely an arithmetical effect, or do you see some multiplier in it?

Let me rephrase this question. Suppose instead of a tax cut of the size projected by the administration, Congress passes one that is considerably smaller in its impact. Do you think that this will simply result in the economy receiving a proportionately smaller lift, or do you think there could be a situation where the tax cut was so little or so late, or both, that about all it did was to reduce the revenues without giving the economy any appreciable push?

Mr. COLM. Congressman Reuss, this matter is certainly not one of arithmetic. Here I am with Congressman Curtis, that we should never forget the "micro" aspect when talking about big averages and all that.

I think the primary multiplier is relatively independent of the size, but not independent of the kind, of tax cut. However, the acceleration effect is very much a function of size, and the reason why I would like to see a more massive tax cut at the beginning is in order to get a greater and faster acceleration effect.

It might very well be that a smaller tax program may add a little bit to consumer demand, but not enough in order really to get business investment going, which is the purpose of the whole performance.

Representative REUSS. Thank you very much.

Chairman DOUGLAS. Dr. Colm, when I graduated from college 50 years ago, and when I did graduate work, there were two basic ideas concerning matter and economics.

So far as matter is concerned, it was supposed to be solid. Each atom was, in a sense, a bullet, but it was a solid bullet.

In economics, all labor and capital was supposed to be employed, or if they were not employed, it was because the return which they received was above their marginal productivity, and consequently they would be laid off.

It was therefore assumed that if you increased the total quantity of purchasing power, this would not increase production but would raise prices. With an increase in the quality of circulating medium not accompanied by an increase in productivity, it would simply raise the price level.

Now at the very time this theory of physics was being taught, Lord Rutherford was proving that matter was in part a vacuum, and that, inside, the atom resembled the solar system charged with electricity.

And in the twenties and thirties we began to realize that unemployment, in England at least, was a continuing phenomenon, and in the United States in the thirties it lasted for well over 10 years in large quantity.

Then the question came as to whether under these circumstances, with underemployment of labor and underemployment of capital, an increase in total monetary purchasing power, whether coming from the Government or from the banking system, could not employ people who otherwise would be unemployed, increase the quantity of goods and services, and the people with increased purchasing power would purchase more goods and services, which in turn would reemploy still others who with more purchasing power would create employment for others and so forth.

Under the influence of Keynes, and with the brilliant article of R. F. Kahn, who has been previously referred to, the theory of the multiplier was developed, and more recently to the theory of the multiplier has been joined the previous theory of the accelerator which my friend and colleague J. M. Clark developed.

Now, however, what we find is that most of the Senators and Congressmen and a large part of the voting public studied economics in the old days when all labor and capital was supposed to be employed, and under which an increase in total monetary purchasing power would simply result in an increase in prices or inflation.

Do you suggest any way of bridging this gap? In the field of physics it was bridged with the nuclear experiments, the atom bomb. That was developed at my university. They took a great chance. They might have blown up the whole university. They might have blown up the whole city. But they took a gamble on the Einsteinian theory.

Now do you think there is a possibility of such a catastrophe as might have occurred in Chicago, if we make this venture in deficit financing?

Mr. COLM. First, Senator, following your analogy with physics, for the layman, the most important—the most challenging—concept, as far as I can understand anything of physics, is the new concept of complementarity, complementarity which I think is attributed by Moore and elaborated by Heisenberg as "the principle of uncertainty."

This concept perhaps should make all of us more modest, because it teaches us that two things which at the surface appear to be contradictory may have a deeper reconciliation even though we have not yet discovered the reconciliation.

Einstein died while trying to reconcile two things which were called complementary and not contradictory, but they were contradictory to our surface, superficial human understanding. I do not deny that there may be prices, rates of prices, levels of prices, and wages which result in unemployment. There would be nothing to do except bring about an adjustment, either getting the price level up or the wages down.

Still I would be very unhappy if this idea would lead to the other conclusion, that when there is unemployment, it proves that wages are too high.

This is where my complementarity comes in. I think there is something to the idea of the quantity of money. If you have a massive injection of money, we know what it does. We have learned it in wars.

But if the quantity of money was entirely right, we would be in a recession today. Look what happened to the quantity of money during the last 2 years in relation to the increase in gross national product. So I think we have empirical evidence that we cannot be satisfied with any of these dogmas which you and I learned when we went to school, and I know that you have long ago overcome this.

So applied to the present problem, I do think that a classical economist might say, "Well, reduce prices, reduce wages until everybody is employed. This would also solve perhaps our balance of payments problem at the same time."

I think it would also create a depression only comparable to that of the 1930's, because, in a dynamic economy, it just happens that the process of response takes more time than the impulse.

If we reduce prices and wage rates, you have a deflationary effect which may spread all through the economy faster than your reemployment at lower factor cost will increase employment and production.

I think that gives the way our modern dynamic economy works, the classical recipe would bring us into a great depression. Therefore I am personally in favor of the injection of purchasing power through tax reduction, accompanied by adequate monetary policies which proceed carefully.

I mean I would not step on the brake too early, as Senator Proxmire said he had read—I wasn't aware of it—in the paper. I think it would be too early, but I would keep my brake in good functioning condition, just because of the uncertainty, because we have these complementary forces working in opposite directions. We have the fact that an increase in purchasing power is the only real incentive we can give business for additional investment on a large scale, and yet we know that if we go too fast or too far, we may end up with inflation.

Therefore I would keep my brake in good working condition, being careful not to use it too early, as long as we are still going uphill. This, by the way, is a compliment to your new staff director, "using the brake uphill." I stole it from a speech by Jim Knowles which he made recently.

Chairman DOUGLAS. Are your working papers on the magnitude of the multiplier in such shape that they could be published as an appendix to your testimony?

Mr. COLM. Senator, I am bold enough to say yes, that we will submit them for the record. I will be on my way to Geneva tomorrow, and members of my staff here will have to see how they live up to my promise.

Chairman DOUGLAS. I would appreciate that very much. Senator Proxmire.

(Appendix: A note on the multiplier and acceleration principle is appended:)

APPENDIX: A NOTE ON THE MULTIPLIER AND ACCELERATION PRINCIPLE

In evaluating the prospective economic impact of an assumed tax cut, we have generally used "multiplier" and "accelerator" analysis. Applied to the present case, the multiplier expresses, as a numerical coefficient, the permanent increase in GNP resulting from the postulated reduction in taxes. The initial impact operates via increased disposable personal income as a consequence of an individual income tax cut; this rise in income raises personal expenditures, followed again by successive rounds of increased income and expenditures. The multiple consequences of tax reduction upon increased consumer spending generate, in turn, additional investment activity to meet the additional demands. This induced effect—supported by the additional stimulus of reduced corporate income taxes—is identified as the accelerator. The joint effect of both multiplier and accelerator must be considered in a total assessment of tax policy.

Numerically, we have calculated an individual income tax reduction-consumption multiplier of about 2; and an overall joint multiplier-accelerator of 3.5. That is, after all spending rounds have been completed, the addition to GNP will be twice the size of the individual income tax cut as a multiplier effect, and 3.5 times the size of the corporate and individual tax cut as a combined multiplier-accelerator effect. The basis for this computation will be briefly described.

A tax reduction-consumption multiplier of 2 means that, in the expansionary period of economic activity here postulated, out of each $100 of income tax reduction, half remains in the income stream as consumption expenditures while half leaves in the form of so-called "leakages." The first two "rounds" of leakages resulting from a tax cut may be illustrated as follows:

Tax relief (equals disposal personal income)	$100
Less: saving	−7
Equals: expenditures (round 1)	93
Less: corporation profits, social insurance contributions	27
Equals: personal income	66
Less: taxes	12
Equals: disposable personal income	54
Less: saving	4
Equals: expenditures (round 2)	50

Thus, out of the $100 tax cut, $93 is spent by consumers initially, followed in the second round by expenditures of $50, and, with the same leakages operating, by successive expenditure rounds of \$27, \$15, \$8, \$4, and so on. It has been calculated that 6 or 7 expenditure rounds take place in a year, so that the GNP increment approaches \$200 (\$93 plus \$50 plus \$27 plus \$15 plus \$8 plus \$4=\$197) in 1 year.

Empirical support for these orders of magnitude is offered, most recently, in Paul Davidson, "Income and Employment Multipliers, and the Price Level," the American Economic Review, September 1962. Davidson's estimated multiplier of 2.11 is roughly comparable with earlier estimates of Eckstein and Musgrave; econometric studies at the University of Michigan, however, have yielded still higher estimates.

The proposed net individual income tax reduction of about \$8 billion—spread over a 3-year period and augmented slightly by increased dividend receipts resulting from corporate tax reduction—is assumed to raise personal consumption expenditures by the end of the period 1963–66 by about \$18 billion above levels that would otherwise prevail; these \$18 billion are solely attributable to the multiplier.

The induced investment thereby generated under the acceleration effect is estimated at about \$17 billion (including a small allowance for the effect of the corporate tax reduction). That such an incremental volume of investment would, in fact, be forthcoming, requires more tentative judgment than the assumptions regarding the multiplier effect. It may be observed, however, that our calculation—predicated on a 19 percent change in investment following upon a 3½ percent change in consumption—compares very reasonably with the relationship shown in the four postwar periods of economic expansion, against which it was tested. Further, the entire calculation, including the impact of tax reduction as well as of expenditure policies, was independently examined for feasibility in the light of potential final demands by consumers, investment, and government; as well as of productivity trends and labor force growth.

Relating the \$35 billion (\$18 plus \$17) increase in GNP to tax cuts totaling about \$10 billion thus gives a joint multiplier-accelerator coefficient of 3.5. The major part of this \$35 billion—some \$30 billion—would occur in the period 1964–65 where it accounts for about 60 percent of the gap between lines III and IV in the appended chart.

Senator PROXMIRE. You see the difficulty with this multiplier concept is, like all other——

Chairman DOUGLAS. I beg your pardon. Congressman Kilburn.

Representative KILBURN. I have no questions.

Senator PROXMIRE. The difficulty with this multiplier concept applied over a period of time is that it is a theory, and as you and Senator Douglas have so well indicated, the theories of economics which we accepted widely a few years ago have been discarded. It may be in a few years we will discard some of the theories we have now.

The difficulty is that we can't empirically test this very well because we can never isolate the multiplier. There are many other factors that affect economic expansion and economic contraction.

This morning's Wall Street Journal has an article by George Shea, a very interesting article, in which he discusses the effect that deficits have had in the past in stimulating the economy. I think this is a very tough one to answer on the basis of other empirical evidence.

He shows that in the thirties we ran deficits that varied from 1.3 percent of the gross national product to 5.5 percent, and that, during the thirties, unemployment ranged between 14.3 and 24.9 percent, and averaged 19 percent.

He also said that lately we have been greatly impressed by European growth and the fact that they run big deficits, they are expanding rapidly, and they have no unemployment. He shows that the countries that have run the biggest deficits have had the least growth. Those that have run more modest deficits have had greater growth.

The argument is not that if you balance your budget or have a surplus that you are going to grow faster. The argument Mr. Shea makes very persuasively on the basis of evidence available is that you simply can't make a strong empirical case that you can stimulate your economy by reducing taxes, increasing spending, and running a deficit. The evidence just isn't in.

The theory may be there to some extent, but the empirical evidence, which is so much more persuasive with most of us, I haven't seen, and I would appreciate it if you could supply some empirical evidence to this effect.

Mr. Colm. Senator, the multiplier I would not call a theory. I would call it a working hypothesis. It is a working hypothesis which has been tested over a 30-year period again and again with empirical data.

I speak with some conviction on this topic, because I published, during the thirties, an article where I tried out various multipliers. I did not claim that I could derive one multiplier and say that is it, but I could say that a certain multiplier had a certain acceleration effect.

I did not know about acceleration effect at that time; I called it a tertiary effect, but it fitted in with the facts.

Senator Proxmire. Yes, but you see the difficulty is this, Dr. Colm. In the thirties we had 1 year after another of huge deficits in relationship to gross national product, 10 consecutive years in which the deficit average would now be equivalent to $20 billion a year. Yet we ended up with 14-percent unemployment.

Mr. Colm. Senator, there is a very important distinction to be made. There are two kinds of deficits. One is a passive deficit which, in the article I am referring to in the thirties, I called a maintenance deficit. That means this: Take the 1959 deficit. It was not planned by President Eisenhower—I don't think he did, nor his Secretary of the Treasury or Budget Director.

Senator Proxmire. They estimated a surplus.

Mr. Colm. They estimated a surplus of $500 million, and ended up with about a $13 billion deficit. This deficit had a minimum stimulating effect because it just happened. The base, the tax base, contracted, and, therefore, revenues fell off. Now it was not without economic effect. If it had not been for that, probably the recession would have moved into a depression. So it was what I called a maintenance deficit—a passive deficit.

But if you obtain a deficit, not by the shrinking of the tax base due to economic contraction, but by a deliberate action either on the expenditure or the receipts side, then you have an active deficit; that means the economic effect really is not the deficit, but it is the effect of the increase in expenditures.

Senator Proxmire. Of course there you take us into an area where we can't argue empirically because we have never done this before. Have we? Deliberately planning a deficit, reducing taxes in a period of prosperity, in a period of heavy deficit, and in a period when we are increasing spending.

Mr. Colm. I tried, through the thirties, to distinguish between the part of the deficit which was due to the shrinkage in the tax base and the part due to the Government action, which was very small indeed; for the latter part, I could associate deficits with multipliers that fitted with the facts.

As a matter of fact, last September in the American Economic Review, there is an empirical article—I think the name of the author is Paul Davidson—who tried the empirical evidence of most recent years and came out with a consumption multiplier of 2.1. Now that is an expenditure multiplier, and also the estimated employment effect.

We have the same kind of—call it commonsense basis—in a recent Brookings book by Wilfred Lewis about the four postwar recessions, and the effect of fiscal policy.

Senator Proxmire, if you say, "Are you terribly sure about your figures?" my answer is "No, I am not." This is a hypothesis. We don't know any facts which contradict it.

I challenge your statement that this concept has been dropped, if I understood you right, for a while. I am not aware of that.

Senator PROXMIRE. Oh, no, no, no. I know it has been far from dropped. I agree 100 percent. I am fighting—Congressman Curtis perhaps too—we are fighting, perhaps, a lonely battle as far as the economists are concerned. There is no doubt that the concept has been adopted. The newspapers have taken it over. Walter Lippmann says it is the thing to do. You are not in style unless you are for this.

We are back in the old days of the Charleston. You fellows are doing the twist. It is up to us, it seems to me, to try to counteract what has now been widely accepted. This is the dogma, this is the new doctrine, and we have to challenge it. You are not alone. We are. Let me try and ask just a couple of quick questions.

Mr. COLM. May I just finish my response to your previous question. I want to say as uncertain as I am about the deficits, I would say that all historical evidence—empirical studies, not theories—are in conformity with the idea, the basic idea that some autonomous factor in the economy, it might be a reduction in taxes, it might be an increase in expenditures, it might be a new invention, it might be just a crazy idea of a businessman that he wants to build an empire, or of an investor on a speculative basis, which, if it succeeds, has an effect which is much larger than the original outlay.

I challenge anybody who says there are economic facts which contradict that notion. When you said there are economic facts which contradict the multiplier of 2 or the ecceleration effect of 3, I have nothing to say in its defense. But the general notion is as much in conformity of economic facts as anything else I know in economics.

Senator PROXMIRE. Now let me get into this. On page 11, you say:

> I believe that a tax cut phased over 3 years will have a continuing negative influence on the willingness of the Government to engage in highly needed new programs.

You seem to feel that the tax cut that has been proposed by the President may have an adverse effect, and you spell them out on page 13 where you talk about the education proposals and so forth. So that, as I see it, if this does discourage some of these programs, in your view at least, it might have a negative influence on economic growth.

What I am saying is that if we cut taxes, and because we cut taxes we don't engage in the kind of research and educational programs we should engage in, if we cut taxes, and because we cut taxes we don't have urban renewal programs which you say bring in $2½ to $3 or more of private money for every dollar of Government money, then you say that the effect of this program may not be positive, it may be negative, isn't that correct?

Mr. COLM. Senator, I did not mean to say that the effect of this program on the economy might be negative. It was perhaps an entirely inappropriate excursion on my side into political judgment.

I said, or really observed, that this tax program has a dampening effect on the willingness to expand these programs.

Senator PROXMIRE. What you are saying is we should cut taxes more than we are perhaps, and engage in perhaps more spending than we plan to engage in, and if there is anything wrong with this program it is that it's not "bold" enough. In other words we need at least a larger temporary deficit to get greater expansion at the present time, is that right?

Mr. COLM. Senator Proxmire, I did not mean to suggest that we now should do more spending. I said we should prepare these programs so that they are ready when the effect of the tax program begins to taper off.

The urban renewal program is a program that requires lots of time, unless you want to pour out money. What I have in mind is pouring out private business money rather than Government money. The Government money is the seed to get it going. It is the same with technology.

I don't suggest any large, huge expenditure program. There might be some increase beyond the present amounts. But the main effect would be on private spending.

But Senator Proxmire, I don't see this as an alternative to the tax program; the tax program, if Congress is willing to do it, can be made effective and soon, while these programs require preparation.

But if we now say that the tax program will bring us back on the track to full employment, so let's relax—then we will be in trouble in 1964, 1965, and 1966.

Senator PROXMIRE. Thank you very much. My time is up.

Chairman DOUGLAS. Congressman Curtis.

Representative CURTIS. First I want to comment on the very modest way in which Senator Douglas seeks to put the reasoning of Einstein on the shoulders of the deficit financiers. Fortunately that is an overstatement of the case.

There are some very fine scholars and economists who do not agree with this theory and are not quite that much alone. Granted, reading the press I find that I am sometime alone, but I am very happy there are many fine economists who are in disagreement.

I never knew that when Professor Einstein first developed his theory in 1902, which I think is the correct date, he ever got a debate. I find it quite interesting that those who are advancing the deficit financing theory, to this day, have not come before this committee or prepared any papers that I have seen, to discuss the problem of debt management or debt policy.

I also find it difficult to get the promoters of this debt financing theory to debate expenditure policy. I am very much concerned about expenditure policy and in many respects I think you will agree. Your theory is based on the idea that the money will be spent, is it not?

Mr. COLM. Pardon me?

Representative CURTIS. Your theory is based on the assumption that the money, or purchasing power, will be spent, either by the Government or in the private sector. Actually, if the private sector spent the money, it would produce the economic result; is that right?

Mr. COLM. Yes.

Representative CURTIS. Therefore, I think it is important to examine expenditure policy. In many instances, as I view expenditure policy, the Government is actually in competition with the private sector. When the Government spends money the private sector doesn't. Likewise, when the Government doesn't spend money the private sector is stimulated to spend.

You note that when the President talks about not increasing nondefense expenditures, he is not telling the full story. In table No. 2 of your statement, you adjust the President's expenditure policies in the nondefense areas by $2.6 billion. This is about the figure that I used. But I think there is an additional a $2 billion item for the Export-Import Bank in 1963 which must be considered. This is a nonrecurring item which also absorbs some of the actual increases for recurring expendiure items in the President's budget, or at least in his request for new obligational authority.

You are entirely right in assuming that, far from a cutback in Federal expenditures in nondefense areas, there has been a very handsome increase.

Therefore, do you oppose, as a basis of the tax cut for 1964, a cut in Federal expenditures?

Mr. COLM. Congressman, you are arguing on the macroeconomic basis.

Representative CURTIS. Yes, that is right.

Mr. COLM. And on the overall basis.

Representative CURTIS. That is right.

Mr. COLM. On that basis I can't follow you. If you would argue, as you sometimes do no the micro basis and tell me exactly where you would cut, we may get together.

I am not for Government expenditure per se. I, myself, was engaged for 5 years in the Budget Bureau in helping to cut agency requests, and, in a few cases, encouraging agencies to come forward with bigger programs.

Representative CURTIS. I want to discuss the micro, but I wanted to mention the aggregate, or the macro, first. Assuring your theory of a tax cut, which really shifts purchasing power from the Government to the private sector, would you agree there is a need, at the same time, to cut or equalize the purchasing power of the Government to meet this shift?

Following this question, we can get into the components. But, do you think it is out of the question to assume that we might get Government out of some of these areas and thus stimulate the private sector to spend?

I can suggest many areas in the micro field where that would occur. But do you reject that possibility in your theory?

Mr. COLM. I do not reject that possibility. Assume for a moment peace breaks out, and we could reduce the defense budget by $20 billion.

Representative CURTIS. Yes.

Mr. COLM. Nothing would please me more than that if it could be honestly done in the light of the international situation. But then we would need a tax cut much larger than the one now proposed. I am now arguing on the macro basis.

Representative CURTIS. That is right.

Mr. COLM. And I would like to see waste eliminated where it exists particularly because I am so aware of deficiencies in other fields. I think you once used the term we should think in terms of quality.

Representative CURTIS. Yes.

Mr. COLM. On the quality of our expenditure programs, and I am 100 percent with you on that.

But to argue on the macro basis, if you say we are cutting revenues by $8 billion so let's cut expenditures by $8 billion, then I would say you will probably end up with a minus figure, because expenditures by and large have a higher multiplier than taxes.

Representative CURTIS. At least we are pinpointing this because I want to examine the details. In my opinion, Congress should have been discussing expenditure policy for years, but we lack the necessary machinery.

Let me relate it particularly to the Alliance for Progress. This was supposed to be a mix of public and private investment.

The criticism directed toward it is that the Government is actually discouraging private investment specifically by savings and loan institutions.

One of the private institutions wanted to go into Argentina and discovered that the U.S. Government had previously offered money for nonprofit savings and loan firms. Of course the private sector can't compete under those conditions.

Here is an example of where the Government could cut its expenditures and have them picked up, in theory, by the private sector. At least this is a possibility that should be examined. If the Government doesn't go into public housing, to some degree the private sector will enter.

I don't know the degree. That is the area for debate. It may be necessary in all of these areas for the Federal Government to run the programs, but I doubt it.

That is why this debate is not on aggregate economics, but rather a question of who can spend the money best. Is it the political bureaucrats—and maybe they can, I am not using that as an epithet; I have high regard for our civil service people, but I use that term to describe them—or business executives and consumers?

Here is where this debate should be centered, rather than on a discussion that anyone who disagrees with the deficit financiers is ignorant, does not want to study, or is a mossback.

Incidentally, I am inserting in the record today an article that I have called "The Intellectual Arrogance," discussing those who seek to win an intellectual argument by intellectual browbeating.

Mr. COLM. I am glad you wrote it before I testified.

Representative CURTIS. No, let me say this, Doctor. You and I have discussed this before. I have a high regard for you and for your papers which are very stimulating.

Let me add that I have read your critique on the Joint Economic Committee, and have it on my desk to put in the record, if it has not already been done, because I was quite interested in the approach.

I would never accuse you of that, but at least in the political arena, the professional economist tries to win his argument by creating the impression that anyone who does not agree does not want to debate, does not want to think about it, or does not want a full discussion. If the press will look at the record, it reveals just the opposite.

President Kennedy said in his Yale speech, "Let's have a national debate on this." Some of us wanted to and still want to. Yet what opportunity has there been? Indeed, we do need a national debate, and I think some of it must be on this debt-management problem.

Most of it is going to center around expenditure policy. The President, in his economic message, made a very good analogy between frivolous and prudent spending, and I think it was very well done.

So, I say, let's take those standards. In fact, I made a speech for the record in which I said let's take those standards and see whether or not the Federal Government and private sector have been frivolous or prudent.

I think both sectors have been very frivolous and prudent.

I think the Federal Government has been very frivolous and has done some things that are very damaging. For that very reason, within this theory of maintaining consumer purchasing power, we should be able to cut back the Government purchases and hopefully substitute private spending in their stead. I don't think you do that through deficit financing.

In fact, I think deficit financing would tend to discourage private spending because of their previous notions in regard to debt. Personally, I think those notions are not too wrong in regard to debt.

Chairman DOUGLAS. I have no more questions.

Senator Proxmire?

Senator PROXMIRE. I just have one brief question, and I apologize for detaining you, but this testimony has been very helpful.

Would you not feel that the effect of a tax cut to the extent that it does simulate demand would not adversely affect our balance of payments inasmuch as people buying more would buy more imports, and inasmuch as the primary thrust, the overwhelming thrust, of this tax cut is in the personal income sector, piecemeal consumption?

Mr. COLM. Senator, this is not an instance where I would plead that we should think in terms of the complementary principle of physics. If we get more business in the United States, if we get the growth rate which we ought to have, we will have more imports.

Certainly exporters may be under less pressure to export because they have a domestic market. Therefore a more rapid rate of growth would deteriorate our balance-of-payments position.

However, I would say, on the other hand, there are more reasons in my mind why I think that a more rapid rate of growth in the long run will help our balance-of-payments position. I have two reasons for that.

One has been here expounded at great length. That is in a more prosperous economy it attracts both domestic and foreign capital. There is less incentive——

Senator PROXMIRE. Let's take that one, it attracts domestic and foreign capital, provided investment opportunities are richer and riper here than they are abroad.

Are you seriously suggesting that German investment is going to come to this country, in view of the tremendous opportunities there, the real unmet needs in Germany, the same thing for France, the same thing in Italy?

Obviously the investment opportunities in these countries, the Common Market countries certainly, probably in Britain and Japan, it seems to me are greater than they are here, and they are going to remain greater even if we do stimulate our economy considerably.

Mr. COLM. I don't expect a flood of capital imports but, Senator, we have already now Italian money in the United States. French money, probably some German.

There are affiliations, there are all kinds of reasons why, let's say, a French company wants to make use of certain facilities here, because it permits using a patent here in a more productive way.

If there is a growing market, some of this will happen. But I am emphasizing more the other aspect. We will have less incentive for investing capital abroad.

But my main emphasis is on the second point, particularly because it is less often made. If you look at American exports through history, they are the primary products: cotton, coal, and wheat, in which we have had a comparative advantage—I don't know how long it will be maintained; in manufacturing industry the United States has always had success with technologically advanced products.

I mean there were times when certain advanced pieces of farm machinery could only be had in the United States. They did not exist anywhere else. It wasn't a matter of cost as long as their use would be profitable to the foreign consumer. The same with business machines, the same in recent years with jets. If somebody wanted a jet of certain specifications, he had to go to Boeing, because there was no competitor.

My whole emphasis, not my whole emphasis but one emphasis of my approach, is that we ought to advance technology. That is one reason why we can't solve our unemployment problem by going slow on technology, because, without that, such a high-wage country simply can't exist in the world economy.

I expect from this program—viewing it in a balanced way: tax reduction, incentive, and promotion of civilian technology—I expect, from that program, advances in technology which will also support our exports.

Senator PROXMIRE. I certainly agree that we have to improve our technology and reduce our costs if we are going to compete abroad. This is fundamental.

Perhaps this should not be persuasive with us at all, but one consideration in making a tax cut is that it does tend to have a somewhat complicating adverse effect on our balance of payments. Congressman Curtis has another question.

Representative CURTIS. Yes. I want to touch, briefly, on an assumption of the macro economists that I have always felt was an error. They tend to rely on gross national product as the sole test of economy growth.

In fact, I think this is a poor test. There are so many other factors. I think we make a mistake in thinking GNP is the only one.

To demonstrate that, one good indication of healthy economic growth is increased leisure time in society. It is important to note how this is spent. Although we have increased, very rapidly, the amount of time a person spends on education, it won't show up in GNP.

Professor Simon Kuznets has said a sustained high rate of growth depends upon a continuous emergence of new inventions and innovations. I agree with that, and I think you probably do too.

Mr. Colm. Yes.

Representative Curtis. Last year McGraw-Hill estimates showed that, by 1965, 14 percent of manufactured sales would be in new products. Would you agree that this is a pretty good indication of rapid growth?

Although these figures are difficult to sustantiate, I think that is a higher percentage, because 2 years ago, 30 percent of the goods and services—and they added services there—on the market were not there 5 years before.

If we apply this same rate, I think services would be greater than the 14 percent in 2 years. This looks like increased innovation, and, therefore, real growth. Will you agree with that?

Mr. Colm. Fully.

Representative Curtis. This is what bothers me. We have this going on, and have called it a new name—automation. This is just very rapid technological growth. At the same time, though, the macro economists refer to this as a period of sluggishness, "tired blood."

I use the metaphor "growing pains." It is rapid technological growth that suggests to me that a proper diagnosis is growing pains. If that is so, we don't need the remedies for tired blood.

Mr. Colm. I agree with your emphasis that we are making technological advances, though I know, from studies made in our organization, there are many instances where opportunities are not utilized which could be utilized.

I don't think the American economy is one of "tired blood," which is a constitutional factor, but I do think that our rate of growth is inadequate for doing the job of creating employment opportunities for those who are now unemployed, for the increase in the labor force—and nobody knows these statistics as well as you do—due to the increase of influx into the labor market of young people.

Representative Curtis. I point to that figure as actual proof of what is the trouble. We want technological growth. The more rapidly we grow, the higher the incidence of obsolete skills created, particularly in the unskilled and semiskilled areas.

If this is true, though, these people will not return to work simply by increasing consumer purchasing power for demands that have changed. They lack the skills necessary to produce the new products.

For instance, we need more cotton. The cottonpicker has displaced these workers, and they are not going to be employed again in cotton.

Mr. Colm. Congressman, pardon me, we don't know how many employment opportunities we create by one additional billion dollars of GNP, because we know, on the average, it is $8,000 per employee, but the marginal figure has varied between $15,000 to $25,000.

But we do know that about $1 billion additional GNP does create about 70,000 additional jobs. It is about in that neighborhood.

Representative Curtis. Do you think that is a constant figure?

Mr. Colm. No; absolutely not.

Representative CURTIS. That tends to depend again on our micros.

Mr. COLM. I couldn't be more with you. I am trying to be short now. My criticism of these figures is, we should study much more as to why that figure has jumped from between $15,000 per additional man to $25,000. We should study each period, and we should have better tools for estimating what another situation might do.

These are absolutely micro studies. I have tried to be short. But whether it is one figure or the other, we know employment opportunities are created.

Mr. Wagner, who did the job on the urban renewal for the National Planning Association, I think, estimated that it might create something like 3 million additional job opportunities, and largely of the less skilled character.

This figure, by the way, I ask be subject to correction in the record. I have quoted now, though I have not looked at that study for a couple of years.

So, Congressman, when you speak of the waste in expenditures and when you speak of the matching of skills with demand, I am sorry I can't change our roles at this moment; but if I were sitting there and you were sitting here, I would ask you, as an expert, what portion of the Government budget do you think is waste or in competition with the private sector, what portion of the additional jobs which we would have to create within 12 months—of 6 million—are only due to lack of matching of vacancies with supply, and I think you would answer, as an expert, that both figures are substantial, but they are a relatively small percentage of the whole.

So while I am with you on your expenditure analysis, while I am with you on your emphasis on structure—and this is why I emphasized the employment service and all that at the beginning—when it comes to quantifying, I think you have an awfully good argument, but not one that explains the situation fully.

I think it is a minor part of the problem. While it is minor, it should not be overlooked. I am all for going into it.

Representative CURTIS. I wish I were a witness, because I would love to answer those questions. This is an area I consider large, and you regard as a minor part of the whole. We could resolve our differences.

But, regrettably, adequate studies are not being made. In fact, this is the first time that I have reached an agreement with one who disagrees with me. This is an area where we should dig in and find out the problems.

Senator PROXMIRE. Thank you, Mr. Curtis.

Thank you very much, Dr. Colm, for your extremely interesting and helpful testimony.

This afternoon, the committee will reconvene at 2 o'clock to hear Dr. Arthur Burns, former Chairman of the Council of Advisers, and now with the National Bureau of Economic Research.

The committee stands adjourned.

(Whereupon, at 12:25 p.m., the committee recessed, to reconvene at 2 p.m., on the same day.)

AFTERNOON SESSION

Chairman DOUGLAS. The hour now being 2 o'clock, the committee will come to order. We are very happy to welcome Dr. Arthur F. Burns, Director of the National Bureau of Economic Research, and former Chairman of the Council of Economic Advisers.

Very happy to have you with us. Will you proceed in your own way?

STATEMENT OF DR. ARTHUR F. BURNS, PROFESSOR OF ECONOMICS AT COLUMBIA UNIVERSITY AND PRESIDENT OF THE NATIONAL BUREAU OF ECONOMIC RESEARCH

Mr. BURNS. Thank you, Senator.

I would like to present a statement to the committee first, and then submit to questioning, if that is all right. I will proceed with my statement.

Chairman DOUGLAS. Yes; go ahead.

Mr. BURNS. I take it that the subject of primary concern to this committee is the fiscal policy that may serve our Nation best at this juncture of history. Before turning to the fiscal problem, I should like to comment briefly on the state of the Nation's economy and on the forces that have brought us where we now are.

In considering the state of our economy, it is well to keep in mind the progress that has been achieved since the end of the recession of 1960–61.

The flow of dollar incomes to individuals has steadily advanced and is now over 11 percent above the level of February 1961. The physical volume of total output has risen 10 percent. Employment in nonagricultural establishments has increased by a little over 2 million, and the overall unemployment rate has declined from nearly 7 percent to about 5¾ percent.

These improvements have brought economic activity to the highest level of our Nation's history. According to the latest statistics, total employment is close to a record-high level. Total output is larger than ever. The same is true of personal income and consumer spending. Indeed, both the income and the spending of the average American are at a record level even after full allowance is made for the higher taxes and higher prices that he has to pay.

Clearly, our Nation, viewed as a whole, is enjoying prosperity and abundance. This does not mean that we do not face serious economic problems. Of course, we do, and they require the closest attention of your committee.

In the first place, our prosperity is unevenly distributed. Some industries—notably agriculture, railroads, airlines, steel, and various branches of the machinery and building trades—are depressed. There are numerous pockets of substantial unemployment in different parts of the country. And while many men are working overtime or at extra jobs, many others are totally or partially unemployed.

Not only is our prosperity unevenly distributed, but the growth of total production in the course of the recent recovery has fallen somewhat short of the average pace of past economic recoveries. This of itself would not be disturbing. However, taken together with the excess unemployment which still existed at the business-cycle peak of 1960, it accounts for the fact that we now have an unemployment rate which, it will be generally admitted, is too high.

Moreover, the pace of economic expansion has slowed down sharply during the past 6 to 9 months. Indeed, the FRB index of industrial production has not risen at all during recent months.

This brings me to the critical question: Why has the present recovery failed to meet reasonable expectations? What is it that has gone wrong?

On a statistical level, the main answer to this question appears to be quite simple—namely, business investment in new capital goods has failed to rise with any vigor. Evidence on this point is plain and decisive.

In the last quarter of 1962, the gross national product, expressed as an annual rate, was $562 billion—or nearly $120 billion higher than in 1957. However, despite this rise in GNP, business expenditures on plant and equipment in the second quarter of last year were merely at the 1957 rate. At present, they are not much higher.

In the course of this recovery, between the second quarter of 1961 and the fourth quarter of 1962, plant and equipment expenditures increased about 14 percent. This rate of increase is about the same as occurred during the corresponding phase of the recovery of 1958–60, but it is much lower than the increase during comparable periods of the earlier economic recoveries of the postwar period.

As these facts indicate, business capital investment has recently been a weak link in the chain of economic recovery. This, more than anything else, explains what has gone wrong in our economy.

Moreover, there is as yet no satisfactory evidence that business investment will soon improve appreciably. Taken together, the various anticipatory series—such as orders for machinery and equipment, contracts for commercial and industrial construction, and estimates of planned outlays on plant and equipment—suggest sluggishness or, at best, only small improvement of business investment in the months immediately ahead.

This unsatisfactory record of investment calls for appraisal. It is important to inquire into the causes of the lag in business capital expenditures.

One factor often stressed is that American industry was burdened with a considerable volume of excess capacity when the recovery started and that this condition continues to exist.

I do not think that this factor is of decisive significance. Excess capacity always develops in the course of a recession, but this fact has never prevented a rapid increase of capital investment when a resurgence of business confidence ushered in economic recovery.

The historical record indicates that, even after prolonged or severe depressions, when excess capacity was, of course, very much larger than in 1961, capital investment has typically rebounded sharply. For example, the depression of the 1870's reached bottom in 1878; the next year, business capital investment rose 24 percent. The depression of the 1880's reached bottom in 1885; the next year, business capital investment rose 34 percent.

Again, business investment in 1922 was 24 percent above the level of 1921, and business investment in 1934 was 31 percent above the level of 1933.

These are not isolated examples. On the contrary, they express what is a normal feature of the early stage of a business-cycle expansion. Despite the excess capacity that emerges in the course of a recession or depression, upon the return of confidence, new firms are established and they undertake new investments, many of the older firms that had done well despite the slump proceed to enlarge their capacity, others build and equip new plants in anticipation of demand, still others undertake programs of modernization, and so on.

In short, the existence of overcapacity in many lines at present cannot be denied. We should not, however, assign causal primacy to this fact. In order to understand why business investment has, of late, been sluggish, the essential point that needs to be clarified is why business expectations with regard to the future have been characterized by uncertainty and hesitation.

It is impossible to speak on this subject with the precision of science. I believe, however, that the following factors have been of some importance.

First, notwithstanding all the theorizing to the contrary, the consumer remains a fickle creature. Despite a sharp rise of incomes, there was very little increase in retail sales between February and September of 1961. Since then, and indeed up to the present, retail sales have risen quite briskly. However, the sluggishness of consumer buying in the early stages of the recovery was an obstacle to improvement of business sentiment.

Second, wholesale prices have failed to rise during the recent recovery. Many factors account for this—among them, the existence of ample industrial capacity, intensified foreign competition in our markets, the moderate pace of our domestic expansion, the recent slowdown in economic expansion abroad, also our Government's vigilance and pressure. But whatever the causes may be, a stable or slightly sagging level of wholesale prices is very unusual for a business-cycle expansion. This factor, combined with the tendency of labor costs to rise, has undoubtedly served to chill business sentiment.

Third, the coming of a new administration raised questions in the minds of many businessmen about the future, and some deemed it prudent to postpone investment commitments until governmental policies clarified. Rightly or wrongly, not a few businessmen felt that the new administration was inclined to pursue inflationary policies which sooner or later might lead to price controls. The Government's action last spring with regard to the price of steel was widely interpreted as confirmation of this fear. Later governmental pronouncements and constructive actions, especially the new depreciation guidelines by the Treasury, did a great deal to restore confidence. Nevertheless, some hesitation and uncertainty have continued to characterize the thinking of a large segment of the business community.

To summarize, the sluggishness of consumer buying before October 1961, the failure of wholesale prices to rise in the course of economic recovery, and uncertainty with regard to the trend of governmental policy help to explain the lack of vigor in recent capital expenditures.

However, there are grounds for believing that the causes of the uncertainty that has gripped the business community go deeper, that they are connected not only with events and developments of the past year or two but also with developments of a more lasting character.

One of these disturbing developments is the deficit in our balance of international payments, which has persisted for about a dozen years now.

Although the balance-of-payments deficit has been reduced during the past 2 years, it has remained large. Gold has therefore continued to flow abroad, while short-term dollar liabilities to foreigners have continued to pile up. The failure to arrest these trends has made many businessmen and financiers uneasy about the future of the dollar.

A second development that has caused uneasiness in the business community is the declining tendency of profit margins.

At the business-cycle peak of 1948, corporate profits—before taxes—accounted for 22.6 cents of every dollar of the net output by corporations. This figure fell to 20.5 cents at the peak of the next business cycle, in 1953, then to 18.0 cents at the business-cycle peak in 1957, to 17.5 cents at the peak in 1960, and to 17.4 cents in the first half of last year.

Senator PROXMIRE. What figure is that? This figure you are giving me now, what figure?

Mr. BURNS. It is the percentage ratio of corporate profits before taxes to the net output of corporations.

Senator PROXMIRE. Thank you.

Mr. BURNS. Actually, the deterioration of profits has been even larger than these figures suggest, since—as you well know—the tax rate on corporate profits is now substantially higher than it was in 1948.

American businessmen are habitually optimistic. They tend to shrug off disappointments and to hope against hope. But the persistence of an unsatisfactory trend of profits is eventually bound to have some influence on the behavior of investors. That is especially the case when they are otherwise troubled—as many seem to have been—by what they regard, whether justly or not, as an uncertain or somewhat unfavorable climate for business enterprise.

The decline in the share of profits in the dollar value of corporate output means, of course, that other income shares have risen. The principal claimants of whom this is true are labor and the Government. This is the essence of the persistent cost-price squeeze.

The conclusion to which my diagnosis of the state of our economy leads me, therefore, is that besides the short-run developments on which I have already commented, two longer range factors have served to restrain business and investor confidence in the future of our economy. They are the protracted erosion of profits and the persisting uncertainty about the dollar.

Fiscal policy alone cannot solve these problems. A wise fiscal policy can help, however, to reduce the obstacles to investment. It is high time that we did something about our obsolete tax system.

The United States is still functioning under the system of taxation that grew up during the great depression and which became still more onerous under wartime conditions.

During the 1930's the main impulse of Federal tax policy was to redistribute income and stimulate consumption. We proceeded on the theory that opportunities for business investment were very limited and that they would remain so. In the light of this theory, corporate taxes were raised and the progressivity of the individual income tax was sharply increased.

During World War II still higher tax rates became unavoidable. The deliberate purpose of national economic policy then was to restrict both consumption and private investment, so as to release the vast resources needed to prosecute the war. Various revisions of tax rates occurred later, the major changes being moderate reductions in 1946 and 1948, a renewed rise during the Korean hostilities, and some reduction in 1954.

However, the general level of personal income taxes is now only a little lower than during World War II. The rate of progression still rises steeply, and for very high incomes the marginal tax rate is still virtually confiscatory. The basic tax rate on corporate profits is even higher than it was in 1945. It was 40 percent then and is 52 percent now.

Nor is this the entire story. State and local taxes have also risen sharply.

The consequence has been that taxes have grown steadily in relation to the Nation's output. In 1929, the combined revenues of the Federal, State and local governments accounted for 10.8 percent of the dollar value of the gross national product. This figure rose to 16.9 percent in 1939, to 24.3 percent in 1946, to 26.1 percent in 1956, and to 28.6 percent in 1962.

When we allow for depreciation of private capital, as we should in order to approximate a true measure of output, we find that total governmental revenues were actually 31.3 percent of the Nation's output in 1962. If we could make allowance for the depreciation of public capital, the revenue percentage would be still higher. In other words, tax payments at present are almost a third, if not fully a third, of the dollar value of the Nation's total output.

Not only is our tax burden large, but the high rates of taxation on individual incomes, especially in the upper brackets, and on corporate profits serve to blunt economic incentives. A tax system that may have had merit under wartime conditions is poorly suited to present conditions when our Nation's great economic need is to stimulate enterprise, innovation, and investment.

The case for tax reduction therefore appears very strong to me. I entirely agree with the President that our income taxes are a drag on the economy. I agree also that a substantial reduction of income taxes is needed, that the reduction should apply both to individuals and to corporations, and that it would be wise to spread the reduction over several years.

These principles are sound and I endorse them. At the same time, and I say this with great regret, I have serious doubts about the specific fiscal recommendations that have been placed before the Congress.

In the first place, the administration seeks to reduce sharply the effective tax rate on individuals in the lower income brackets, while only modest reductions are recommended for the top brackets when account is taken of the proposed treatment of deductions. As far as

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corporations are concerned, if the administration's proposals were adopted, several years will elapse before a corporation with a given income in excess of $25,000 would pay appreciably less than at present.

These proposals would be justified if our primary economic need now were to stimulate consumption. That, however, is not the case. The economy is not suffering from sluggishness in consumer expenditure or from any deficiency in consumer buying power. Consumer spending, as I indicated earlier, has been rising quite briskly. At the same time, the liquid assets of consumers have been rising at an extraordinary pace.

The weakness of our economy is in the sphere of capital investment. Given enough time, the expansion of consumer spending will no doubt serve to stimulate investment spending. This, however, is a slow and roundabout method of getting the larger investment that we need in order to enlarge employment and improve efficiency.

My second doubt with regard to the President's proposal centers on the financial implications of a tax reduction of $10 billion in the face of rising expenditures. It is important to grasp the financial magnitudes implied by the President's proposal. Whether one agrees or disagrees with the proposal, it is essential to have some understanding of the financial arithmetic that it involves.

The trend of Government expenditure has been rising and rising rapidly. Federal budget expenditures alone, which omit outlays from trust funds, are scheduled to go up $6.5 billion this fiscal year. The increase last year was $6.3 billion. The average increase since 1957 has been a little over $4 billion per year. The increase projected for fiscal year 1964 is $4.5 billion. The new obligational authority requested for fiscal year 1964 exceeds the estimated expenditure by $9 billion. Clearly, there is no indication here that Federal expenditures will soon stop increasing or even that the rate of increase of expenditures will soon decline.

Let us assume, therefore, that Federal budget expenditures will continue rising and that the rise will be $5 billion per year. In saying this, I do not mean to assert that this will take place. My aim is to show what would be likely to happen to the budget if the President's tax program were adopted while expenditures continued along the recent trend.

It is necessary, of course, to make some assumption also with regard to the rate of growth of the gross national product. Let us say that the dollar value of the gross national product will rise at an annual rate of 6 percent, starting his calendar year. I doubt if many would want to argue that this is a niggardly or pessimistic assumption about economic growth.

Fiscal projections are notoriously uncertain, the more so as they are extended into a remote future. I may point out, however, that if the Federal budget is projected on the stated assumptions, it appears that the budget would not be in balance before 1972 and that the public debt meanwhile would rise about $75 billion above its level at the end of this fiscal year.

Estimates made on the assumption of lower growth rates become so staggering that I prefer not to present them.

My purpose in going as far as I have is to emphasize the general conclusion to which the arithmetic inescapably points, namely, that unless the rising trend of Federal expenditures is halted or sharply curbed, the adoption of the recommended tax proposal is likely to involve our Nation in budget deficits over many years and on a very substantial scale. We are not dealing here with a proposal for a temporary deficit.

If the Congress sanctions long-range budget deficits, it will be adopting a novel concept for our country. This concept marks a departure not only from the old-fashioned theory that the budget should be balanced every year, but also from the modern theory that the Federal budget should be balanced over a business cycle or over a few years.

It is possible that if the new theory were tried out that the result would work out well. I cannot be categorical on this point. In my judgment, however, the risk of failure is too large to justify acceptance of the theory.

I believe that the danger of inflation and the risk of devaluation of the dollar are being understated these days. Let me mention only the fact that liquid assets held by the public have recently risen sharply. The increase was $25 billion in 1961 and $34 billion in 1962, in contrast to an average annual increase from 1955 to 1960 of only $13 billion.

It takes time before an increase in the supply of money or of liquid assets has an effect on the price level, but if experience is any guide the effect will eventually be felt. I seriously doubt if we could have a protracted and substantial increase of the Federal debt without exposing our currency——

Representative REUSS. Could I interrupt and ask you if you would repeat for us the figures you just gave?

Mr. BURNS. Yes. I gave figures on the increase in liquid asset holdings by the public and I pointed out that between 1955 and 1960 the average annual increase was $13 billion, in the year 1961 the increase was $25 billion, and in 1962 the increase was $34 billion.

Senator MILLER. Is that billion or million?

Mr. BURNS. Billion.

Let me resume, if I may.

I seriously doubt if we could have a protracted and substantial increase of the Federal debt without exposing our currency, and with it our economy and international political prestige, to a very grave risk.

Nor is inflation or its speculative anticipation the only danger of a policy of long-range deficits. A nation's mood can change suddenly. A series of large deficits in times when the economy is advancing may cause a revulsion of feeling and later paralyze the Government's ability to deal with a recession.

In view of these dangers, I find it impossible to endorse the administration's fiscal recommendations as they stand.

I do believe, however, that there is great merit in the President's plea to the Congress to reduce the heavy drag of Federal income taxes on private initiative and incentive. Also, a large consensus has emerged in our Nation on the need to reduce both individual and corporate income tax rates. I hope, therefore, that this committee will seek ways of modifying the President's fiscal proposals so that they can better promote the purpose he seeks to achieve.

My advice to the committee consists of four points. First, I suggest acceptance of tax reduction of the order of magnitude recommend by the President. If the tax cut were much smaller, it would be unlikely to provide the stimulus that our economy needs.

Second, I suggest acceptance of the general principle of spreading the tax reduction over several years. This is the prudent course in present circumstances.

Third, I suggest modification of the President's specific tax proposals so that they may provide a stronger stimulus to investment.

Fourth, I suggest that Federal expenditures be kept for a time at. or preferably below, this fiscal year's level.

If the Congress followed this general plan, deficits would still be likely for several years. However, long-range deficits would be avoided.

I realize that many Members of the Congress may find my suggestion with regard to Federal expenditure unacceptable. In that event, I would suggest that the Congress give serious consideration to raising new funds through a sales tax or some other form of indirect taxation.

These suggestions are based on my conviction that a healthy rate of growth of our economy requires substantial reduction in income taxes. We can and should carry out this reform without subjecting our Nation to the risk of long-range deficits.

Other countries of the world—Japan and the nations of Western Europe—have kept redesigning their tax system throughout the postwar period in the interest of stimulating investment. It is high time that we did the same and on a substantial scale.

Whether we like it or not, financial incentives are a powerful force in economic life. Even countries like Sweden and Yugoslavia, which have social systems that differ from our own, have recently revised their tax laws so as to give greater recognition to this fact of human nature. I do not think the United States can afford to act otherwise.

This, gentlemen of the committee, is my statement. I want to thank you for your patience, and I now turn to your questions.

Representative Reuss (presiding). Thank you, Dr. Burns.

Senator Douglas, who was particularly interested in your testimony, has what seems to be a touch of the flu this afternoon.

Mr. Burns. I'm sorry——

Representative Reuss. So he may not be back. At least I urged him to take care of himself, though he very much wanted to come back.

I have some questions which may be covered by questions my colleagues will ask. I will start with Senator Proxmire.

Senator Proxmire. Dr. Burns, it is very refreshing to get testimony which contradicts the overwhelming support for the administration's viewpoint which previous witnesses have professed. I think you have analyzed this most impressively and I am happy to hear a renowned economist who feels that we can achieve our economic goals without increasing our deficit.

I would like to press you on that particular point because it seems to me that that is the crux of your difference with the many people who have testified before who are also very capable.

Isn't it true, Dr. Burns, that if we maintain the—if we, say, adopt the President's tax cut recommendations generally, but maintain spending at the present level, that is, at the 1963 level, which is $4½ billion less than the President recommended that the impact on the economy would not be as stimulative, would not provoke growth to the extent that the administration's proposal would?

I am hopeful that your answer is going to be that it would be at least as stimulative, but I am not so sure from your remarks that I have yet gotten the documentation to refute other arguments.

Mr. BURNS. Senator, let us make the assumption that the Government adopts a fiscal policy with a view to stimulating the economy and that this fiscal policy involves incurring deliberately a budget deficit of some size.

Let us say that the planned budget deficit is $10 billion. This deficit can be realized in different ways.

Plan A, let us say, involves increasing Federal expenditures by $10 billion.

Plan B involves, let us say, increasing expenditures by $5 billion, and also cutting taxes by $5 billion.

Plan C involves, let us say, a cut in taxes of $10 billion.

Now let us contrast these three plans.

The theory which is now fashionable among economists is that the first of these plans would be most stimulative. The reasoning is that if the Government undertakes to increase the deficit by spending $10 billion, that much purchasing power will be promptly added to the economy. Those who take this viewpoint will go on to argue that if, on the other hand, taxes are cut by $10 billion, a portion of that sum will be saved by individuals or by business firms. In other words, the deficit of $10 billion created through a tax reduction will lead to an increase in the community's spending of something less than $10 billion.

It follows that plan A is the most stimulative on this line of thinking, that plan B is somewhat less stimulative, and that plan C is still less stimulative.

I disagree with this theory. The difficulty with it is that the theory lays exclusive stress on the direct flow of dollars to individuals or businesses, on the cash flow effect. The theory ignores entirely the effect on the thinking of individuals and business firms about their future and therefore misses what may be most important about a tax reduction. The reason why I think that plan C, to return to my example, is more stimulative than plan A is that under plan C individuals and businessmen will begin thinking very differently about the future. They will be in a position not merely to use the larger cash income which is at their disposal, but they may well be in a mood also to dip into their accumulated assets and to use their credit.

Now, the important objective of fiscal policy at a time like the present should be to stimulate individuals to use their brains, their energy, their disposable income, and also their assets and even their borrowing power in the interest of enlarging their economic activities and through that the Nation's economy. Plan C, especially when so designed as to stimulate investment, will do this.

My theory, therefore, Senator, is different from the theory that has now become so familiar.

Senator PROXMIRE. That is a very impressive answer. You emphasize the crucial importance in a free enterprise system of the psychology of the business investor and of the consumer.

Mr. Burns. That is correct.

Senator Proxmire. No matter what the Government does, it is, as long as we have a free society, its actions are bound to be less significant than the actions of the private individual.

Now, I would like to ask you how you answer this problem. Many people argue, and I presume that you would agree, that a nagging problem we have in unemployment is the fact that we have—one case of unemployment is that we have people who are unskilled or whose skills have become outdated because of technological progress. Farmers, even steelworkers and automobile workers. Certainly miners. Many others. We have people who have inadequate education. We have areas of the country, in West Virginia, Pennsylvania, northern Wisconsin, southern Illinois, where unemployment is very heavy.

Now, all of this suggests that we concentrate on direct Government action, to provide capital investment and training, to do all we can here to put people directly to work.

On the other hand, if we do emphasize this, it seems to me we fall into the trap which you have discussed of diminishing the confidence that businessmen and investors may have in the future because we do increase Government spending and in doing so we tend to aggravate the deficit.

Now, how about this? Do you feel it is possible by scrutinizing our spending programs to reduce old programs and concentrate on new programs? Or do you feel that the Federal Government at least should not emphasize these programs?

Mr. Burns. Senator, I think that we have a serious problem in dealing with unemployment. One of the finest things that this Congress has done is to pass legislation providing for enlarged training programs for individuals, especially those who are out of jobs. I believe, Senator, that our educational system is obsolete. We spend a great deal of money on education at the present time in our localities and the Federal Government is making a substantial contribution. Our tendency, and I speak as a professional educator, always is, when a new educational need is pointed out, to spend more money. Very often, I will grant, that is the only way of accomplishing the desired objective.

But I submit that there is great waste in our educational plant throughout the country. I submit that vocational education has been sadly neglected in many of our communities. I submit that we are spoiling the lives of many children by emphasizing college education as if that were the only way that an individual could become a decent and useful citizen.

The fact of the matter is that our youngsters vary in their abilities. They vary in their interests. Some individuals are psychologically disturbed. Not everyone can even go through high school. And yet these individuals who are unable to climb up our competitive educational ladder are often told in effect by their parents and by their teachers that life will hold out little for them. The dignity of skilled labor, to say nothing of unskilled work, is not estimated highly in our society. Many of the youths who leave school, who might in the right environment have become good craftsmen, are depressed and see no future. They may not even take a job that is readily available to them.

I think that there are serious problems that face our country in this whole area. I dont' think spending more money is by any means the whole answer to these problems.

We have got to do some pretty basic rethinking and replanning. If necessary, let us spend more money as well. I know of nothing that is more important than giving our young people who are growing up the opportunity to lead useful lives and to have good jobs. But greater Federal spending is only a part of the answer. I think other things are more fundamental.

Senator PROXMIRE. Thank you.

Representative REUSS. Mr. Widnall.

Representative WIDNALL. Dr. Burns, I am very interested in what you have just been saying and would like to make this comment. I think that we have been guilty of repressing the activities of some people who aren't qualified for college by setting up too many standards as to what an employee must have in order to be interviewed.

Businesses do this. They won't even look at a man unless he has a college education in many instances. He may have very superior qualities that they could use in their business. Government does it through civil service standards where you can't file or be qualified unless you have had certain educational requirements.

Commonsense, "stick-to-itiveness," they are not evaluated at all today in job qualifications.

I think that we have placed our standards too high for many jobs. We are not taking into consideration the native ability of a person to apply himself if he is interested in a particular field.

Mr. BURNS. As a matter of fact, if I may make an observation here, one of the great industrialists of this country told me recently that his company is now hiring Ph. D.'s and insists on having Ph. D.'s for jobs that used to be handled marvelously by simple A.B.'s, and that could still be handled well by simple A.B.'s.

Representative WIDNALL. I think there is obviously a loss in that direction.

You mentioned that we have had abnormal increases in liquid assets in 1961–62. To what do you attribute this abnormal increase?

Mr. BURNS. We had a very large increase in bank credit. Loans and investments of our commercial banks rose sharply because of the relatively easy credit policy that we have pursued. I think that is the fundamental reason. It is not the only reason, but it is the most important one.

Representative WIDNALL. So that in that field you possibly think there should be a more restrictive approach to credit?

Mr. BURNS. No; I do not. I think that our credit policy up to now has been on the whole quite sound. I made, however, a cautionary remark with regard to the future. That was the purpose of citing those statistics.

Representative WIDNALL. That is all.

Representative REUSS. We would like to welcome Senator Jordan and Congressman Clausen here this afternoon. We are very happy to have you sit here with us.

Dr. Burns, if I heard you correctly, you told us that according to your calculations the long run effects of the President's tax reduction program, coupled with an assumed increase in Federal spending in succeeding fiscal years, the budget would first be balanced in 1972. I wonder if you would be good enough to file with the committee, so that we may have the benefit of your studies, your calculations leading to that projection?

Mr. BURNS. I can tell you the essentials now.

The calculation I reported to the committee assumes, first, that expenditures will increase at an annual rate of $5 billion. This has been the recent trend.

It assumes, second, that the dollar value of the gross national product will rise at an annual rate of 6 percent, which, if I may now say so, is a little romantic.

Third, it assumes that for every additional dollar of gross national product, Federal budget receipts will go up by 16 cents.

Representative REUSS. Those are the——

Mr. BURNS. Those are the critical assumptions. After that, the calculating machine will grind out the figure that I recited. Of course, I must stress again the conjectural character of these calculations. However, I also want to note that my calculations are made on conservative assumptions in terms of the deficit to which they point.

My purpose in reciting that figure of $75 billion, and you may have noticed that I omitted the staggering figures that would follow if the assumed rate of growth were less than 6 percent, was to indicate that a continuation of the recent expenditure trend, if taken together with the President's tax proposals, poses the serious problem of long-range deficits.

We are not involved here, we are not discussing here, a temporary or transitional deficit if the expenditure trend continues.

Representative REUSS. Can you shed a little more light on that 16 percent tax take figure? That sounds rather small to me, and if it is small, then, of course, we would achieve budget balance before 1972.

Mr. BURNS. You might be right. I would suggest that my calculation be checked by your committee. I would suggest that the Treasury be asked to submit estimates of its own.

Let me tell you a little about that specific calculation. The first thing that I did in trying to arrive at the link between budget receipts and the gross national product was to determine the mathematical relationship between these two variables since calendar year 1954. When I did that, I found that for every dollar increase in the gross national product, the increase in budget receipts was only 12½ cents. That troubled me. I therefore proceeded to abandon that calculation, and what I use now, in effect, is the average ratio of Federal budget receipts to the gross national product since 1954. That is how I get 16 percent.

But to repeat, the calculation of budgetary prospects is very sensitive to this percentage factor. My calculation I must say is awfully rough and perhaps it should be refined. I did try to take into account the results of the earlier Mills plan. I also tried to take into account the shift of gasoline and other revenues in the late 1950's to the trust accounts. However, these factors would not change the calculation or they would make the marginal relationship of Federal budget receipts to the gross national product a little smaller than the 16 percent figure that I used.

Representative REUSS. Your central advice to the Joint Economic Committee, as I understand it, is to accept the general dimensions of the President's tax cutting proposal in their budgetary impact, at least, but to keep the expenditure side to about what it was in the current fiscal 1963 year.

Mr. BURNS. I would prefer to see budget expenditures reduced. However, even stabilization at the current rate would be very helpful. I would also urge the committee to consider carefully the precise structure of the President's tax recommendations.

Representative REUSS. May I interrupt you at that point because I want to come to the internal structure in a moment.

Mr. BURNS. Very well.

Representative REUSS. Right now I was interested in net loss in revenues.

Mr. BURNS. Right.

Representative REUSS. The adoption of your advice would result in a budget deficit in the upcoming fiscal year on the order of $7 or $8 billion rather than on the order of $12 billion. Is that about it?

Mr. BURNS. That is correct.

Representative REUSS. Do you have any suggestions as to where would be the best place to cut the $4 or $5 billion in the current budget?

The big area of increase of some $4 billion plus was in defense and space expenditures. We can't do much about the carrying charges on the national debt. I agree with your observations about the economic benefits of generally low interest rates, and to the extent that they are held to lower levels, interest costs are lower. But how would you cut the budget by $4 or $5 billion?

Mr. BURNS. Congressman, I don't want to duck your question. Please don't misinterpret me, but I do want to say this. If it were the will of the Congress that expenditures not go above their present level, and if the President turned to his Budget Director and instructed him to find ways of revising the budget for fiscal 1964 so that items of lowest priority could be whittled down, that problem would be handled.

Now, my specific ideas on expenditures may or may not recommend themselves to you. You and I would soon get into a hassle as to what is an item of high priority or low priority. I am not ducking your question but I do want to point this out.

Representative REUSS. I think that is a fair answer and I accept it.

Mr. BURNS. The procedure for cutting expenditure I described is the way to do it. But if you still want me to answer your question and tell you what I as a citizen happen to think, subject to reconsideration after you and others point out to me the error of my ways, I am quite willing now to proceed and answer your question.

Representative REUSS. Well, I wish you would, although my purpose is not to get into, as you say, a hassle with you. I do want to hear your views on this. Would you tell us your views as a citizen?

Mr. BURNS. Well, I would say that, first of all, while I am eager to see space exploration advanced, and if I were younger I would even like to take a trip to the moon myself, I still must say in all sincerity that from the viewpoint of science and from the viewpoint of getting this busy world's work done, we do not need to push our space program on anything like the present scale. I don't think we ought to stop the program. I don't even think we can stop it. Something new and vital has happened. Man wants to explore the widening universe and I think that government should encourage him to do so. But we surely do not need to spend money on the space program on the scale that we are doing.

We are proceeding on a theory that it is important to get to the moon before the Russians do. I say to you, Mr. Congressman, we may spend this vast sum of money and be second to the moon after all. As far as I am concerned, that would not necessarily be a disaster.

That is one possible area for saving.

Then again, as you know, we are spending vast sums on agricultural programs and I think it is scandalous that we continue doing so. There are billions to be saved in that area and I do hope that not many years will pass before Congress finally faces up to this problem.

I think there are savings to be made in our veterans' programs. In fact, I think that every one of our programs, if looked at carefully with an eye to economy, will yield dollar savings.

The budgetary process in government, as I have observed it over the years, and the same is often true of business firms and of educational institutions, is something like this. A fellow comes in with a budgetary request. Usually he asks for more money than the year before. Then he is questioned about the increase that he is recommending and he is asked to justify the increase. He is hardly ever asked to justify the amount that he is already spending.

Representative REUSS. Thank you very much.

Senator Miller?

Senator MILLER. Mr. Burns, I apologize that I came in late. But let me assure you that while it has been my observation that the numbers of previous witnesses have overwhelmingly been in favor of the administration's position, the logic and the reasons presented are not necessarily overwhelming. So I trust you will not be deterred in presenting your views before this committee.

Now, I would like to start out by laying a foundation with respect to your economic philosophy. You have on the table before you, I think, a copy of the Economic Indicators for January 1963, and you will recall that on page 2 of the Economic Indicators, are reflected some statistics with respect to gross national product.

I find that gross national product from the end of 1960 through September of last year, or for you might say the first seven quarters in the last 2 years, increased by some $51.9 billion. However, in the column next to that is a reflection of the increase in gross national product on 1961 prices.

I wish the prices were reflected on the basis of December 30, 1960, but they are not.

However, the difference is not tremendous.

Nevertheless, when you use 1961 prices we find an increase in gross national product of only $37.7 billion, and I am advised that the difference of $14.2 billion during the seven quarters is inflation.

Projected out through eight full quarters it would be about $16 billion or about $8 billion a year in what some people refer to as inflation taxation.

Well, if it is an inflation tax of $8 billion a year, that is about 12 percent of our annual tax take.

Now, over on page 35 of the Economic Indicators we find the increase in the national debt for this period of time about $18 billion. So it appears to me that, on the basis of the figures which the President's Council of Economic Advisers has given this committee, we have gone deeper into debt by $18 billion and we have inflation of about $16 billion.

Now, in view of that is there not some relationship, perhaps not precise, but is there not some relationship between an increase in the national debt and a reduction in the purchasing power of the people's money?

Mr. BURNS. I do not believe, Senator, that there is a close relationship between the increase in the public debt and changes in the price level over short periods of time. On a year-by-year basis, over 2-year intervals, the relationship is highly irregular. I would not interpret the figures that you presented in the way that you did. I would say, however, that if the public debt rises and rises substantially over a protracted period, then a significant influence on the price level is virtually bound to occur.

Such an increase is virtually certain to lead to a substantial increase in the money supply which, after a while, will work its way through the system and serve to raise prices.

Senator MILLER. Now, another question. If we have a tax cut for fiscal 1964 of approximately $3 billion net, because what is being proposed——

Mr. BURNS. I think the figure is, if you will excuse me, $4 billion.

Senator MILLER. Well, may I suggest that we did go into this with Mr. Dillon. I believe he used the figure of $2.9 billion net. But in any event, whether it is $2.9 billion or $4 billion doesn't matter for the purpose of my question. It seems to me that on the one hand we are giving the people what we say will be increased purchasing power of about $2 billion to $4 billion, but on the other hand we are holding out to them a budget deficit of $12 billion, which to me implies sooner or later, and of course no one knows whether it is sooner or later, but in your view I take it that it will certainly be some time and in the view of the Economic Indicators for the last 2 years it might be very soon—it looks like we are going to have on the other hand a reduction in their purchasing power of perhaps $8 billion or $9 billion.

Now, if this happens, aren't we going to be worse off from the standpoint of our economy than we are right now?

Mr. BURNS. I understand your general position. I must disagree with what you have stated if I have understood you correctly.

I do not believe that the budget deficit which the President has proposed for the coming fiscal year will in and of itself necessarily prove inflationary. Moreover, I believe that our economy will continue expanding. While a rise in the price level will make the actual increase of incomes lower than it appears to be, we are still likely to have an improvement in individual incomes in this country.

What concerns me about the President's proposal is not so much the large deficit that he is proposing for the coming fiscal year but that the program that he has presented has built into it deficits for a long period ahead. That is the central difficulty.

I am quite willing to take the risks, and I will grant you that risks are taken, with a short-range deficit. Even if we stabilize expenditures at the present level and even if we have a favorable rate of growth, it will not be before 1966 or 1967 that we have a balanced budget again.

I for one, reluctantly to be sure, am willing to take that risk but I am not wiling to face the prospect of deficits for the next 10 years or longer with a huge piling up of the Federal debt. Unhappily, that is the fiscal arithmetic of the President's proposal. And that is the essential point that I tried to put before the committee.

Senator MILLER. Now, if we were here in this room a year from now, and the President's program had gone into effect, or let us say 18 months from now we were here, and we had on the one hand demonstrable figures that tax cuts of about $3 billion or $4 billion had been extended to the people and they had enjoyed them, but that the Economic Indicators put out by the President's Council of Economic Advisers showed that during this period there had in effect been an inflation in the GNP of $8 billion, would you at this point think we were better or worse off than we are at this time?

Mr. BURNS. I cannot answer that question. What I will think a year from now will depend on all sorts of things that will happen here in the next year. Your question is hypothetical. I see, however, your purpose. And I must say that if taxes were reduced and if our economy did not rebound, I would be seriously concerned.

I believe, however, that the reduction of incomes taxes is long overdue and that such a reduction is likely, provided we control expenditures, to stimulate the growth of our economy.

I would like to be able to say to you that this will inevitably happen. I cannot say that, but I can say that this is very likely to happen and this outcome is much to be sought.

Senator MILLER. Thank you, Doctor.

Representative REUSS. Mr. Curtis?

Representative CURTIS. First, let me personally welcome Dr. Burns and say how happy I am to have such a distinguished scholar insert in the record a point of view in basic contrast to those expressed before.

In your estimates of the balanced budget for 1972, projecting this deficit financing theory, will that be a year of full employment and full use of plant capacity, which is part of the base of the President's economic theory? Or is this just a budget balance?

Mr. BURNS. I stated earlier, Congressman, the assumptions that underlie this calculation. I assumed a certain rate of growth. I assumed a certain rate of increase in expenditure and I assumed a certain relationship between budget receipts and the gross national product.

Now, the rate of growth of the gross national product that I assumed is 6 percent. If we were fortunate enough to escape inflation on a large scale; if, let us say, the price level rose merely 1 or 2 percent then it would be very fair to interpret the figure that I presented for 1972 as applying to a year of very full employment.

Representative CURTIS. Yes, this full employment theory is predicated upon a 4-percent unemployment figure. As I understand the deficit financing theory advanced by Dr. Heller and others, they believe in balanced budgets, but not as we do. In their theory, deficit financing at a period of recession would be recouped in a period of uprise, measured by gross national product. They expect a balanced budget at the time of full employment. Are you familiar with this?

As I view the model presented by Dr. Heller, even under their theory, they will not reach full employment and full plant capacity in 1964 based on this budget. Have you reviewed this?

Mr. BURNS. That is my understanding of it; yes.

Representative CURTIS. Therefore, there must be some other reason behind this theory that they haven't forthrightly presented. I am quite interested in your——

Mr. BURNS. Let me qualify what I said a moment ago. As I read the report by the Council of Economic Advisers, the expectation is that full employment will not be reached this calendar year 1963.

Representative CURTIS. Or 1964.

Mr. BURNS. I am uncertain about 1964, and that is why I—I do not recall the Council saying anything definite about 1964.

Representative CURTIS. I think the testimony——

Mr. BURNS. That is why I wanted to qualify my answer.

Representative CURTIS. I think we should be careful. The testimony will reveal that we cannot count on that, but, on the other hand, let the record clear that issue.

Have you calculated the debt in this model you presented? I guess not, if it is limited to the assumption you gave us of a 1-year balance. Do you know what the figure of debt would be at that time?

Mr. BURNS. I stated earlier—I believe you were out of the room then, Congressman—that on the basis of the assumptions that I stated, the public debt would rise about $75 billion above the level that is now estimated for the end of this fiscal year.

Representative CURTIS. The end of fiscal 1963?

Mr. BURNS. Right.

Representative CURTIS. During the August hearings of this committee, as well as the Ways and Means, I requested the governmental witnesses and others to direct their attention to the problems of debt management and the economic impact of managing the debt. I also requested or suggested that they examine our ultimate debt policy. Is this something we want? I asked Dr. Colm this morning, after reaching his balance, what was the policy to be to reduce the debt. Do we want the debt?

Actually, Dr. Burns, there has been very little discussion, at least among economists in the congressional forums, of debt management and the economic consequences of the debt.

Would you comment on that and, if possible, direct your attention to studies that have been made of the problems of debt management and its economic consequences?

Mr. BURNS. That is a very large question, Congressman. My belief is that the major problem facing the country at the present time is one of limiting the increase in the public debt. The likelihood of any reduction of the public debt is very remote and I do not expect this to occur in the calculable future.

Representative CURTIS. Although that would produce desirable results economically but not politically, what are the economic consequences of holding the debt here? You see, when we don't collect the money in taxes, we on the Ways and Means Committee must decide how to manage, sell, and market this additional debt. So far, no one has been willing to render us any professional advice. We are asking for a lot of trouble in this area, particularly with the balance-of-payments problem. The recent situation developing in the European Common Market is posing some very serious debt management problems, where we had been counting on a very good international trade.

Dr. Heller said that the stimulus to be derived from the tax deductions will be largely unavailing if the debt is marketed in the private sector. Mr. Martin, Chairman of the Federal Reserve Bank, has told us that if it is marketed there, he doesn't know how to withstand resulting inflationary pressures and potential damage to monetary policy. This is where the debate has been left, with no one from the administration coming forth and discussing the problem.

Mr. BURNS. I believe, Congressman, that an increase in the public debt of some magnitude is now virtually unavoidable.

Representative CURTIS. What is the damage, then?

Mr. BURNS. I believe that if we proceed wisely and limit expenditure, that the benefits are likely to be larger than any damage that I at least can foresee. I must say in all honesty, however, that increases in the public debt are very likely to result in an increase in the money supply, in an increase in the liquidity of the private economy. A modest increase may do our economy good, but we must keep it within bounds.

Representative CURTIS. My time has expired. Thank you.

Representative REUSS. Senator Proxmire?

Mr. Clausen, he defers to you.

Representative CLAUSEN. I have nothing.

Representative REUSS. Senator Jordan?

Senator JORDAN. Nothing.

Representative REUSS. Senator Proxmire?

Senator PROXMIRE. Dr. Burns, I wish you were in the Senate because I wish you could have supported me when I introduced my amendment last time just to pare the space program by $185 million. That would have cut it 5 percent, and it was a scalpel cut, believe me, because I documented specific waste in the program.

I got four votes. I was defeated 67 to 4.

The reason I bring this up——

Mr. BURNS. What program was that?

Senator PROXMIRE. The space program. NASA. The appropriations for the national agency for space.

The difficulty is in cutting these programs. It is extraordinarily hard. While many of us feel there are areas we can cut, and Senator Miller and others have fought hard, we are a minority and I doubt if we will be a bigger minority this year. However, I ask you the realistic, tough question that we are going to have to face. Would you favor a tax cut that would increase the deficit if the administration's spending proposals should be adopted by the Congress this year? And I would venture to speculate that they will be adopted and may be increased.

Mr. BURNS. If the administration's spending proposals are adopted by the Congress, I would still favor a reduction of income taxes, but in that event I would recommend to the Congress that it seek new sources of revenue, and the only major source available is the politically unpalatable sales tax or value added tax.

In other words, if in the judgment of the Congress this country should continue increasing Federal expenditures, then I am still in favor of a cut in income taxes, but this loss in revenue should be made up through new excise taxes of one kind or another.

Senator PROXMIRE. Then you are in fact recommending a sales tax because the realistic assumption is that spending is probably going to increase. This recommendation of yours is not an isolated recommendation. I understand that Vice President Nixon at Harvard Business School 2 or 3 years ago made a similar suggestion. I am not sure he called it a national sales tax but he proposed a manufacturer's excise tax.

Aren't you concerned about what this does to the progressivity, the equity of our tax structure? When you look at our overall tax structure, the people after all pay local taxes and property taxes and Federal excise taxes. The analysis I have seen indicates that the people in the lower income taxes pay just about as large a proportion of their income in total taxes as people in the upper brackets until you get over $30,000 or $40,000 a year. Therefore, it seems to me that we would be providing a greater degree of regressions, destroying out progression which has been a very important principle to me and I think to many people in the Congress and out of the Congress.

Mr. BURNS. I would say this, Senator. We have to make a choice. What is it that we as a people and our Representatives in Congress desire most? Do we seek to promote what we consider to be our ideas of equity, of social justice, of reform, or do we seek to promote economic growth?

If our cardinal objective is economic growth, then I would argue strenuously that a tax system which is designed to limit consumption a little and stimulate investment is a better tax system than the one that we have.

That may lead us to a tax system that is more regressive than the tax system that we have. I am not sure that it will necessarily do that. I believe that a sales tax could be devised which would not bear any more harshly than our present tax system does on individuals with moderately low incomes, provided these individuals had some interest in thrift rather than in spending every dollar which they earn plus every dollar which they are able to borrow.

In other words, we have to make a choice. Do we want to stimulate consumption or do we we want to stimulate investment and thereby get faster economic growth?

If we want faster economic growth, then I feel quite sure that we will need to redesign our tax system. We will have to lower our present income taxes so as to stimulate people to produce more rather than devote their energies on the scale that we have been doing to consumption.

Let me make one additional observation, Senator, which I think is of great importance. I cited some figures on the scale of governmental expenditure. I indicated that at present, if we take Government at all levels, our taxes account for about a third of our Nation's output. Although not all governmental expenditure is of the consumption type, that is preponderantly true. In fact, you will find that the consumptive type of expenditure looms larger in our Government than in that of other industrial countries of the world. This is a drag on our economy.

In short, we have to balance various considerations. Do we or do we not want faster growth?

Senator PROXMIRE. Did you say that our consumption is a greater proportion than in other countries of the world and that this is a drag on our economy? I didn't understand that.

Mr. BURNS. No. What I stated was, what I meant to state was, that the consumptive factor in governmental expenditure is larger in this country than in that of other modern industrial nations. The main reason is not far to seek. Because of our position in the world we have to spend vast sums of money on defense and related programs.

These programs do not build up the strength of our economy. They are a drag and a drain on our economy. That unhappily is our ordeal. And this is one reason why the rate of growth of our economy compares unfavorably with that of some other industrial countries.

Senator PROXMIRE. Well, now, I think we can see that. We can see that certainly in the fact that we are focusing, concentrating our research, for example, overwhelmingly in defense and space, not in industrial developments, and so forth. Therefore, we aren't in a position to get our costs down, innovate with new products, compete, and so forth. But it is very, very difficult to accept the notion that our tax system does in fact retard investment to the degree that you assume. After all, we just had General Motors enjoying the largest profits in the history of the world. $1,450 million. American Telephone & Telegraph almost as large a profit. We are very happy about it. I think it is great. I hope they have bigger profits next year.

But the fact is, that profit opportunities in American industry still seem to be considerable. Furthermore, these companies have enormous cash earnings. I am not just talking about the bellwether companies but industry generally. Their earnings in relation to their investments are far greater than they have been for many, many years. Between 1946 and 1962, as I recall, earnings, cash earnings, expanded nearly threefold and investment less than double. They do have the ability to invest if they have the will and they have the opportunity to make profits, certainly in many, many areas, and good profits.

The fact is that the average rate of profit, as I understand it, is something like 8 to 10 percent. It is lower now than it has been in industry but it is still far higher than putting their money into Government obligations.

It seems to me that the investment opportunities are there and while you can argue very properly that there is restraint in the corporation income tax, in the personal income tax, the fact is that there is also a kind of a safeguard for risk. If a corporation invests and loses, Uncle Sam carries half the load of the loss. And, of course, there are also great benefits for the individual investor who invests and loses, and we are opening up more in our law. So it is difficult for me to see that the case has been made so emphatically and clearly that our tax system necessarily is a drag on investment.

Now I would like to ask you one other thing because this has become crucial in the hearings of this committee so far, and the discussion of the tax cut. You seem to differ very strongly with Dr. Colm, Dr. Heller, Dr. Gordon, the other experts, who appeared, on what will happen to the multiplier. You seem to feel, and I tend to support this viewpoint, that the multiplier depends on psychological developments. It depends on what happens to the attitude of people after they get this tax cut. It is not automatic, I take it, in your view that if there is a tax cut of $8 billion you are going to get a multiplier of 2 or 3 or 4. Whether you will get any multiplier at all depends on how people feel about that tax cut, whether they spend it, invest it, or whether they simply save it and don't put it into a productive investment.

Is this not correct?

Mr. BURNS. That is entirely correct, Senator. I would say that if we have a tax cut and if individuals feel that they are being rewarded better than they had been, if they see a new vista of hope in the future, they would be inclined not only to use the additional income that is now at their disposal but also to dip into their accumulated assets, which are substantial, and here and there to borrow where they can.

The basic thing in economic life is expectations with regard to the future. The basic point that Government must always bear in mind is how its policies will help to shape favorable expectations with regard to the future. A little bit more money in the hands of consumers or business firms will help, to be sure, but much more important than that is the change in attitude towards life, towards the future, that such a revision in our tax laws along with other governmental policies will help to bring about.

Senator PROXMIRE. My time is up.

Representative REUSS. Dr. Burns, as I understand it, you approve of the general amounts of the President's proposed tax cut, but you think that the cut to a considerable extent should be shifted from consumers to investors. Is my understanding correct that most of this shift in emphasis you would achieve by a somewhat greater reduction in the corporate income tax than is now contemplated in the President's tax proposal?

Mr. BURNS. I would certainly regard it as helpful to lower the corporate income tax beyond what the President has proposed. As I understand it, the immediate effect on corporations of the President's proposals will be adverse financially. It will not be until 1969 that corporations having an income in excess of $25,000 will experience any substantial tax reduction.

Now, some rescheduling there would be helpful. I also think that it would be desirable to take a close look at the recommendations that the President has made with regard to the individual income tax.

As the recommendations stand, if you take into account what the President has proposed with regard to the treatment of various deductions, then the reduction in taxes is very sharp at the lower end of the income scale but only modest at the upper end of the income scale.

I have heard some individuals of means say, that under the President's proposal they would in fact have to pay more than they are paying at the present time. Whether this is correct or not I do not know, but I can conceive of such a result.

Representative REUSS. Now, having heard that, I would like to put to you for your comment my offhand reaction to your total proposal to tip the teeter-totter away from reductions to consumers and toward reductions in corporate income taxes and income taxes of higher bracket income taxpayers. I am obliged to tell you that my reaction is that your proposal, Dr. Burns, is going to create a greater deficit and is going to give the economy less of an upward boost than the President's proposal. Thus ironically, if I should be right and you should be wrong, and this may not be the case, you are far from being a budget balancer and fiscally responsible, but a budget buster and fiscally irresponsible, which would be an odd result.

Now, let me tell you why I have my difficulties.

If you give tax reductions on the consumption side, the pattern of recent years shows, as I understand it, that about 92 or 93 percent of that will be spent. If you give it on the side of the corporate income tax, by and large the corporation retains about half of that and pays about half out in dividends. The amount of that 50 percent of the reduction spent by the receivers of dividends is not going to be anything like 92 percent of even that 50 percent because dividend receivers tend to be in the higher income brackets.

Therefore, for a given amount of revenue reduction, you are going to be able to get only about 25 or 30 or 35 percent of the increment in consumer spending.

Then on the investment side, I am struck by the fact that for the last 2 years, at least, corporations far from spending on investment the total of their retained earnings and depreciation allowances have spent considerably less than that.

In 1962, for example, corporations had retained earnings and depreciation allowances of $35.3 billion and spent only $32.3 billion. The year before, 1961, they had retained earnings and depreciation allowances of $32 billion and spent only $29.6 billion.

So that it seems to me that corporate investors aren't now investing that which they have to invest. The thing which is going to make them invest more, by and large, is greater consumer demand throughout the economy.

Now, I realize that is more or less an age-old controversy between Republicans and Democrats, but I would be very interested in your answer to my doubts and perturbations on this point.

Mr. Burns. I tried to deal with that point in my opening statement, Congressman. I would readily grant that corporations could be investing much more money than they are presently doing. I would readily grant that many individuals could invest much more than they are presently doing. But I have tried to point out that the shortcoming of our economic performance in recent times is due precisely to the relatively low rate of investment expenditure, and I have argued that investors are not spending more because they lack the incentive to do so.

Now, you are entirely right in saying that an increase in consumer spending will eventually stimulate investment outlays. I have no doubt about that.

However, if I am right in arguing that our economy has performed unsatisfactorily of late because investment expenditure has been deficient, if I am also right in arguing that consumer spending has been proceeding briskly, then the wise thing to do is to stimulate investment expenditure now rather than follow the slow route of stimulating consumer spending and having the increase in consumer spending work its way down until it eventually stimulates investment.

Your method will work, Congressman. It will help to achieve the volume of investment that both you and I seek, and which this country should have in order to have full employment and in order to have a higher rate of growth.

Your method, however, in my judgment, will work more slowly. It will yield results more slowly than the method that I have proposed. That is the difference between us.

Representative REUSS. You think, then, that the prospect to a businessman of being able to retain a larger part of his income, if he makes it, is more of an incentive than a larger consumer market, which would surely have the effect of increasing his profits? I realize, of course, that if the corporate tax rate remains the same he will still have to cough up a large part of those profits for taxes.

Mr. BURNS. I believe that a larger after tax income for individuals and for corporations will change the attitude, the thinking of businessmen and investors, with regard to the future. I believe that in that event they will be far more likely to use their energy in undertaking new capital expenditure programs and in putting their money—and I am not saying they do not have it—to work.

If I may digress a little, I had a very interesting conversation not long ago with a Yugoslavian economist. I asked him about their tax system. And he told me, "Well, we don't have a tax system like yours. You believe in a progessive tax system and in very high income tax rates. We don't."

I said, "Well, that is very interesting. But what do you do in your country?"

And the answer was that Yugoslavia used to have a progressive income tax. It never was very high, it never reached the height of ours, not nearly so. But still they decided to substitute for the progressive income tax a proportional income tax.

I told him that I would like to know why they have done that.

The answer was, "Well, the Government decided that it was important to stimulate savings and investment."

Let me refer to another country, Sweden. No so long ago Sweden proceeded to raise the sales tax and to lower the income tax. That was done by the Government, and it was done with the full approval of the trade unions of the country. The reason was that Sweden had reached the conclusion that it is important to stimulate effort and initiative, to stimulate production, to stimulate invesment, and that this result could be brought about by substituting an indirect tax to some degree for the high income taxation of the country.

Representative REUSS. Sweden has something like full or super full employment, of course, does it not?

Mr. BURNS. That is correct.

Representative REUSS. So they aren't faced with quite our problem of putting to work resources that are now lying idle.

At any rate, I appreciate this exchange with you, as I always do. And you certainly make the best possible case for your side.

Senator Miller?

Senator MILLER. Dr. Burns, we are trying to get businessmen to have an incentive to invest more and to grow more. Why would you favor the President's tax cut approach, which is apparently an across-the-board deal? Why not be more refined about it and give the tax cut only to those businesses that grow?

In other words, if you grow you get a tax cut; if you don't grow, you don't get any, you don't earn it. Would it not be feasible to come up with some kind of an approach like that which might actually do far more by way of stimulating investment than just having an across-the-board cut?

Mr. BURNS. I am inclined to think, Senator, that we need a uniform set of rules for our taxpayers. I am inclined to think that we should seek to create an environment that will make individuals and business firms feel that it is worth their while to invest more. A tax cut that applies not only to those whose enterprise has grown in the recent past but that applies uniformly to all, is most likely to produce the kind of environment that we need in this country if we are to have a more rapid rate of growth.

Senator MILLER. Let me get into another subject.

What is your opinion as to why we have had a continuing drain on our gold supply, almost a billion dollars in each of the last 2 years, worse than that before then? Is it because the international bankers have lost confidence in our dollar?

Mr. BURNS. Basically, our country has lost gold because our international balance of payments has been in a deficit condition for many years now. As far as the foreign bankers are concerned, their thinking has oscillated.

In the fall of 1958 they first became a little uneasy about the dollar. They later became quite critical of the way in which this Nation was conducting its finances. You may recall that in the fall of 1960 we had an incipient gold crisis.

Recently, foreign finance ministers, central bankers, and private financiers have apparently changed their thinking about the dollar. They now feel more confident in our currency than they did before. They feel that we are making progress in handling our balance-of-payments problem. They even feel that we have exaggerated our balance-of-payments difficulties.

This seems to be foreign opinion at the present time.

My own view is that the reason foreign financiers have changed their thinking is not because we have made any substantial progress in handling the fundamentals of our balance-of-payments problem. They have changed their thinking because balance-of-payment surpluses are no longer as extensive in Europe as they had been previously. Europe has experienced a very considerable increase in wages and in the level of prices in the past 2 years. Wages abroad are rising more rapidly than productivity is increasing. The price level is going up.

Many Europeans are now concerned about their future balance of payments. Being concerned about their later international position, they naturally look at us and say that ours is very good.

In my judgment, they exaggerated our difficulties in 1958 and in 1959 and in 1960. At the present time, they are more lyrical about the dollar's position than our actual financial situation justifies.

Senator MILLER. Might I say, I would feel a lot more comfortable if I could reconcile your remarks with the fact that there is this continual drain.

If we weren't going into a deficit on our gold supply, I would be in thorough agreement. But I can't reconcile what you have said with the fact that we are still getting a billion dollars call on our gold supply year after year.

How do you reconcile it?

Mr. BURNS. The essentials of our problem, I believe, are these: We are doing a tolerably good job on the exporting side. We have a substantial surplus on merchandise trade. We also have a sizable surplus on account of services.

On the other hand, we are spending several billions of dollars a year through our military programs abroad. Our aid program is also something of a drain on our balance of payments. If you consider the international political commitments that we have, then the difficulty that we face with regard to the balance of payments and with regard to gold becomes plain.

I should add, however, that our private investments abroad have also been quite large. This factor, however beneficial it may be and actually has been in the long run, has intensified our balance-of-payments problem in recent times.

Senator MILLER. Then why is it, since you think this is fundamentally a balance-of-payments problem, why is it that they don't convert their balances into American dollars rather than going into our gold supply at the rate of a billion dollars a year?

Mr. BURNS. Well, there is a limit to the dollar balances that different European countries find it convenient or commercially desirable to hold here. Also, some countries follow the practice of holding their reserve largely in gold.

Senator MILLER. One final question, Doctor: On the recommendations in the education field, I was hopeful that you might recommend that we do something more on economics education in our high schools. Do you have any opinion on that subject?

Mr. BURNS. I think that our high school curriculums have been directed on an excessive scale to traditional academic subjects. I believe that vocational training has been relatively neglected. I believe, also—and this may be what you have in mind—that instruction in economics is as important to our high school students as it is to our citizens generally. Better instruction in economics in our high schools is very badly needed, sir.

Representative REUSS. Mr. Curtis?

Representative CURTIS. The second area of policy that I have been anxious to develop is in the expenditure area. I am very pleased to listen to your remarks on the need of expenditure reform, for the purpose of balancing the budget, not only in the aggregate, but also in the details.

The budget presented to the Congress calls for increased spending in the nondefense areas. It has been hidden somewhat by a failure to cut back on nonrecurring items.

For instance, there is a $2 billion item in the 1963 budget for the Export-Import Bank which, of course, is nonrecurring. That becomes a very neat little $2 billion item in which to put recurring expenditures in other areas. Where should we cut these expenditures? Agriculture actually has an increase in its request of $1.4 billion; HEW has an increase of $1.7 billion; and many of the other nondefense areas have sizable increases, which are, as I pointed out, hidden by these deletions of the nonrecurring items.

Dr. Colm, who testified this morning, has a chart which indicated it would be about a $2.6 billion expenditure rate increase.

I do not want to get into these details here, because I know you aren't here to testify on that. But, do you not feel that it would be wise for the Congress to study the details of expenditure policies? Some expenditures are desirable, some are necessary. Some would produce economic growth, and others, as you point out, such as defense, cut down our long-term growth.

Am I correct in the assumption that, in approaching an expenditure policy, you feel that this detailed work is necessary?

Mr. BURNS. I think that detailed work is very necessary by the Congress on expenditures. I feel that members of my profession have also been ignoring the details of governmental expenditures. Economists these days concentrate on what they speak of as fiscal policy. They tend to neglect the structural side of expenditures, and the justification of expenditures along individual directions.

The belief has grown up in our country that the increase in governmental expenditures is accounted for largely, if not entirely, by the needs of the military. That is not true. If I remember the figures correctly, between the fiscal year 1957 and this fiscal year, budget expenditures have increased by about $25 billion, and only $10 billion of this increase is accounted for by military budgets.

If I remember the figures for this fiscal year correctly, the increase, the projected increase is $6½ billion. However, defense, the space program, and the international programs account in the aggregate for only $3.1 billion of the $6.5 billion increase.

Senator PROXMIRE. What period is this?

Mr. BURNS. I am referring to this fiscal year, fiscal year 1963.

And, of course, there are the substantial expenditures through our trust funds on which I have not commented in these last statistical remarks.

Representative CURTIS. I appreciate that. I tried to point that out in the previous fiscal year 1963. When we take account of these nonrecurring items in the 1964 budget, and the gain from disposing of capital assets, the rate of increase in the recurring nondefense expenditures is somewhat comparable.

I am happy to receive your statement of the need for economists to pay attention and assist the Congress in evaluating expenditure policy.

I do not know if you agree with me, but I want to emphasize this point.

I have long felt that our monetary policy should be neutral, if possible. This is my interpretation of Mr. Martin's attempt to have our money grow as our economy grows. As to fiscal policy, I feel very strongly that the main purpose of taxation is to obtain revenues for the Government, with the minimal economic impact. But in both of these areas, there are schools of thought that feel that neither policy should be neutral, but rather should be deliberately designed to produce economic growth.

In the area of expenditure policy, we should be making an affirmative policy. Here is where we deliberately go. If we are going to subsidize something, let's subsidize it and argue why. We shouldn't do it through a tax favoritism, a tax cut, or monetary policy in the nature of a subsidy. Let's do it deliberately in our evaluation of expenditure policies.

Unfortunately, the Congress is not in a position to evaluate expenditure policies in this fashion. Neither does the executive department evaluate them this way. Now we are going to go through another session without Congress having the machinery to evaluate expenditures.

I have in my hand an interesting document that I am going to put in the Congressional Record, including some remarks I will make on the floor. It is a report of the Joint Committee on the Legislative Budget, February 1948. Under the Legislative Reorganization Act of 1946, the Joint Committee on the Legislative Budget was created. It met once or twice and, to my knowledge, this was the only report ever issued. This includes a minority report.

This machinery, designed so Congress would develop a legislative budget, proved to be unworkable. Although this is still law, Congress has developed nothing further whereby it could draft a legislative budget after reviewing either the President's budget or subsequent appropriations. Had these been effective, we could have evaluated expenditure policy as well as debt management policy.

I make these comments not only for the record, but also for your comments.

Mr. BURNS. Well, Congressman, I think you and I will have to part company at this point just a little. I think our Government has become so large that its operations cannot be neutral with respect to the economy. Whether we like it or not, the Government's actions in the monetary and in the fiscal sphere are bound to have an influence.

Neutrality is a dream.

I see no way of attaining it. Therefore, as I see it, the objective of monetary policy, the objective of tax policy, and the objective of expenditure policy should be to foster a healthy, economic environment.

This means, among other things, an environment in which individuals and business firms will, on the whole, feel good about their prospects. It means an environment in which the economy at large is growing.

Whenever we consider monetary policy, whenever we consider expenditure policy, whenever we consider tax policy, we should ask ourselves the basic question, whether this or that change in policy will make people feel better about their economic future.

And we should design our programs with a view to achieving that objective.

I wish I could agree with you that governmental policy in these directions should be neutral. I think that it is a dream that we have no way of realizing at the present time any longer.

Representative CURTIS. My time is up, but I would like to make this comment: From the standpoint of reality, you are probably correct on the tax policy. But it makes a difference in what your objectives are.

Granted, that with the great revenues necessary to balance the budget, we must expect an economic impact from the writing of tax laws. It makes a difference, however, which economic effect you deliberately expect when you write that law. The net result, I must agreee with you, is that when we write taxes in Ways and Means, we must recognize their potential economic impact. I hope we will continue to do so.

Representative REUSS. Senator Proxmire?

Senator PROXMIRE. I just have a couple of more questions.

Senator Sparkman pointed out to Dr. Heller—and I would like to ask you about it because you were the Chairman of the Council on Economic Advisers from 1953 to 1956, I believe, and you, therefore, were the presiding economic genius at the time of the 1954 tax cut. Senator Sparkman said that some people feel that the 1954 tax cut did result in the stimulation of the economy, but it also may have resulted in the recession which we suffered after 1957, because industry overbuilt, they invested too much in terms of the consumption, in other words, it wasn't a balanced tax cut.

So I would like to ask you, if we have a tax cut for investments, if we have a tax cut that succeeded in spurring corporations to invest more, and we already have our facilities operating at about 82 percent of capacity, and well short of optimum, for what purpose are we really asking them to invest?

Do we not have to stimulate consumption, or there is no point in investment? Is it not true that business primarily invests because they estimate that the market is going to be there? And unless we do something to encourage that market or increase that market, there is little reason why any sensible businessman would build more plant.

Mr. BURNS. Senator, let me comment first on the recession of 1953 and 1954.

As you may recall, the Korean war came to an end in June 1953. Our defense budgets were cut back very sharply. Even before they were cut back, businessmen began adjusting their inventories. These, I believe, were the principal factors which accounted for that recession.

As for the tax cut which became effective in 1954, what happened then was that we eliminated the excess profits tax. We reduced individual income taxes on the average by about 10 percent. We made certain adjustments in the structure of the individual income tax to deal with personal hardships. We enacted a modest dividend tax credit, and we also made provisions for some accelerated depreciation.

These, in substance, were the major tax changes that became effective in 1954.

So much for history.

Now, as for your question with regard to the present condition of over-capacity in many lines of industry——

Senator PROXMIRE. Let me just say that, also, I was implying in my statement that there was some feeling that that tax cut may not have been well advised from the standpoint of long-term public policy, because we suffered a recession since 1957, and many people felt that we were overbuilt investmentwise, and that we never have been able to utilize our facilities very fully since 1957, because these cuts which you describe precisely were cuts that stimulated investment and did nothing about consumption.

Mr. BURNS. The cuts that I have described did a great deal about consumption. As a matter of fact, retail sales began rising in January 1954. This was a rather unusual development at a time of recession. Characteristically, retail sales move with the business cycle. In the past, they even tended to lag a little at cyclical upturns. In that recession retail sales moved up very early. I believed then, and I believe now, that the cut in personal income taxes was in large part responsible for the vigorous upsurge in consumer spending that occurred.

Senator PROXMIRE. It was not distributed evenly throughout the income spectrum, wasn't it concentrated primarily in areas where people would invest?

Mr. BURNS. On the contrary, if you will examine the tax cut for individuals, the reduction averaged about 10 percent. The percentage reduction was very small at the upper end of the income scale. I think that if you will go back to that piece of legislation you will find that my statement is verified.

Now, I want to say a few words about overcapacity at the present time, but I don't want to repeat myself.

I dealt with that question at considerable length in my opening statement, and you will find my views expressed at some length in the record.

Let me just say this. Whenever you have a recession, overcapacity develops, you have idle capacity and you have idle men. That is the nature of a recession. And yet you find, if you examine the history of business cycles, that the existence of extensive overcapacity has not been a bar to new investment. The interesting question is, why should people want to invest—and this is the question that you put to me—when you already have extensive overcapacity?

The reason is as follows: A change occurs for one reason or another in the psychological factor that you have expressed earlier, that is, in people's attitudes about the future.

New business firms will be established. These business firms will have to provide a new plant, and they will have to equip the new plant.

Moreover, when we speak of overcapacity, what is it that we really mean?

We are speaking of an average. Suppose that a given industry is operating at, let us say, 80 percent of capacity. The degree of overcapacity will not be spread uniformly among the firms in the industry. If the industry as a whole is operating at only 80 percent of capacity, there will be some firms that are operating at 20 percent of capacity, and there will be others that are operating at 90 or 95 percent of capacity, or at full capacity.

Now, those firms which have done well in the recent past will have an economic reason for extending their capacity even though the industry as a whole statistically shows overcapacity.

Moreover, there are always opportunities when the economic climate is favorable. There are always opportunities for undertaking large improvements in equipment, for undertaking modernization of one kind or another, for undertaking the investment that is associated with new products.

Take the steel industry at the present time. Everyone will tell you, and you know it perfectly well, that statistically you have a great deal of overcapacity. But much of this overcapacity is obsolete. Our steel firms are building new capacity on a large scale in order to put themselves in a position to be competitive with regard to steel producers abroad, and with regard to producers of competitive building materials in our own country.

I believe that the importance of the factor of overcapacity has been greatly exaggerated. It is not a decisive factor in the inadequate investment that we have recently had. My opening statement elaborates this view, and presents some evidence.

Senator PROXMIRE. I certainly appreciate the fact that there are all sorts of irregularities in capacity, and the average statistics are not satisfactory, and so forth. Nevertheless, we come right down to what gives the businessman a psychological justification for expanding in one period as compared to another.

There is expansion going on right now, but it is not enough, there is a plant investment this year of $37 billion to $60 billion; but it is not enough.

Let me ask this about this psychological factor and try to put it into a modern, up-to-date political context. It seems to me when you listed the reasons why business doesn't invest you gave as No. 2 stable prices, and you combined that with rising wages.

Now, we saw a marvelously clear demonstration of this in 1962—well, last year, I guess it was—when the President cracked down on the steel industry. And when he indicated that he felt that the agreement that labor had made was not inflationary and he saw no reason why prices should increase, shortly after this we got the big stock market drop. Business psychology was that we were going to have stable prices, and the President was going to stand in the way of inflation, and the Government was going to use the full force and power and majesty of its office to prevent prices from rising.

This was bad business news. I think the President very wisely sees that a psychology of stable prices is not a psychology of expansion.

Now, what he is doing is making a tax proposal which is in the judgment of many businessmen inflationary. Now, if stable prices doesn't stimulate the businessman, an inflationary psychology is likely to do so, because he has to go buy inventory for the size of his plant, and the price of that plant increases. So isn't it possible that the President's proposals, while economically you and I may not agree with them, have the effect of persuading business people that there is an inflationary psychology moving our Government today, and that, therefore, this is a good time to invest and a good time to start moving.

Mr. BURNS. Let me make two or three observations in response to your most interesting statement.

First of all, I believe that the Government's action with regard to the price of steel was interpreted by the business community as being a harbinger not so much of price stability but of governmental price controls. This is what the typical businessman feared and fears.

Let me say, secondly, that while all of us, including businessmen, talk about the evils of inflation, individual businessmen are undoubtedly stirred to more energetic action by the expectation of rising prices. As I have pointed out in my opening statement, the stability of the wholesale price level has served to chill business sentiment in recent times.

There is much practical wisdom in your observation, Senator.

Senator PROXMIRE. Thank you very much.

Thank you, Mr. Chairman.

Representative REUSS. Senator Miller?

Senator MILLER. Dr. Burns, we have been hearing a lot about a "managed deficit" lately. Could you tell us how you would define such a phrase as a "managed deficit"?

Mr. BURNS. Well, I assume that those who speak of a managed deficit have in mind the management of governmental finances, which will involve running a deficit, in such fashion as to stimulate the growth of the economy and lower the level of unemployment that we have had lately.

Senator MILLER. Do you think we have had a managed deficit during the past 2 years?

Mr. BURNS. Senator, the record will show that nearly every succeeding estimate of Federal expenditure—and we have had a number of them here in the past 2 years—has been higher than the preceding estimate. Now, whether that shows good management or not is something that everyone will have to judge for himself.

Senator MILLER. What I am getting at is that tied in with the idea of a managed deficit ought to be stability in the purchasing power of money. Of course, we lost purchasing power of our dollar by about $8 billion a year for each of the last 2 years.

But do you think stability in the dollar, stability in the purchasing power of our dollar, should be a part of this concept of a managed deficit?

Mr. BURNS. I think stability of the dollar is important to our Nation today, and it is highly important to our Nation's future. If we are to have a deficit—and I am afraid we will—we certainly should try to manage the deficit in such fashion that injury to the dollar will be minimized.

Senator MILLER. Thank you.

Now, just in passing, because considerable emphasis has been placed by you in your testimony on the investment side of the tax picture, would you say whether you favor or do not favor the proposal to repeal the dividend exclusion and the dividend credit?

Mr. BURNS. I regard the dividend tax credit as recognizing the fact that on a considerable scale dividends are taxed twice under our system. The dividend tax credit we have is modest when compared with the practice of other countries such as Canada or England. I believe that the elimination of the dividend tax credit would be undesirable.

Senator MILLER. Now, a lot of attention may be focused by some people on the fact that we have had a substantial increase in gross national product. I pointed out earlier in my question that this amounted to $51.9 billion during the first seven quarters in the last 2 years. But when you interpret this in terms of 1961 prices it only comes out to $37.7 billion. But still there are some who will say that a $37.7 increase in gross national product during seven quarters is a very notable achievement.

I suspect, however, that you have to break that down to determine whether or not it is a notable achievement. I can visualize a situation where you might have a $37 billion increase in gross national product, and you actually might be worse off than you were at the beginning of that period.

Will you discuss this theory a little bit for us in terms of your experience as an economist?

Mr. BURNS. Let me say this, Senator. Our measure of the gross national product is imperfect. The statisticians and economists have worked on this problem of measurement for many years. They have not as yet solved it satisfactorily. Our measure of the gross national product is a mixture of outputs and inputs.

Let me explain what I mean by this. Suppose that a private enterprise embarks on the production of a new product. This new product may—this new venture may turn out to be entirely unsuccessful. That is, although a great deal of effort is put into the marketing of this product, somehow the firm does not succeed in selling any of it. Since the value of this new product turns out to be zero, this new venture, this assumed enterprise will make no arithmetical contribution whatsoever to our gross national product.

Now, by way of contrast, let us assume that the Government hires an additional employee, and that the Government pays this additional employee $10,000. This additional employee may be, as most of our civil servants are, very constructive.

On the other hand, he may simply interfere with the efficiency of other people, so that his contribution is not merely zero, but negative. Such things are rare, but they do happen. However, as we keep our statistics, the hiring of this individual and the payment to him of $10,000 will increase our gross national product, as we measure it, by precisely $10,000.

We have, therefore, in the gross national product a very imperfect measurement. In saying this, I do not intend to criticize our statisticians. It is very difficult to put into a single set of consistent accounts governmental operations along with private operations.

In the case of the private economy, we value the output. In the case of the public economy, we value the input. Our gross national product is an arithmetic sum, therefore, of both outputs and inputs. It is a curious hybrid. We tend to forget this fact, and we treat the gross national product figure as if it really were a measure of output.

For practical purposes we can't at present do better than that. However, the limitation of which I speak must not be lost sight of.

Senator MILLER. Would you care to evaluate the increase in GNP during the past 2 years?

Mr. BURNS. The increase in GNP during the past 2 years has consisted almost entirely of an increase in consumer expenditure and of governmental expenditure. The first factor, the increase in consumer expenditure, has been larger than the increase in governmental expenditure. I believe that the increase in consumer expenditure does reflect an increase both of real consumer incomes and of the real output which made the increase in incomes possible.

Representative REUSS. Senator Javits?

Senator JAVITS. Dr. Burns, I apologize for being so late. You are my favorite economist on the national scene. But I was frozen on the Senate floor; there is a slight matter there which requires one of us as a sentinel from time to time.

I see the notes on your statement. And I would like to ask you these few questions, first expressing my pleasure at your presence, and the tremendous benefit I think you could do for us in the country in taking the time to testify.

What do you think of coupling the tax cut with tax reform which has come in for some discussion here in the last few days? Do you approve of it? Do you disapprove of it? And, if so, how and why?

Mr. BURNS. Let me say this, Senator. Terminology may be getting in our way. We speak of tax reform these days as if tax reform meant closing certain loopholes and the like. In my judgment, the most important kind of tax reform that this country needs and should have is a reduction in income taxes both for individuals and for corporations. As for the President's specific proposals, I have doubts about some of them, particularly the treatment of deductions.

Senator JAVITS. When you say deductions, will you define that for me, specifically? What kind of deductions?

Mr. BURNS. Well, as you may recall, what the President proposes is that the various deductions that are now permitted under the individual income tax are to be allowed only in part. What the President would do—and this is an oversimplification—is to take 5 percent of the individual's adjusted gross income and treat as a permissible deduction only the excess over that figure.

Senator JAVITS. And that, you think, is questionable in economic recovery terms?

Mr. BURNS. I think that the impact of that on individuals, and the implications of the proposal with regard to certain of our national objectives such as the promotion of homeownership, will have to be studied very carefully by Congress and the economists. I also feel that the President's proposal involves a dubious concept of income. In effect, when you and I pay our income tax to the State of New York, we no longer have that money for other uses. The President would cut the degree to which the income taxes that we pay to the States can be treated as a deduction in computing the amount on which we are to pay Federal income tax.

Senator JAVITS. I notice also that you have a strong feeling about investment stimulus as being an important aspect of making the economic improvements which we desire. Do you feel that the President's suggested treatment of capital gains will have any influence on that?

Mr. BURNS. In general, I think that there is much to be said in favor of the President's recommendation with regard to the treatment of capital gains. I feel, however, that if an individual's estate is to be taxed on the increase in capital value that occurred during the lifetime of the deceased, in that event the estate tax itself should be lowered. Unless we do that, there will be great hardship for many individuals. There will be difficulty for small business enterprises and even the possibility of their survival may be in doubt.

Our present heavy capital gains tax is a penalty on transactions in securities, and to a certain degree, also in real estate. Our present capital gains tax tends to restrict the mobility of capital, and that is not a good thing.

Senator JAVITS. But the President's recommendations, other than the State tax aspect, in your opinion would tend to give more fluidity?

Mr. BURNS. By and large, I think that the President's recommendations will tend to do so. My hope is that Congress will take a constructive view of the President's proposal.

Senator JAVITS. I notice that you urge a cut in expenditures, and would ask you this. Knowing the budget as well as you do—and we are down to about $22 billion or thereabouts, in that order of magnitude—other than cuts in national debt, veterans or defense, could you give us any idea of the areas in which you think we could find places to cut that would not be cutting into the bone and sinew of the national interest?

Mr. BURNS. Senator, I already commented on this earlier. I believe as strongly as any man in this country does in having a national defense that is not only as strong as we need, but perhaps a little stronger. If we are going to make any mistake in this area, let's err on the side of spending too much rather than too little.

However, I am not prepared to regard even the military budget as being sancrosanct as it stands. There are considerable differences of opinion among military experts with regard to the size and even the character of our military budget.

As far as the space budget is concerned, I am all in favor of space exploration. But I do not believe that it is wise at this juncture to try to get to the moon quite as fast as the President proposes.

I believe that substantial sums can be saved in the agricultural part of the budget.

I do not regard the budget on account of veterans as being sacrosanct. I believe that savings, some small and others considerable, can be made in practically every part of the budget if we have the will to do so.

Senator JAVITS. Coming down to the end of the road, as we often do, when we have to vote yea or nay, if you were me—I won't say any other colleague—but if you were me, representing as I do the State of New York, whose interests you are well aware of, and you faced the kind of deficit which is not indicated, and after having gone through everything else you still found yourself in that position, would you still feel that a tax cut in the order of magnitude asked for by the President has a preponderant economic advantage over and above the disadvantages of the deficits?

Mr. BURNS. I would be in favor of the President's proposal to cut income taxes on a substantial scale if the President and the Congress could see their way clear to curbing expenditures. If, as a minimum, expenditures were stabilized at the present level, then I would definitely, if I were in your exalted place, vote in favor of the general kind—that is, the order of magnitude—of tax reduction that the President has proposed.

On the other hand, as I stated earlier, if in the judgment of the Congress it is necessary to increase expenditures on a large scale, in that case I would still favor a reduction of income tax rates; but in that event I would strongly advise that new sources of revenue be found by the Congress.

Senator JAVITS. Thank you for that statement.

May I have one more question, Mr. Chairman?

I have been taking the line here, Dr. Burns, with the witnesses that what we need in addition to a tax cut for economic improvement is various types of legislation, among them, and very importantly, legislation to deal with national emergency strikes more effectively, legislation regarding the transition without hardship on workers from the present conditions to automation, review of the antitrust laws, further aid to our export industries, and generally measures of that character.

Would you give any opinion on that?

Dr. BURNS. I believe that you are calling attention to a very important matter. The Congress and the country are now concerned preponderantly with taxes and with tax reduction. There are limits, however, to what tax reduction or any fiscal policy will do for our country. You have called attention in your remarks to one important area, the area of industrial disputes, also the area of technological change. In other words, you have called attention to the need for efficiency and for improvements in economic efficiency.

To some degree, we should attain this through a wisely planned tax reduction for stimulating investment. But many problems will still remain for the individual and for the business firm.

I must confess that I am concerned about the labor situation in this country. I believe that the day may be coming when Congress will need to consider more seriously than it has of late what this country should do to protect the general public, our Nation's health, our Nation's safety, and our Nation's economy from destructive industrial struggles.

I have been opposed to governmental interference in collective bargaining. I still do not like the idea. But I am beginning to feel that compulsory arbitration may be needed to deal with emergency disputes of a nationwide character. Whether this is the right answer or not is debatable. But I do not know of a more important problem for the Congress to consider. If not this year the next, sooner or later, you gentlemen of the Senate and of the House will have to wrestle with this problem.

Senator JAVITS. Dr. Burns, I thank you very much. You have always illustrated to me how a liberal mind can be married to conservative economics, and you have demonstrated it again today. And I am very grateful to you.

Thank you, very much.

Representative REUSS. Thank you very much, Dr. Burns, for your help and your patience in being with us for almost 3 hours this afternoon. We are very grateful to you.

We now stand adjourned until 10 o'clock tomorrow morning in this chamber, when we will hear a panel discussion on fiscal policy.

(Whereupon, at 4:45 p.m., the committee recessed, to reconvene at 10 a.m., Tuesday, February 5, 1963.)

JANUARY 1963 ECONOMIC REPORT OF THE PRESIDENT

TUESDAY, FEBRUARY 5, 1963

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

The committee met at 10 a.m., pursuant to recess, in room 1202, New Senate Office Building, Senator Paul H. Douglas (chairman of the committee) presiding.

Present: Senators Douglas, Proxmire, Pell, Miller, and Jordan of Idaho; Representatives Griffiths and Curtis.

Also present: James W. Knowles, executive director; John R. Stark, clerk; Roy E. Moor and Donald A. Webster, economists.

Chairman DOUGLAS. The committee will be in order.

We are very pleased to welcome a new member of the committee, Senator Jordan of Idaho. We are very glad to have you here.

Senator JORDAN. Thank you, Senator.

Chairman DOUGLAS. We are very honored to have our witnesses come from various parts of the country to testify this morning. We are going to ask them to testify, starting with Professor Hellmuth. Two of the papers submitted seem to be somewhat long. I wonder if in those cases, Mr. Hellmuth and Mr. Linter, you could summarize them so that it would not take more than a maximum of 15 minutes, and the entire statements will be inserted in the record.

Thank you very much. We will begin, then, with the critique by Professor Hellmuth, of Oberlin College.

STATEMENT OF WILLIAM F. HELLMUTH, DEAN, COLLEGE OF ARTS AND SCIENCES AND PROFESSOR OF ECONOMICS, OBERLIN COLLEGE

Mr. HELLMUTH. Thank you, Senator Douglas.

I wanted to say that the 1963 Economic Report is an important and effective presentation to educate the country to the economic realities of this year.

I will skip over parts of this to stay within the time limit.

I have arranged my statement under five different headings: First, the need for a strongly expansionist policy; second, the choice between alternative expansionist policies; third, an analysis of the amount, timing and form of the proposed tax reduction program; fourth, an evaluation of the proposed tax reforms; and, fifth, some other brief comments.

I think in view of the earlier testimony before the committee, the case for an expansionist policy is clearly apparent, and I won't take your time to develop that.

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In terms of the choice of expansionist policies, it seems to me this is the real question now before the committee and before the Congress. The question today is not whether the Government should follow an expansionist economic policy, but what type of Government policy would most effectively promote expansion and what the magnitude and timing of this policy should be.

We have tried monetary policy over the last 5 years when we have had a short fall from full employment and from an adequate growth rate, and it alone has clearly not been able to do the job. Mr. Martin, the Chairman of the Federal Reserve Board, has indicated that he sees for monetary policy in this context primarily a defensive and a secondary role.

Some people have suggested reducing taxes and an equal reduction in Government spending. It seems to me this is not likely to produce expansion and may well go in the other direction, in that the cuts in Government spending will be a direct cut in total demand which is already inadequate, and it is quite likely that the cut in taxes will not be fully spent but in part will go into saving, so that the net result of a balanced budget at a lower level would mean a less adequate demand than the already inadequate total demand that we now have.

Another alternative would be to leave taxes alone and raise Government spending. A very persuasive case can be made for this policy on the ground that a number of services, such as education, hospitals, urban renewal, recreation, conservation, and other programs provided largely by Government are badly needed. The social balance at this time requires more public spending, at least in terms of additions to our total gross national product.

President Kennedy has chosen the tax-reduction path to economic expansion. His several messages—the state of the Union, Economic Report, the Federal budget for 1964, and his special tax message—present persuasively and effectively the arguments for tax reduction and tax reform. The major reduction in taxes is planned to encourage substantial increases in consumption spending and also in business investment. Deficits in the Federal budget are likely over the next 2 years, whether or not there is a tax cut. The proposed cut in taxes is likely to enlarge the deficit temporarily on the expectation that the higher personal incomes and larger profits resulting will cause Federal revenues to rise rapidly enough to balance the budget, probably by fiscal year 1966.

Under this policy the Government rejects the idea of a passive deficit arising automatically from a sluggish economy. Instead, the administration proposes a deficit deliberately enlarged in the short run to bring both the Federal budget into balance and the national economy into balance with unemployment below 4 percent and an annual growth rate of more than 4 percent.

It seems in some circumstances that there has been an excessive preoccupation with balancing of the Federal budget to the neglect of the much more important problem of balancing the national budget. Economic analysis of budget policy in recent years indicates that the Federal budget comes into balance substantially below a full employment level. The economic recovery in 1959 and 1960 faded before the economy had gotten onto a high plateau of prosperity. The budget on a national income basis shifted from deficit to surplus in the first quarter of 1960 well before full recovery had been attained and while unemployment had dropped only to 5.1 percent in contrast with an unemployment rate of 4.1 percent during the peak of the previous boom.

In other words, fiscal policy under the present Federal tax system applies the brakes too hard and too soon. In fiscal 1963 the Federal budget would be in balance if last year's gross national product had been about $575 billion. But a gross national product of about $600 billion is necessary to achieve a high enough level of output, income and employment to reduce unemployment below a 4-percent rate. I would raise the question whether a 4-percent unemployment rate is an adequate goal. I think in the long run we should aim for higher standards of a 3- or 3½-percent maximum unemployment rate.

An evaluation of the fiscal policy aspects of the President's proposal raises not the question most often heard in the newspaper columns, whether this proposal is too much and too soon, but rather the question whether the tax cut is not too little and too late or too slow. An increase of $30 to $40 billion in gross national product is needed now to lower unemployment to 4 percent. The Economic Report indicates that the cuts in income taxes when fully effective would increase disposable income by about $8½ billion in 1965. With an estimate that 93 percent of this will be spent on consumption, there would be an additional $8 billion of consumption. With a multiplier of two, the total direct increase in gross national product will be about $16 billion. Then to the extent that the higher level of consumer demand generates more investment, there will be a further increase due to the acceleration effect and the subsequent effects from that, so that we might get an increase in gross national product from the tax cut of about $25 billion a year by 1965, when what we need is an expansion of $30 to $40 billion right now.

If our objective then is the realistic and relatively modest one of producing economic growth and reducing unemployment, I recommend that the tax cut proposed by the President be accelerated; that the first and second stages of the rate reduction, for example, might be compressed into a larger first step and become effective in 1963, with the final reduction perhaps scheduled for July 1, 1964. Acceleration of the reduction would allow the anticipated economic benefits to be more rapidly and more certainly realized.

Moving next to a discussion of the form of the income tax reduction, the rate reductions and reforms will contribute substantially to greater tax equity and to a stimulation of the economy. The rate reduction would apply to every individual and corporation now paying Federal income taxes. Almost a million individuals and families in the lowest income brackets, those least able to pay, will be removed from the tax rolls. The increase in the standard exemption to $300 per taxpayer is a minimum and is some reflection of the increase in the Consumer Price Index since the individual exemption was last increased to its present level of $600 per person in 1948. Since then the Consumer Price Index has increased 26 percent.

The proposed minimum standard deduction serves, in effect, to recognize the higher cost of living for the lowest income groups. For these groups the standard deduction as presently defined of 10 percent of income has been a regressive feature in our tax laws. The new minimum standard deduction would be the most valuable feature for the proposed changes for the lowest income groups, providing for them some equivalent to the large rate reductions in the higher income groups. The relief would most likely go into increased spending, since the marginal propensity to consume of these groups would be very close to 100 percent.

There will be gains also in convenience and simplicity in the tax laws. The economic effects of the tax reduction will contribute directly to stimulation of the economy. Tax rates, when the proposed third stage of the reduction is in effect, will be much lower, as follows: On individual income the rates will be reduced varying between 18.2 percent as a minimum and 30 percent as a maximum, with the rates on long-term capital gains for individuals reduced between 22 and 58 percent. On corporate income the rates on the first $25,000 on taxable income are to be reduced 26.7 percent. Above $25,000, the rate reduction is 9.6 percent, with the capital gains rates for corporations reduced by 12 percent from their present level. More purchasing power would be available in the private sector of the economy, leading directly to an increase in consumption.

Business will have both more incentive to investment and an improved financial capacity to add to plant, equipment, and inventories. When the proposed reductions are considered along with the 1962 changes, including the investment credit and the revision in the service lives of depreciable assets, it seems to me we have a carefully balanced program that provides both additional incentives and financial capacity for business to increase its spending and a substantial increase in total demand so that there will be consumer markets that will justify the increased business investment.

The sharply lower rates on all tax schedules will help to end or minimize the prevalent question today: What is the tax angle? Instead the lower rates will restore to the deserved and intended prominence the much more important questions: Is it efficient? Is it profitable? Is it good business? The emphasis in both personal and business decisions will tend to shift away from the tax aspects and focus on the real economic considerations.

In general, Members of Congress, businessmen, investors, and economists believe that decisions made in free competitive markets should largely determine price, production, investment, and employment. For about 20 years, however, tax considerations have played a major and probably increasing role, and the forces of the free market a declining role. Adoption of the proposed program of both tax reduction and reform would be a major step toward minimizing the nonmarket factors in the decisions of consumers and businessmen.

Turning now to tax reforms, the income tax is a most precious asset. It must not be allowed to waste away. It depends not only on a prosperous and expanding economy, but also on the confidence of the mass of the people in the justice of the tax laws and their administration. Congress this year has an opportunity that comes once in a generation; the opportunity to adopt certain reforms to improve the equity, neutrality, simplicity and favorable economic effects of the Federal income-tax system, and remove some of the major distortions and inequities which have crept into the system.

The unique opportunity this year is the chance to combine major reforms with large and universal rate reductions. Tax reforms never come easy. The only realistic opportunity for major reforms which remove the preferential provisions is to combine reforms with major tax reductions. At such a time even those taxpayers who lose the benefit of some preferential provisions will, in almost every case, still enjoy some tax reduction. Separation of tax reforms from the bill proposing tax reductions would be likely to mean no broad and important reforms. Reforms need the sweetener of tax reduction.

Reforms will also have a stimulating effect on the economy. They help to make possible larger reductions in tax rates; they restore market and economic considerations to deserved prominence. The reforms help to strengthen consumer demand.

The most important reforms in my judgment are the proposals dealing with capital gains. The President, the Secretary of the Treasury, and Treasury staff have scored a "ten strike" in these recommendations. They have succeeded in designing a package of changes which contributes significantly to the economic growth of the country while at the same time making a major improvement in the equity of the tax system. Perhaps the most important single change in the capital-gains package is the feature that requires constructive realization of gains at the time of transfer by gift or death. The omission of these gains from taxation under present law has served to "lock in" investors who hold securities or real estate which has appreciated in value. The "lock in" feature of the capital-gains tax is not due only to the fact that the sale of the asset subjects the owner to a tax on the realized gain but also to the fact that the owner can avoid the tax entirely by transferring the property with an appreciated value either by gift or as part of his estate at death. The recipient of the appreciated property is able to use the value of the asset at the time of transfer as the new tax basis so that this increase in value is never subject to income tax.

The proposed provision for inclusion of these gains in the tax base will encourage investors to sell or switch their securities when economic conditions justify a transfer. The new provision will tend to remove the tax consideration, since taxes in this case will be uniform so long as the property has been held more than 1 year. It will no longer be a question whether the gain is taxed, but rather when it is taxed. This important change will tend to make savings invested in equities especially more mobile and more responsive to economic change.

In terms of revenue and perhaps in terms of controversy, the outstanding proposal is the President's recommendation that a floor equal to 5 percent of taxable income be set on the itemized deductions. The President and the Treasury are following here a path that deserves a full explanation. The basic approach is good. A widespread and effective educational campaign, however, will be needed to point out the advantage and overcome the opposition. I hope that this proposal can be considered on its merits and not in the light of the emotional arguments which will be raised against it. This proposal is essentially a move to restore the standard deduction for use to most taxpayers. The standard deduction in effect would become standard.

Essentially Congress and the country here have the choice of whether they prefer a complicated system with liberal use of itemized deductions accompanied by a high-rate schedule, or a simpler, larger, more straightforward tax base together with a significantly lower rate schedule. I would much prefer the latter not only for its equity advantages but also for the important advantages of stimulation that it will have for the economy. Some of the reforms are necessary in order to get the substantially lower rates that are here proposed.

I also comment in my statement on the repeal of the dividend credit and the dividend exclusion as proposed and go through a calculation that indicates that the whole package of changes here would produce increases in after-tax income for stockholders in all income groups, with the greatest rate of increase going to the people in the highest income groups. For example, a person presently in the 20-percent tax bracket, with the repeal of the 4-percent dividend received credit, but with the change to the lower rate schedule for both corporations and individuals, would receive an estimated 11-percent increase in his dividends. A person now exposed to 91 percent marginal tax rate would receive an increase of 196 percent in his after-tax dividend income.

Percentage depletion and the provision for exploration and development costs are the most glaring inequities in the Federal income tax system. Deductions against income which may be many times the actual cost are permitted by these provisions. As a result, individuals and companies engaged in the extraction of oil, gas, and other minerals often pay a much lower effective rate on their income than if they were engaged in most other businesses. This more favorable tax position, in turn, serves to attract more resources into these industries than would tax provisions which were neutral.

The four changes proposed in the tax treatment of mineral industries are good as far as they go. In terms of a broad program of reform, however, one might have hoped for some bolder recommendations. For example, with no change in the present percentage depletion rates, a maximum deduction for the depletion of any property might have been set at the cost of the productive property.

In summary, let me commend the President and the Council for a carefully reasoned and persuasive economic report. The critical need for an expansionist program by the Federal Government is well established. There is a real question whether the proposed tax cut alone, large as it is by historical standards, is sufficiently large to boost the economy as much as is needed at this time.

And last, the President's tax reforms integrated with the tax reductions represent a major step toward a fairer, more understandable, less complicated, more stimulating tax system. If a major tax program is not enacted this year, it is likely to be in 1964 or the following year, and the economy will probably drag until action is taken. The best prospect for solution in the near future for both persistent unemployment and a lagging growth rate is offered by an expansionist Federal tax and fiscal policy in 1963.

Thank you.

(Mr. Hellmuth's prepared statement follows:)

STATEMENT BY WILLIAM F. HELLMUTH, DEAN, COLLEGE OF ARTS AND SCIENCES, AND PROFESSOR OF ECONOMICS, OBERLIN COLLEGE

The 1963 Economic Report is an important and effective presentation to educate the country to the economic realities of this year. The report spells out the economic basis for a bold and active use of fiscal policy to meet the major economic problem of a soft economy with excessive unemployment and an unsatisfactory growth rate.

Let me indicate at the outset my general approval of the major part of the economic analysis and the policy recommendations in the 1963 Economic Report and related documents, incorporating the President's bold program for tax reduction and reform. There are some aspects of these recommendations which economic analysis supports more strongly than other parts.

Our assignment is to focus on the fiscal policy analysis and tax recommendations. My statement considers these matters under five headings:

I. The need for a strongly expansionist policy.
II. The choice between alternative expansionist policies.
III. An analysis of the amount, timing, and form of the proposed tax reduction program.
IV. An evaluation of the proposed tax reforms.
V. Other comments.

I. NEED FOR A STRONG EXPANSIONIST POLICY

In view of the disappointing experience of the last 5 years, a major move forward in the economy is long overdue. The Economic Report documents the sad economic performance of the period since 1957. In only one month over this 5-year period has unemployment been below 5 percent. Unemployment in January 1963 shows no improvement over unemployment a year earlier. This persistent high level of unemployment is intolerable. The utilization of productive capacity has been unsatisfactory. The rate of economic growth has been inadequate. Reflecting both the unhappy performance of the economy and its own countercyclical role, the Federal budget, by each of the three usual measures, has shown a surplus in only one year since 1957. The high hopes reported in the Economic Report and these hearings a year ago that the economy would move ahead with a balanced budget in 1962 have been disappointed. We need to do better. We have not realized our hopes for the soaring sixties in the economy.

The current prospects for 1963 and 1964 indicate no factors active in the private or public sectors of the economy which will generate a major move ahead. In the short run we must achieve a fuller utilization of our manpower and industrial capacity to realize an increase in GNP (gross national product) of at least $40 billion at an annual rate. This would get the American economy to what would represent a satisfactory performance now. This would represent a solution to our pressing short-run problem. Beyond this we must achieve a growth rate of over 4 percent a year to maintain full employment, to absorb the increases in sight in the labor force, to use effectively our rising productive capacity, and to provide jobs for those persons who were displaced by technological improvement. The economy needs a large increase in consumption demand to take up the current slack. It also needs the prospect of steadily growing demand and incentives to investment to achieve a satisfactory growth rate once the slack has been removed.

Regardless of political or economic viewpoint, no one doubts that the economy must move ahead. Also, no one doubts that the Federal Government must play an active role in this move ahead. There is clearly sharp controversy, however, over what this role should be.

II. CHOICE OF EXPANSIONIST POLICIES

The crucial question today is not whether the Government should follow an expansionist economic policy, but what type of Government policy would most effectively promote expansion, and what the magnitude and timing of this policy should be. Elementary textbooks in economics prescribe easy credit and monetary policies, increased Government expenditures, and/or tax reductions to promote economic expansion.

The Federal Reserve has followed a policy of easy money and credit since the middle of 1960, and for 4 of the last 5 years. Long-term interest rates have been low, while short-term interest rates are relatively low, but cannot be reduced further without endangering the balance-of-payments situation. It is clear now that monetary policy cannot bear the major part of the burden to achieve a satisfactory level of employment and output and income in the short run and a satisfactory rate of economic growth in the long run. Mr. William McChesney Martin, Chairman of the Federal Reserve Board, stated in his talk to the American Economics Association in late December that monetary policy now could play only a defensive role and would occupy the secondary position in a policy to promote expansion and growth.

An active fiscal policy to promote expansion involves greater spending, lower taxes, or both. A policy of reducing taxes and also of an equal reduction in Government spending would not produce any gain in total demand over the present situation, and might even represent a loss. The full amount of reduction in Government purchases of goods and services would appear as a cut in total demand, while probably some part of the tax reduction would be saved and not spent. We might get less total spending as a result of these two changes, than if taxes and Government spending remained at their present levels.

Another alternative would be to leave taxes alone and raise Government spending. A persuasive case can be made for this policy, largely on the grounds that a number of services, such as education, hospitals, urban renewal, recreation, conservation, and other programs provided largely by Government are badly needed. Galbraith and others would argue that society would get greater benefit from resources used in these programs in the public sector than from a comparable increase in the activity in the private sector. Also, a program of leaving taxes unchanged and raising Government spending would be more certain to introduce additional spending into the economy than an equal dollar amount of tax reduction, which leaves the decision whether (and how much) to increase spending to private individuals and businesses. Some increase of Federal spending is projected in the budget, but less than the annual increase in any of the past 3 years. Further increases are also indicated by the increase requested in new obligational authority. The size of these increases, however, is not large enough to offset the persistent slack in the economy.

President Kennedy has chosen the tax reduction path to economic expansion. His several messages—state of the Union, Economic Report, the Federal budget for 1964, and the special tax message—present persuasively and effectively the arguments for tax reduction and tax reform. A major reduction in taxes is planned to encourage substantial increases in private consumption spending and private business investment, so that the economy will move ahead to eliminate the present unsatisfactory level of unemployment in the short run and to attain a higher, more satisfactory, growth rate in the long run. The substantially larger GNP will yield increased Government revenues, even with lower tax rates. Deficits in the Federal budget are likely over the next 2 years, whether or not there is a tax cut. The cut in taxes is likely to enlarge the deficit temporarily, on the expectation that the higher personal incomes and larger profits resulting will cause Federal revenues to rise rapidly enough to balance the budget, probably by fiscal year 1966. Under this policy, the Government rejects the idea of a passive deficit arising automatically from sluggish economy. Instead, the administration proposes a deficit deliberately enlarged in the short run to bring both the Federal budget into balance and the national economy into balance, with unemployment below 4 percent and an annual growth rate of more than 4 percent.

An economic analysis of budget and fiscal policy of recent years indicates that the Federal budget comes into balance at a level of GNP below a level adequate to achieve an acceptable floor under economic growth and an acceptable ceiling on unemployment. The economic recovery in 1959 and 1960 faded before the economy had gotten onto a high plateau of prosperity. The budget on a national income account basis shifted from deficit to a surplus in the first quarter of 1960 well before full recovery had been attained and while unemployment had dropped only to 5.1 percent (seasonally adjusted). At the peak of the previous boom (July 1956–June 1957) the comparable unemployment rate was 4.1 percent. This suggests that Federal fiscal policy tends to shift from expansionist to restrictive effects before the recovery has been fully achieved, and long before a restrictive anti-inflationary policy is needed.

Thus fiscal policy, with the present Federal tax system, applies the brakes too soon and too hard. The 1963 Federal budget would be in balance if 1962 GNP had been about $575 billion. A GNP of about $600 billion, however, would have been necessary to achieve a high enough level of output, income, and employment to reduce unemployment below a 4-percent rate. And I would question whether a 4-percent unemployment rate is not too high to be a longrun goal, and suggest that a really acceptable ceiling would be a maximum of 3- to 3½-percent unemployment.

Not only does the present tax system provide a balanced budget when the national economy is still unbalanced on the low side; the present tax system also takes too large a fraction out of an increase in income as income rises.

As GNP rises, the increase in Federal taxes is about one-third of the increase in GNP. The large and sweeping reductions in Federal rates on personal and corporate income under President Kennedy's proposals would reduce the marginal tax take of GNP to about 27 percent. In addition, the Federal Government budget would be balanced at a GNP about $30 billion higher than the present level at which balance would be achieved.

An evaluation of the fiscal policy aspects of the President's proposal raises not a question most often heard in the newspaper columns whether this is too much and too soon, but whether the tax cut is not too litle and too late, or too slow. An increase of about $30 to $40 billion in GNP to about $600 billion a year is needed now to lower unemployment to 4 percent. A further 4-percent increase (currently about $25 billion a year) is needed to provide additional jobs for a growing and more productive labor force. This suggests the need for a GNP at an annual rate of about $625 billion in the first quarter of 1964 and of about $650 billion 2 years hence.

The Economic Report indicates that the cuts in income taxes when fully effective would increase disposable income by about $8.5 billion in 1965. It is estimated that about 93 percent of this will be spent on consumption, an additional $8 billion of consumption. With a multiplier of 2, the total direct increase in GNP will be $16 billion. To the extent that the higher level of demand generates more investment, more jobs will be created, income will be higher, more consumer spending will follow. The full additional increase in GNP due both to the direct and induced effects of the tax reduction thus may amount to $25 billion by 1965, when an expansion of $30 to $40 billion is needed now. Thus the economic analysis in the Economic Report seems to suggest that the additional spending generated by the proposed tax reduction is much more likely to be too small and too late and fail to achieve the low unemployment and the 4½-percent rate of economic growth, than it is to bring on too fast an increase in demand accompanied by a strong inflationary situation.

If our objective is the realistic and relatively modest one of producing economic growth and increased income and employment to reduce unemployment to not more than 4 percent by the end of 1964, I recommend that the tax program proposed by the President be accelerated. The proposed first and second stages of rate reduction, for example, might be compressed into a big first step of the reduction and become effective in 1963. The final reduction could be scheduled for July 1, 1964. Acceleration of the reduction would allow the anticipated economic benefits to be more rapidly and more certainly realized. I fear that the timing proposed in the President's recommendation is the leisurely and less certain road to a lower level of unemployment than we now have, but still short of the goal of a maximum of 4-percent unemployment.

III. INCOME TAX REDUCTION

President Kennedy has proposed the boldest, largest, and most farreaching reduction and reform in the 50-year history of the income tax. I commend the fact that the emphasis is on rate reductions, and not on the introduction of selective tax incentives and gimmicks to try to achieve the national objectives.

The canons of taxation first proposed by Adam Smith in the "Wealth of Nations" almost 200 years ago are still valid as criteria to judge major changes in a tax system. Adam Smith enumerated equity, convenience, the certainty of the tax, the economic effects (including both compliance and administrative costs and the effects on incentive and on the allocation of resources), and the adequacy of the revenue from the tax.

The rate reductions and the reforms would contribute substantially to greater tax equity. The rate reductions would apply to every individual and corporation now paying Federal income taxes. Almost a million individuals and families in the lowest income brackets—those least able to pay—will be removed from the tax roll. The proposed increase in the minimum standard deduction to $300 per taxpayer (or family) and to $100 per dependent will remove from the tax rolls single persons with incomes below $900, in place of the present $667 tax-free maximum, and married couples with incomes below $1,500, against the present $1,333. The individual exemption was increased to its present level of $600 per person in 1948. Since then, the Consumer Price Index has increased 26 percent. The proposed minimum standard deduction serves in effect to recognize the higher cost of living for the lowest income groups. For these groups, the standard deduction as presently defined at 10 percent of income has been a regressive feature in our tax laws. The new minimum standard deduction would be the most valuable feature of the proposed changes for the lowest income groups, providing for them some equivalent to the large rate reductions received by taxpayers in the middle and upper income groups.

The rate reductions, together with the reforms, will make the taxes apply more uniformly to all taxpayers, regardless of the type of economic activity in which they are engaged, the type of expenses they incur, or the form in which they receive their incomes. We will move closer to the goal that equals will receive equal treatment, and that the unequal treatment for unequals will be correlated more closely with differences in their ability to pay. Taxes, in my judgment, should be neutral between different kinds of economic activities. Under the present complicated tax system with differential tax treatment for certain classes of income and different types of expenses, the tax system has drifted far from this goal. The rate reductions and reforms will go a substantial way toward returning to the relatively straight and narrow path of tax neutrality.

A major gain will be made in convenience and simplicity. The law will be simpler and much more understandable to the average citizen and taxpayer. The rate schedule applicable to ordinary income will have a broader and more general application; the exceptions will be fewer and less valuable due to the lower rates on ordinary income. This will go a long way toward reversing the ill repute into which our tax system has fallen over the last 20 years. Citizens are disillusioned when they discover the rate schedule does not mean what it says and that it applies only to a fraction of the income of certain taxpayers, especially those in the upper income brackets. The lower rate schedule will provide a schedule with which taxpayers, the Congress, and the executive branch can live. Costs of compliance for individual and corporate taxpayers will be reduced. Administration costs for the Government will be smaller.

The application of the tax system will also be more certain, another of Adam Smith's canons. For example, there will be less opportunity and, with lower rates on ordinary income, less pressure for shifting ordinary income into capital gains.

The economic effects of the tax reductions will contribute directly to stimulation of the economy. Tax rates, when the third stage of the proposed reductions is in effect, will be much lower on all income, as follows:

Individual income: Rates on ordinary income reduced between 18.2 and 30 percent; rates on long-term capital gains reduced between 22 and 58 percent.

Corporate income: Rates on the first $25,000 of taxable income reduced 26.7 percent; above $25,000 reduced 9.6 percent; rates on capital gains reduced 12 percent.

More purchasing power will be available in the private sector of the economy. Personal income after taxes will be higher, directly by about $8.5 billion a year and by much more when secondary effects are included. A substantial increase in consumption will result. Personal savings available to finance additional investment will also increase.

Business will have both more incentive to invest and an improved financial capacity to add to plant, equipment, and inventories. The average rate of return on new investment, considering only the lower corporate tax rates, will be about 10 percent higher on an after-tax basis, than under present tax rates. With businesses organized as proprietorships or partnerships, rates of return after taxes will be between 18.2 and 30 percent higher, depending on the owners' tax bracket. Increased sales, resulting from greater consumer spending, will lead to larger dollar amount of profits before taxes; profits after taxes will be increased both as a result of larger pretax profits and the reduced tax rates. The larger after-tax income will permit larger dividend payments and more internal financing of capital outlays and expenditures for new products and new markets.

The sharply lower rates on all rate schedules will help to end or minimize the prevalent question today, "What's the tax angle?" Instead, the lower rates will restore to the deserved and intended prominence the much more important questions, "Is it efficient?" "Is it profitable?" and "Is it good business?" The emphasis in both personal and business decisions will tend to shift away from the tax aspects, and focus on the real economic considerations. One example is the statement in the Wall Street Journal of Wednesday, January 30, which quoted Frederick J. Millet, partner in Goodbody & Co., that the Kennedy tax program may be "a good thing"; that the thinking of many investors "for a long time" has been "dominated" by tax considerations rather than an appraisal of the basic values of stocks they buy and sell.

In general, Members of Congress, businessmen, investors, and economists believe that decisions made in free, competitive markets should largely determine price, production, investment, and employment. For about 20 years, however, tax considerations have played a major and probably increasing role and the forces of the free market a reduced role. Adoption of the proposed program of both tax reduction and reform would be a major step toward minimizing the nonmarket factors in the decisions of consumers and businessmen.

IV. TAX REFORMS

The income tax is a precious national asset. It must not be allowed to waste away. The income tax depends in part on a prosperous and expanding economy. It also depends on the confidence of the mass of the people in the justice of the tax laws and their administration. Our income tax system depends in a large measure on the self-assessment of tens of millions of individual taxpayers. If the feeling continues to spread that the tax system favors certain groups and industries, either through preferential legislative provisions or through uneven or capricious enforcement, the people will lose confidence in the tax system and our country will have lost something it will be very difficult to recover.

Congress this year has an opportunity that comes once in a generation; this is the opportunity to adopt certain reforms to improve the equity, neutrality, simplicity and favorable economic effects of our Federal income tax system and to remove some of the major distortions, inequities, and complexities which have crept into the system.

The unique opportunity this year is the chance to combine major reforms with large and universal rate reductions. Tax reforms never come easy. The only realistic opportunity for major reforms which remove or reduce preferential provisions is to combine reforms with major tax reduction. At this time, even those taxpayers who lose the benefit of some preferential provision, will in almost every case still enjoy some tax reduction. The effect of the reform will be to reduce their relative share in the tax reduction, but generally not to increase their taxpayments. Certainly their complaints and opposition to the reforms will be loud and persistent, but not nearly so sharp as if their taxes were being increased. Separation of tax reforms from the bill proposing tax reductions would be likely to mean no broad and important reforms. Reforms need the sweetener of tax reduction.

The most glaring inequities in my judgment are those provisions which allow certain income to be entirely or partially free of tax, by exclusion or preferential features applying to some types and sources of income, and to deductions for certain expenses beyond actual cost. The Congress is to be commended for substantial progress in recent years in removing some of these glaring inequities in the tax system. The Life Insurance Company Income Tax Act of 1959, and many features in the Revenue Act of 1962, provide instances of recent changes in the tax laws in which income, previously in a large measure free from taxation, has been brought into the tax base. The 1962 act included reasonable restrictions on entertainment, gifts, and travel expenses; the extension of taxation to producer cooperatives, mutual savings banks, savings and loan associations, and mutual fire and casualty insurance companies; the closing of opportunities to use foreign tax havens; and the taxation as ordinary income of gains from the sale of certain depreciable property. The provision for information returns on interest, dividends, and patronage refunds will also be important in raising the level of taxpayer compliance. Congressional committees are relatively well prepared for major legislation on income tax rates and reforms based on careful studies and hearings.[1] The Congress is to be commended for its patience and careful work in these fields. In each case, the change was vigorously opposed. The steps in a number of cases did not go as far as reformers would have liked, but there is general agreement that these represent major improvements. Another kind of change in recent years, such as the depreciation section of the 1954 code and the investment credit and the revision of depreciation guidelines in 1962, have changed the timing of income subject to tax, but have not affected the total amount of income subject to tax in the long run.

The most important reforms, in my judgment, are the proposals dealing with capital gains. The President, the Secretary of the Treasury, and the Treasury staff, have scored a "10 strike" in these recommendations. They have succeeded in designing a package of changes which contribute significantly to the economic

[1] See especially Committee on Ways and Means, 86th Congess, "Tax Revision Compendium" (Washington, 1959).

growth of the country, while at the same time making a major improvement in the equity of the tax system. Perhaps the most important single change in the capital gains package is the feature that requires constructive realization of gains at the time of transfer by gift or death. The omission of these gains from taxation under present law has served to lock in investors who hold securities or real estate which have appreciated in value. The lock-in feature of the capital gains tax is due not only to the fact that the sale of an asset subjects the owner to a tax on the realized gain, but also to the fact that the owner can avoid the tax entirely by transferring the property with appreciated value either by gift or as part of his estate at death. The recipient of the appreciated property is able to use the value of the asset at the time of transfer as the new tax basis so that this increase in value is never subject to income tax.

This moderate proposal provides for exemption of transfers of a small amount of property, for convenient payment of the tax, for reduction of the taxable estate as a result of the income tax on the unrealized gains, and for averaging of the gains over several years.

Contributions of securities or real estate would not be subject to a tax on the appreciation in value. This might lead to a substantial increase in gifts of security and real estate to churches, colleges, universities, hospitals, and other charitable institutions. And this incentive to more giving might offset some of the other aspects of the reforms, which may remove some of the tax incentives for contributions.

The proposed provision for inclusion of these gains in the tax base will encourage investors to sell or switch their securities when economic conditions justify a transfer. The new provision will tend to remove the tax consideration, since taxes in this case will be uniform so long as the property has been held more than 1 year. It will no longer be a question whether the gain is taxed: but rather when it is taxed. This important change would tend to make savings invested in equities especially more mobile and more responsive to economic change. If only a few of the recommended reforms survive in the final tax bill, on grounds both of improved equity and contribution to economic growth, this provision for the constructive realization of gains at death or by gift should be included.

The other features of the capital gains reforms also merit commendation. Extension of the holding period to 1 year from the present 6 months gives some theoretical justification for only partial inclusion of these gains in taxable income. The lower effective rate would be available to investors but not to speculative transactions.

The reduction of the percentage of long-term capital gains included in taxable income from 50 percent to 30 percent is most generous, and generally a greater percentage reduction than is granted to ordinary income. This would be a major reduction even if the general rate schedule were not being reduced; with the lower rate schedule applied to a smaller percentage of the gain, the tax saving becomes even more valuable with the effective rates now ranging between 4.2 and 19.5 percent. Elimination of any maximum rate on capital gains, such as the present 25 percent maximum rate, does mean that the effective capital gains rate will bear the same relation to the ordinary income tax rate for taxpayers at all income levels, an improvement over the present arrangement.

The proposal for unlimited carryover of capital losses will encourage risk taking and stimulate economic growth as well as equity.

The recommendations also include a revision of the definition of capital gains to exclude those types of situations which may have been justified under the outdated conditions of World War II, or by the very high rates which are now to be removed. Capital-gains treatment would no longer be available to real estate tax shelters or to restricted stock options. Stock options permit some executives to convert what is really a type of ordinary income into capital gains. It is much fairer to treat these gains as ordinary income for tax purposes, especially if the income-averaging recommendation and the lower rate schedule are adopted.

These changes relative to capital gains go a long way to remove major distortions now caused by the tax laws. These reforms will also reduce the effort now devoted to figuring out tax angles and tax avoidance possibilities, and would cause a reallocation of resources to the production of meaningful goods and services which add to our standard of living and increase our productive capacity. The package of capital gain reforms, largely due to the greater activity expected from the elimination of the lock-in aspect, is estimated to yield an additional $800 million annually.

In terms of revenue and perhaps in terms of controversy, the outstanding proposal is the President's recommendation that a floor equal to 5 percent of taxable income be set on the amount of itemized deductions. The President and the Treasury are following a path here that deserves a full explanation. The basic approach is good; a widespread and effective educational campaign, however, will be needed to point out the advantage and overcome the opposition. I hope that this proposal can be considered on its merits, and not in the light of the emotional arguments which will be raised against it. This proposal is essentially a move to restore the standard deduction to use for most taxpayers; the standard deduction would be in general use. Itemized deductions would apply in the relatively unusual case; the rationale for itemized deductions has been lost when 40 percent of the taxpayers use it. The floor on itemized deductions is an attempt to get away from the complexities and paper work for taxpayer and tax administrator involved in the present system under which a large and rapidly increasing percentage of taxpayers itemize deductions. The proposed lower rate schedule is made possible in part by limiting itemized deductions; the revenue gain from the floor on itemized deductions is equal to about one-fifth of the reduction in the tax rate schedule. Essentially Congress and the country here have the choice of whether they prefer a complicated system with liberal use of itemized deductions accompanied by a high rate schedule, or a simpler, larger, more straightforward tax base together with a significantly lower rate schedule. The reforms will also be of substantial importance in stimulating consumer demand.

Enactment of the proposed recommendation into law would make the tax system more neutral between different ways in which consumers spend their money, would contribute to equity between different taxpayer groups, such as homeowners and renters, and would substantially simplify tax payments for about 6.5 million families.

Another major change proposed is the repeal of the dividend credit and the dividend exclusion. The dividend credit and the dividend exclusion on one hand have failed to serve their stated purpose to increase the percentage of external funds raised through equities instead of through debt. On the other hand, the sizable rate reductions proposed in both individual and corporate tax rates would leave stockholders in a much more advantageous position than is provided by the dividend received credit. Corporations would be in a position to pay larger dividends and stockholders' dividends after personal income taxes would be substantially increased. The example presented in the following table illustrates the gain for stockholders in different tax brackets from adoption of the proposed changes, including repeal of the dividend credit. Note that the higher a stockholder's income bracket, the greater his percentage gain from the adoption of the new proposal.

Comparison of present situation with proposed changes on corporate income after tax and on stockholders' division income after tax (at selected tax rates)

	Present	Proposed	Percent change
Corporate profit before tax	$100	$100	
Corporate income tax	50	45	−10
Corporate profit after tax	50	55	+10
Payout percentage	60	60	
Addition to retained earnings	$20	$22	+10
Dividends paid	$30	$33	+10

STOCKHOLDER'S INCOME AFTER TAX, AT SELECTED TAX RATES

Present tax rate		Proposed tax rate		Percent change
Percent	Amount	Percent	Amount	
None	$30.00	None	$33.00	+10
20	25.20	15	28.05	+11
50	16.20	40	19.80	+22
91	3.90	65	11.55	+196

NOTE.—Allowance is made for 4 percent dividend received credit under present tax system, but not under proposed system. Dividend exclusion of $50 per taxpayer is not reflected in the example.

Percentage depletion and the provisions for expensing exploration and development costs are among the most glaring inequities in the Federal income tax system. Deductions against income which may be many times the actual cost are permitted by these provisions. As a result, individuals and companies engaged in the extraction of oil, gas, and other minerals often pay a much lower effective rate of tax on their income than if they were engaged in most other businesses. This more favorable tax position, in turn, serves to attract more resources into these industries than would tax provisions which were neutral.[3]

The four changes proposed in the tax treatment of mineral industries are good as far as they go. Adoption of each of these recommendations would be a clear step toward improving the equity and the economic effects of the tax system. In terms of a broad program of reform intended to remove inequities and revising preferential tax treatment now accorded particular types of transactions, enterprises, or taxpayers, however, one might have hoped for some bolder recommendations. For example, with no change in the present percentage depletion rates, a maximum deduction for the depletion of any property might have been set at the cost of the productive property; expenses would be deductible in full but no deduction would be permitted in excess of costs. This would place a limit on deductions for depletion and exploration and discovery costs on the same basis as for other expensive and long-lived assets.

Some sources might support restriction on the preferential treatment for the oil industry of development expenses and percentage depletion on the ground that many more wells are drilled now than are needed for economic and efficient extraction.

The administration proposals on the oil, gas, and mineral industries should be expanded to achieve greater equity and to improve the allocation of resources between different industries. Equity and economic considerations would support the elimination of, or stronger restrictions on, percentage depletion allowances than are included in the proposed reforms.

Clear improvements in equity, more revenue, and no adverse effects on incentives are associated with the proposals relating to taxation of sick pay, minimum on casualty loss deductions, and taxation of employer-financed premiums on life insurance coverage above $5,000 per employee.

V. OTHER COMMENTS

The 1964 budget document itself is presented in a normal-sized book form, a startling and welcome improvement in the view of most of its readers. More important than the format, however, the cash consolidated budget and the Federal sector of the national income accounts are presented on an equal footing with the administrative budget in the new document. This greater attention to the cash budget and the Federal sector of the national income account brings into focus the greater merit of these measures in analyzing the financial and economic effects of the Federal budget.

The budget also puts a new emphasis on programs and program costs, as opposed to agency and object of expenditure types of budgets. The program presentation emphasizes the problem of choice. The proposed budget for the Department of Defense, for example, presents separately the costs of the strategic retaliatory forces, the continental air and missile defense forces, the general purpose forces, the sealift and airlift forces, the reserve forces, and other major programs. This presentation will facilitate more intelligent budgetary decisions and a wider understanding of the budget choices, both for Congressmen who must vote on these and for citizens who try to keep informed on important Government programs and policies.

In summary, let me commend the President and the Council of Economic Advisers for a carefully reasoned and persuasive economic report. The critical need for the adoption of an expansionist economic program by the Federal Government this year is well established. There is a real question whether the proposed tax cut alone, large as it is by historical standards, is sufficiently large to boost the economy as much as is needed at this time. And last, the President's tax reforms integrated with the tax reductions represent a major step toward a fairer, more understandable, less complicated, more neutral tax system. The reduction and reforms together will increase economic incentives and strengthen the operation of the private sector of the economy. Some major reforms will

[3] Committee on Ways and Means, 86th Congress, "Tax Revision Compendium," pp. 294–300, 967–984 (Washington, 1959).
Joint Committee on the Economic Report, 84th Congress, "Federal Tax Policy for Economic Growth and Stability," pp. 430–449, 877–888, 897–903 (Washington, 1955).

still remain to be undertaken. The proposed tax reductions and reforms will generate additional income, output, and employment and will also both sweeten the incentives and enlarge the financial capacity to invest. If a major tax program is not enacted this year, it is likely to be in 1964 or the following year. And the economy will probably drag until action is taken. The best prospect for solution in the near future of both persistent unemployment and a lagging growth rate is offered by an expansionist Federal tax and fiscal policy in 1963.

Chairman DOUGLAS. Thank you, Mr. Hellmuth, very much.

We are very glad to welcome Dr. Jacoby, former member of the President's Council of Economic Advisers.

STATEMENT OF NEIL H. JACOBY, DEAN, SCHOOL OF BUSINESS ADMINISTRATION, UNIVERSITY OF CALIFORNIA AT LOS ANGELES

Mr. JACOBY. Thank you, Mr. Chairman.

If it pleases the chairman and the committee, I would like to read my statement, which is fairly brief.

I am grateful for the invitation to appear again before this distinguished committee to offer comments upon the recent budgetary and tax proposals of President Kennedy to the Congress.

I wish to state at the outset that I agree with the major features of the President's diagnosis of the status and problems of the U.S. economy, and with the broad fiscal strategy he proposes to adopt in an effort to surmount those problems. It seems to me quite evident that our economy has too large a margin of unemployed resources, resulting from a sluggish overall growth of demand and an insufficient flexibility in adapting to technological changes. It is equally apparent that the primary cause of this condition is an overburdensome and absurdly complex system of Federal taxation. The President has, quite rightly, asked the Congress to curb future increases in Federal spending, and to reduce the rates and reform the structure of the tax system in a 2-year program. He deliberately accepts an immediate enlargement of the Federal cash deficit in a calculated risk that private demand will expand sufficiently to eliminate excessive unemployment, and will bring the budget into balance under conditions of high employment.

The fiscal strategy proposed by the administration is sound and desirable. But there are serious flaws in the emphases and priorities it gives to particular measures within this strategy. Specifically, I believe that the administration's proposals are faulty in four principal respects:

First, the amount of the proposed budget deficit is dangerously and unnecessarily large. It can and should be reduced by courageous action to cut certain planned Federal expenditures that are yielding little public welfare per dollar.

Second, greater emphasis on earlier and larger tax cuts on corporate incomes would bring about larger gains in employment per dollar of tax reduction. While $10 billion of tax reduction annually is an appropriate aggregate amount, the proposed concentration on personal incomes will fail to produce maximum economic growth.

Third, many proposed structural reforms move in the direction of greater complexity and inconsistency and should be abandoned. Although the Nation needs a simpler, more broadly based system of income taxation, many of the administration's proposals do not involve progress toward that goal.

Fourth, clear priority should be given to tax rate reductions now, with or without structural reforms. The administration's proposal to tie rate reduction indissolubly to structural reform runs the grave risk that interminable debate over particular reforms will delay the employment-generating stimulus of rate reduction until after the economy has slipped into a recession.

I shall now briefly set forth the considerations that have led me to these conclusions.

1. Reducing the prospective deficit by expenditure cuts: President Kennedy now foresees a deficit in the consolidated cash budget of $8.3 billion for the current fiscal year ending June 30, 1963. He proposes to expand Federal cash payments by $5.7 billion during the fiscal year 1964. He forecasts a rise of $3.8 billion in Federal cash receipts, based on anticipated strong growth of the U.S. economy from this time onward, and after allowance for a revenue loss of $2.7 billion resulting from the first stage of his program of tax reduction and reform. Thus, he arrives at a prospective deficit of $10.3 billion in fiscal year 1964.

Now, an annual cash deficit of $10.3 billion for the Government of an economy as large and with as much current slack as the U.S. economy, in a world whose economic expansion has slowed up significantly in recent times, does not of itself provoke alarm. Yet the proposed deficit is of unprecedented size for a third consecutive peacetime year of economic expansion. After all, we are not budgeting for a recession or a year of economic decline.

Given the present unsatisfactory position of the U.S. balance of international payments, and our inability to discern the future with great confidence, it would be reckless to risk running a deficit any larger than this. What causes apprehension is the distinct possibility that the actual cash deficit for fiscal 1964 will turn out to be considerably larger, because the growth of the economy will be less than expected. The President has assumed that the real gross national product will rise to $578 billions in the calendar year 1963, under the stimulus of tax changes. In my view, the U.S. economy is already well advanced in the expansion phase of a business cycle, and the tax stimuli contemplated for 1963 are too weak to make a 4.4 percent gain in real GNP likely. The chances are at least even that the Federal cash deficit for fiscal 1964 will exceed $10.3 billions; and this must not happen. The President himself concedes there could be a $5 billion deficiency which could have raised the deficit to 11.3 billion. One is driven to the conclusion that tax rate reductions to become effective during 1963 should be increased, and that contemplated Federal cash expenditures in fiscal year 1964 should be proportionately reduced.

1. Let us consider what could be done to reduce planned Federal cash expenditures. There is unwarranted pessimism and defeatism on this subject. It is often noted that 57 percent of all Federal cash payments proposed to be made in fiscal year 1964 will go for national defense, space, and interest on the national debt; and that no less than 80 percent of the planned increase in spending between fiscal year 1963 and fiscal year 1964 will be devoted to these purposes—which laymen often accept without question. Since all other Federal outlays will rise only by $1.2 billions, the practical margin for expenditure reduction seems to be negligible. After all, it is said, the expendi-

tures of a government serving an expanding population must at least rise proportionately.

Such conclusions are superficial. They ignore the substantial opportunities that exist for reducing—as well as curbing increases in—several categories of Federal spending that are adding little or nothing to the growth of output of the U.S. economy and, in some instances, are actually impeding growth. At a time when the announced keystone of the administration's fiscal policy is the promotion of economic growth, surely it is only prudent to apply the most rigorous tests to the productivity of every Federal spending program. The process of stripping off fiscal fat is even more painful than that of holding the line. But, it is clearly implied by the strategic decision the administration has wisely made that the American people will be better off if more Federal tax money is left in their hands to spend or invest as they will. With determined effort, it is both desirable and possible to reduce the planned aggregate increase of $5.7 billion in Federal cash outlays in the fiscal year 1964 by one-half or by $2 to $3 billion. This would leave room for some acceleration of corporate tax reduction, as well as for possible miscalculations of our economic future which are of larger dimensions than the administration contemplates.

It is incumbent upon those who advocate expenditure reduction to specify the proper fields for action. Among Federal programs for which a "Metrecal" fiscal diet would help put the economic body in better trim, I suggest the following: agricultural subsidies, which are impeding the movement of manpower to more efficient uses; veterans' benefits and services, which seem to rise endlessly in cost although wars have receded in time; and foreign economic aid programs (including particularly aids to Yugoslavia and Poland), many of which do not appear to be making a clear contribution to U.S. interests. The time has come for a rigorous reassessment and trimming of heavy U.S. military assistance in Europe. I suggest that substantial cuts in Federal cash outlays are possible by limiting the further growth of such Federal credit programs as those of the Small Business Administration and the Farmer's Home Administration, for which reasonably adequate private credit sources are available. Pressure should also be put on Federal credit agencies with large inventories of loans, such as the Federal National Mortgage Association, to sell assets to private financial institutions and thus produce a cash credit to the Federal budget. I recognize that some such action is contemplated. I think it should be stronger.

Most of these expenditure cuts will be offset in large part by private and State and local government expenditures, so that they will not reduce aggregate demand.

2. Increasing the employment-generating effects of tax reduction: The proposed aggregate reduction in Federal tax liabilities of about $10 billion—based on calendar year 1963 levels of income—is an appropriate amount of stimulus to the economy, and the concept of programing reductions over a 2-year period is valuable. But it is apparent that changes in the distribution of income-tax reductions, both in timing and as between individuals and business corporations, are necessary if the employment-generating effects of the whole program are to be adequate.

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In essence, the President proposes to reduce the income-tax liabilities of individuals by an average of 23 percent through three successive rate reductions begining January 1, 1963 and ending on January 1, 1965. He asks that the rate on small corporations drop from 30 percent to 22 percent retroactive to January 1, 1963. But large-business corporations would not be granted any meaningful rate reduction until January 1, 1964; and then only a nominal cut from 53 percent to 50 percent of net income. They would have to wait until January 1, 1965, for a second small cut to 47 percent. Meanwhile, much of the effects on their cash positions would be offset by a proposed acceleration in their tax payments to the Treasury. The ultimate results of the whole program are essentially these: Individual income tax liabilities would drop by an average of 23 percent beginning now; those of large corporations would drop less than 10 percent beginning a year hence. More than 80 percent of the total ultimate drop in tax burdens would accrue directly to individuals; less than 20 percent directly to business corporations.

I assume that economic impact on aggregate demand and employment, rather than philosophical or political considerations of "equity," is the criterion upon which this tax program should be judged. If so, it is clear that much heavier weight must be placed upon reducing the taxes paid by substantial business corporations which acount for the preponderance of demand for business investment goods. For them, the proposed reductions are "too little and too late" to attain the central goal of a rapid rise in business investment. In order to provide both stronger incentives and the means of financing a long overdue modernization of U.S. industrial plant, and to obtain the superior leverage of investment expenditures upon total demand and employment in the economy, the tax rate applicable to annual corporate income in excess of $25,000 should be cut to 47 percent effective no later than July 1, 1963, and to 42 percent effective no later than July 1, 1964, thus bringing the rate down to its relatively high World War II level. The loss of revenue should be compensated by smaller reductions in other tax rates or by curtailed expenditures.

The logic of this requirement rests squarely on the proposition that the slow growth of the U.S. economy in recent years has been primarily due to a deficiency of domestic private investment. The facts are incontrovertible that U.S. business investment in recent years has been laggard, both in comparison with our own past and in comparison with the advanced economies of Europe and Japan. It is equally clear that there has been a secular decline in aggregate corporate profits after taxes, taken as a percentage of sales or of the national income. These facts are not unconnected.

In its 1963 Economic Report the Council of Economic Advisers analyzed the failure of the U.S. economy to rise as vigorously during 1962 as it had forecast a year earlier. After noting that other segments of demand had expanded in line with expectations, and that the percentage of disposable personal income spent by consumers rose during 1962, they wrote:

> It was therefore the failure of expenditures other than consumption to rise as fas as had been expected that held down the rise in incomes and in turn consumer expenditures. The error, then, was in the area of business investment, which fell about $8 billion short of the level that had been expected for the year 1962 (p. 15).

The logical conclusion to be drawn from this analysis is to strengthen investment incentives. However, the Council argued that businessmen were restrained from undertaking more investment by the existence of redundant plant capacity, and that higher consumer demands were necessary to take up this slack. The argument is faulty. In fact, I think this constitutes the strategic analytical blunder by the administration. Much unused industry capacity in the United States today is old and relatively inefficient. A large and rising part of business demand for plant and equipment, about one-half as I recall, is for modernization and improvement programs designed to cut costs, improve products, or turn out totally new products, and is unrelated either to the current state of consumer demand for existing products or to the amount of alleged "capacity" to produce them. Thus, American steel companies have continued to build modern mills—Bethlehem recently announced plans for a $250 million plant in the Chicago area—despite the fact that steel industry operations averaged well under 80 percent of rated capacity all through 1962.

The opportunities for stimulating investment in an advanced economy with dynamic technology by offering strong incentives are greater now than they have ever been in the past. It would be unfortunate to forego them because of illusions about "excess" capacity, especially when they can help produce that superior productivity and technological leadership so necessary to the maintenance of U.S. national security and finanical strength in the world today.

A meaningful corporate tax cut—a meaningful cut—would help to balance U.S. international payments by reducing the flight of business capital abroad in search of the higher yields that have prevailed there. A special tax has been proposed on movements of U.S. capital to Europe in order to discourage foreign investment. This proposal recognizes the powerful effect that higher after-tax yields on foreign investments have had on American business. This being true, why not solve the problem directly by increasing the relative yield of domestic investment through a lower tax rate, thus diminishing the incentive to go abroad?

There can be no doubt about two propositions. (1) Business investment does respond sensitively to the higher incentive of a larger tax yield. (2) The multiplier effect upon total demand and employment of a given amount of increase in business investment is much higher than that resulting from the same increase in consumer demand. The immediate result of a real cut in corporate taxes would be to leave more money in treasuries of corporations and to raise the prospective yield from investing those funds. Experience shows that the bulk of those funds assuredly would be invested, with a subsequent manifold increase in demand for consumer goods and services. Those not invested would be distributed to stockholders in cash dividends, and they would spend them.

To concentrate on personal tax reductions, as the administration proposes, is to refuse to allow the investment multiplier to work for the economy. Our vast space research effort is creating endless opportunity for new products and new investment, but the tax system must give business adequate inducements to invest.

3. Simplification of structural reforms: The President has proposed a large number of reforms in the structure of the Federal in-

come-tax system, which, by nearly universal agreement, needs to be broadened in base and simplified in concept and application. There is time here only for a few observations.

One main object of structural reform is to broaden the base of the personal income tax—to apply the appropriate rates to a larger fraction of personal income. My impression is that, taken as a whole, the proposed structural revisions do not make significant progress toward this goal. They do make some progress. Proposals to have a minimum standard deduction, to make more liberal allowances for child care, to raise the charitable deduction, whatever their merits in equity, would whittle down the tax base. Of course, they are more than offset by a proposed tightening up of deductions for purchases of drugs, minor casualty losses, and a repeal of the sick pay exclusion and the dividend credit and exclusion.

I favor the repeal of the dividend credit and exclusion, provided that a larger and more rapid schedule of corporate tax reduction is undertaken. All that ever commended it in the first instance was that it constituted an initial step in moderating the appalling discrimination now practiced against income from corporate dividends, which results from heavy taxation of income, first in the hands of corporations, and again when it is distributed to individual stockholders. It is better to proceed directly by cutting the corporate income tax rate.

The President argued that the 4-percent dividend credit is unjust because it reduces the burdens of taxpayers with large incomes more than it cuts those of taxpayers with small incomes. However, this is equally true of the present $600 exemption for each dependent, in which he recommends no change. Yet the law now subsidizes the taxpayer in the 90-percent marginal rate bracket to the extent of $540 for each dependent, but awards a subsidy of $120 per dependent to the taxpayer in the 20-percent marginal rate bracket. Clearly all such irrational exclusions of income from a tax base should be eliminated in a truly comprehensive program of broadening of the base.

The proposal to permit individual taxpayers to average their incomes for purposes of taxation is long overdue. It should foster growth by lightening the burden on those whose incomes fluctuate greatly from year to year, as is the case with many entrepreneurs as well as professional persons. It struck me as peculiar that the administration should embrace the averaging principle in the case of individual incomes, but should reject it in the case of oil and gas companies. However, it appears that the proposed denial to oil and gas companies of the privilege of combining different properties into one operating unit for purposes of computing the 50-percent-of-net-income limit on the depletion allowance of 27½ percent of gross income is really an indirect method of cutting the depletion allowance. If the depletion allowance should be reduced—and I have not studied the subject sufficiently to have an opinion on this question—it would be preferable to do so directly and openly, rather than to deprive oil and gas company managers of the power to average the results of their highly risky operations.

The administration has made a number of desirable proposals for structural reform—including the modification of the capital gains tax, which I think is very good. Most of them appear, however, to relate to equity rather than economic growth. In their totality they do not move as far along the road toward broadness and simplicity of income taxation as is desirable. It is to be hoped that the President will bring forth further and bolder proposals for this purpose in the future.

4. Tax reduction—with or without tax reform: Congress must now determine priorities in changing Federal taxes. The administration has wisely assigned precedence to the goal or more rapid economic growth. The chosen fiscal instrument for attaining that goal is tax reduction. Other considerations, important though they are, should not be allowed to stand in the way of timely reduction of tax rates. The personal interests involved in structural reforms of income taxes are so complex that they could occupy months of debate. Indeed, equity in the distribution of the costs of Government has been a perennial subject of controversy throughout modern times. Reforming the Federal income tax is a desirable and important goal; but reducing the burdens that high rates are imposing upon economic progress is an urgent need.

Thank you.

Senator PROXMIRE (presiding). Thank you very much, Dr. Jacoby.

Professor Lintner.

STATEMENT OF JOHN LINTNER, HARVARD GRADUATE SCHOOL OF BUSINESS ADMINISTRATION

Mr. LINTNER. Mr. Chairman, I am very happy to have this opportunity to discuss the fiscal policy of the Government with this committee. Over the last several years the evidence has been becoming increasingly clear that the tax rates on personal and corporate incomes in this country are substantially too high. These rate structures (with the exception of the repeal of the excess profits tax on corporations and some excises) are only moderately lower than those set in World War II and the Korean emergencies. These rates were entirely appropriate not only during these war periods themselves but in the early postwar years as well. The economy at that time was bloated with a great excess of liquidity, and there were tremendous accumulated backlogs of demand—especially for consumer durable goods, housing, plant and equipment and other construction—which added up to more demands for output than the economy could readily provide. Even as late as 1955–56 there was substantial pressure of demand, especially in the equipment industries, upon our capacity to produce output. But since 1957 the economy has operated with substantial slack even in recovery periods. My essential position is, and has been for some substantial time now, that the tax structure, which was entirely appropriate when the economy was operating under conditions of large backlog demands and excessive liquidity, is simply inappropriate and stifling under more normal peacetime conditions such as we have been having for the last 4 or 5 years.

Since the President's recommended tax program represents a fundamental—though much too long deferred—attack upon this essential problem, I strongly support the broad outlines and objectives of his proposals. The emphasis is properly placed upon a body of permanent tax legislation designed to improve the performance of the economy in more prosperous times as well as levels of activity over business fluctuations as a whole, and, very importantly, in the longer run even more than in the short. These tax cuts are not a quicky-dicky gimmick. And in this context of a much-needed permanent change in the fiscal posture of the Government, I believe that it is very important that the tax cuts be spread across the board with at least rough proportionality, including reductions in top-bracket personal income tax rates, and a reduction in corporate rates, at least to 49 if not to 47 percent immediately, and then hopefully lower later. Indeed, the proportionality should be much more uniform up the scale, from a longrun economic standpoint.

And from the standpoint of accomplishing these longrun basic objectives, I am also glad to see that the cut is massive in size, amounting to roughly $10 billion when the net revenue loss is figured at present levels of economic activity. (The actual increase in the size of the deficit which we would have in the absence of tax cuts will be only a fraction of this, of course; and the amount of tax reductions now proposed must also be viewed in the context of a $2 billion increase in social security taxes which took effect on January 1, 1963.) Even the more optimistic projections of the probable performance of the economy over the next year or so indicate that the added stimulus from tax reductions of the size asked will not produce excessive levels of activity. I might add that in my judgment this is also true of the acceleration in the timing of the reductions which Mr. Hellmuth and Mr. Jacoby were speaking of, and which I would also favor as indicated later in my text.

Since this basic change in the general level of tax rates is already substantially long overdue, I regret that it could not have been made earlier. In view of the time that will inevitably be consumed in the appropriate careful consideration of the recommended changes, I believe that every effort should be made to expedite the timing of the reductions as much as is possible. In this connection it is significant that with an increase of $2 billion in social security taxes in this year already on the books and a reduction at an annual rate of less than $6 billion in personal rates, to take effect for 6 months of the year, involving a reduction in personal tax liabilities of only about $2½ billion this year, there is very little net stimulating effect on this basis within the first phase of the President's program, and I would prefer to see the annual rates of tax reduction this year increased by $2 billion or so. The increase of $1½ billion in corporate taxpayments this year is also relevant on a cash flow basis.

To avoid misunderstanding, let me be clear that the reason for promptness is not to offset impending recession, for this is not now the prospect anyway, but rather to get about our business and do the job that needs to be done as expeditiously as possible. The economy is simply in the position of an otherwise very healthy man who for some time has needed a rather major operation; the sooner he gets the job done, the healthier and more productive he will be.

Because of the unavoidable increase in the near-term deficit that is involved in this tax program, it is particularly important that the efficiency of present spending programs be raised to the highest possible level—that special efforts be made to insure that the objectives of current activities be accomplished at minimum cost. Moreover, the closest scrutiny should be given to the real need for any new programs (defense, some parts of education, urban renewal, and perhaps space are probably the clearest priorities). But given the resulting level of Government expenditures that meet this test of benefits really justifying the costs for the economy and the so-called built-in increases involved in present programs, I believe—and I believe the American public would agree—that the value of additional private spending over the next few years is clearly greater than the desirability of further increases in Federal expenditures. Given this judgment, the action required is clear: the tax burden upon both American business and American consumers must be eased. Doing so is a prudent, responsible, constructive, and much-needed action which will strengthen and improve the performance of the economy, release private enterprise, and raise living standards. Moreover, as I develop later, it should also at the least substantially reduce—and offers a good chance of eliminating—the chronic deficits which have been plaguing the Government. Deficits will still, of course, be seen in recession years, but there is a good prospect this tax program will eliminate the cumulative deficit over the cycle which the present tax structure clearly involves.

I shall not review the evidence for the slowdown of the economy and the inadequate performance of the last several years, but I would like to emphasize that while some people regard the inadequacies of these last two recoveries as a reflection of weakness on the part of private economy, I would deny that allegation. Federal tax receipts on an accrual basis rose by nearly 30 percent of the entire increase in gross national product in 1961–62—and that is too much. The inadequacies of the last two recoveries simply mean that the private economy lacking strong backlog demands has been forced to run with an excessively heavy tax load on its back. A perfectly conditioned athlete climbing a mountain with a 150-pound load pack won't make the progress that he would make were the load removed.

Other people are inclined to doubt that the proposed tax reductions would have their intended stimulating effect. They point to the fact that tax reduction for a married wage earner with two children with the lowest tax bracket would amount to only a few dollars a week, depending on the exact income, and so on. The suspicion is then raised that such nickels, dimes, and quarters will get lost in the shuffle and not increase consumer spending. The point is sometimes made that these driblets would be used to repay debts of commercial banks and consumer installment finance companies rather than be spent. I suggest that such people living on the margin where they are burdened with debt are likely to either go back into debt or to increase their own spending, or that other people will increase their spending.

The evidence is entirely clear that these doubts and fears whether or not the tax reduction would be respent on balance by large numbers of people are simply not well founded. Indeed, when one is talking about changes in tax laws which Congress and the public regard as continuing legislation, all of the evidence points to exactly the opposite conclusion. Moreover, this evidence is massive. Economists and statisticians have spent more time, effort, sweat, and foundation money examining consumer spending behavior than on any other segment. Different economists have developed and rely on statistical relationships on consumer spending on goods and services and incomes which differ in details and do make some difference in handling *other* questions. Note that I have emphasized the word "other." But to my knowledge no economist has produced any evidence that dollars not paid in taxes because of a tax reduction are treated any differently than any other increase in disposable income due to an increase in employment, wage rates, salaries, or other sources. Every study of consumer spending behavior has taken income after taxes as the relevant income variable, and none has found any significance in the size of the taxpayment as such.

This does not mean that every individual or every individual family will immediately increase his or its spending by some fixed fraction of his greater income after taxes. The emphasis there is on the word immediate. But it does mean that when we are talking about tax reductions for large numbers of people and that when we look beyond the first few weeks or the first calendar quarter, that very large fractions of the total tax savings of the whole group will show up in additional spending, and the fraction spent within 6 months or a year is very large indeed.

Both the President and the Council in their reports refer to the fact that American householders as a whole regularly spend between 92 and 94 percent of after-tax income so that—and I am skipping part of the quotation—if we cut 8 billion from the consumer tax load, you can expect more than 7 billion increased expenditure. I have heard it suggested that if the range is as loose as 92 to 94 percent, that a 2-percent reduction in consumer spending out of disposable incomes which run about $400 billion could fully offset the $8 billion increase in disposable income due to tax reduction and leave no net stimulus in consumer spending even on an economywide basis.

But a simple, straightforward look at the historical record shows that this fear is also unfounded. The Revenue Act of 1948 reduced taxes by 4.7 billion retroactive to January 1. Consumer tax liabilities were 2.4 billion lower in 1949 than they were in 1948. Consumer spending was 2.9 billion higher. The ratio of spending to after-tax income increased 1.3 percent from 94.2 to 95.5 percent. The actual spending ratio was above the 92 to 94 percent range common in more recent years because of the continuing effect of postwar backlog demand, but the evidence surely supports the proposition that a very high fraction of money not sent to Washington will be spent. Personal income tax rates were also reduced effective January 1, 1954, with some further reductions that year. I have appended an exhibit which shows seasonally adjusted annual rates of personal income tax liabilities, disposable income, consumer expenditures, and the ratio of spending to after-tax income for the fourth quarter of 1953 through the first quarter of 1956. The spending ratio increased in every quarter during this period of tax reduction on through the first quarter of 1955, and while the ratio subsequently fell off slightly, it remained higher than before the tax cut, as shown by both the quarterly and the annual data.

I am not suggesting that Congress should count on any higher fraction of spending out of tax reduction than out of other income, nor am I ruling out the possibility of some temporary decline. But on the basis of the record, I think we can have great confidence that any such decline would be very small in size and very limited in time.

To repeat my earlier observation, all of the available evidence indicates that a very high fraction of any tax remission will be spent within a reasonably short period of time. This being the case, we can confidently expect that if consumers' disposable income is increased by tax reductions of about 8 billion, their rate of spending will, within a relatively short period of time, be approximately 7½ billion larger than it otherwise would have been.

This increased spending means increased sales for business, increased employment, profits, increased tax receipts, and so on, and it means a further increase in personal income, after the taxes on these added incomes, of over $3¾ billion, which then will lead to still further spending out of these larger incomes. Tracing the process through, it appears conservative to estimate that the total increase accumulated would be about $15 billion of consumer spending over and above the level it would have had in the absence of personal tax reduction. While the estimates are not precise figures, this is at the lower end of the range. It is a conservative figure. It must be emphasized that this is a permanent expansion in the gross national product over the levels it would otherwise have had.

It should also be noted that this increase in the gross national product and the sales of business which will result from a reduction in personal tax rates will also result in substantial increases in corporate profits. Indeed, the statistical evidence would indicate that this kind of an expansion in gross national product would increase the level of profits before taxes by something like 3 billion. A little more in the shorter run, a little less perhaps in the longer run. The one-half of this increase which is left after taxes will improve the ability of business to finance new expansion and, more importantly at the present time, the increase in the sales themselves will substantially reduce the substantial excess capacity which has been holding down plant and equipment outlays.

The cash flow position of business within the last year or 18 months has been very substantially better than the increases in their plant and equipment expenditure, but excess capacity was not significantly reduced, and incentives were not strong. The combination of increased markets, reduced excess capacity, and increased fund flows, mostly profits, will lead to larger capital outlays by business, which will further enlarge the increase in the gross national product that is attributable to the personal income tax cut.

It should be noted that this induced increase in business capital spending also increases personal income, employment in the production of the additional capital goods, and thereby leads to still further increases in consumer expenditures. In addition, with sales volume higher, business will be needing and producing more inventory which further swells the increase in gross product.

All told, on the basis of all the evidence, it seems reasonably conservative to estimate that there will be an increase of $2½ billion in gross national product after a reasonable period of time for each $1 billion tax reduction to consumers. Again this is at the lower end of the range of uncertainty.

So far I have discussed the expansionary impact that would follow from reduction of personal income taxes, including both the direct increases in consumer outlays and the induced increases in business investment which they would bring about. I think these induced increases in business investment should not be overlooked. These effects can be counted on with considerable assurance and they are sizable and they are very important. In themselves, they would serve to eliminate a substantial part of the continuing sizable gap between current utilization of plant and equipment and desired operating rates as shown by McGraw-Hill surveys to corporate executives who are inside their plants and are in the best of all possible positions to give estimates of what their current operating rates are and what their desired operating rates are, which is relevant to the question of obsolete and broken-down capacity.

Also, it will serve to eliminate at least a substantial part of the difference between the current output of the economy and the economy's reasonable potential, as well as making a substantial dent in the excesses in recent unemployment rates, the last report being 5.8 percent. But tax reductions are needed—and I want to emphasize this particularly—they are needed not merely to increase employment in the labor force in the short run, and to improve the operating ratios of business and the bringing of the economy to a better current level of operation in the short run, they are equally needed as permanent tax legislation designed to improve the containing performance and growth of the economy over the longer pull. We must deal with the problems of shackled growth and expansion as well as with the short fall in current operating rates.

With these objectives in mind, the recommendations that individual tax rates be reduced in rough proportion across the board become essential parts of the program. As indicated, I would like to see a more nearly equal proportion of rate reduction on up across the board for the middle and higher bracket rates. Reductions in these rates and in the corporate tax rate become particularly important in this context of the continuing expansion and growth. We are talking about a tax package as permanent legislation, with the eye on growth and further expansion just as much as on current short fall in operations.

Excessive marginal tax rates in the higher brackets lead to an inordinate expenditure of brains and time in legal tax avoidance and lead to serious misallocations of resources and business decisions which are quite distorted apart from special tax considerations. Perhaps even more significant, these rates have great importance from the standpoint of the flow of enterprise in unincorporated businesses and the supply of venture capital in the economy.

I think many of our discussions fail to take adequate account of the importance of the middle and higher tax brackets from the standpoint of the unincorporated business in the economy. Correspondingly, while it is appropriate and desirable that the larger amount of dollar reductions go to the individual taxpayers, the rates should be reduced more roughly in proportion across the board and it is also very important that the corporate tax rates be reduced. Here I feel that the justification for a reduction to 49 percent is virtually incontrovertible. Further cuts in the corporate tax rates require further justification and are perhaps somewhat weaker. But in view of the importance of the Government removing itself from a position of a majority stockholder in business, the present 52-percent rate, to that of a minority stockholder, it seems that a minimum cut in the corporate tax of 3 points getting down to 49 is rockbottom.

Further reductions are fully justified, in my judgment, as a part of the package for continuing growth. But to get rid of a rate above 50 percent on the corporate incomes seems to have a particularly high priority.

More vigorous recoveries and more vigorous growth and the prospect of continued more vigorous expansion all depend heavily on substantial increases in the recent rate of private plant equipment expenditures. These will be stepped up as a result of the increased sales that will follow from other parts of the tax reduction. But these outlays depend in an essential way upon the profitability of new investment outlays. Unless prospective profit rates to the investors after taxes are adequate to justify tying up the funds and living with the capital stock, the new investments simply won't be made. The recommended reduction in corporate profits tax rates improves this relevant prospective profit rate on any given investment and at the same time enhances its financial feasibility.

The middle brackets and the upper brackets for the unincorporated successful business—unincorporated—have the same effect. For both reasons these changes lead to investments that would not otherwise be made. These changes, including the reductions in middle and top bracket rates, would have the further important effect of substantially improving the psychological climate, and while psychology may not be relevant in itself, certainly the favorable economic effects are very relevant in this context. Although it is not possible to make precise estimates of the dollar amounts of new investments that will follow from these changes, but taking all companies together, and again using conservative estimates, the statistical evidence indicates that within a reasonable period of time there will be something more than a dollar of additional new investment for every dollar of tax reduction even with the relatively inadequate operating rates and excess capacity of the last few years, and that the increments will be larger once capacity is more fully utilized.

In sum, the enactment of this package would substantially increase sales, utilization of existing capacity, and improve profit margins and profits and have crucial importance, raise the profitability of the incremental new investments upon which the vitality and growth of the economy depend.

I now change to a different subject and note that there are many people who are quite willing to grant that all these good and desirable things will follow from a tax cut, but nevertheless hold back or oppose it on the ground that it costs too much or that we can't afford it.

They point to the fact that the budget deficit for the current fiscal year is now estimated at $8.8 billion and the gross Federal debt is already over $300 billion and say it is not responsible or prudent to deliberately increase these figures by a tax reduction, however attractive the benefits might otherwise seem to be. I should like to make three comments in this connection.

First of all, it must be recognized that the increase in the deficit attributable to a cut in taxes even in a period as short as a year will be substantially smaller than the amount of the tax cut figured at current levels of activity. I trust that this point is well understood, and I shall not dwell on it especially since others are in a better position than I to provide detailed estimates.

Chairman DOUGLAS. I wonder if you will pardon me if I raise this point. You have somewhat exceeded your time. We have a number of members of the committee who will wish to ask questions. I wonder if you would be willing to summarize in a minute. The whole statement will be printed.

Mr. LINTNER. I apologize, Senator Douglas, for running over, and I will be brief. In my statement, I indicate there are two judgments that have to be made in this connection, carefully and hardheadedly. Are the benefits that we get from the tax cut worth the cost? And is it something that, even if desirable on these grounds, is financially prudent to do? The financial prudence argument is sometimes answered on the easy basis that an individual who is continuously going into debt is a foolish spendthrift, and that the Federal Government should constrain itself in the same way. But the finances of the Federal Government are much more like those of a corporation. I do not argue that corporations also should all go int debt continuously either. But I do point out that corporations that have a good solid line of products and efficient managements which are maintaining and expanding their position in their industries and show a solid rate of growth in sales, assets, and income that prudent investors think are going to continue, these companies are not criticized if they increase their debt.

I note in this connection that the American Telephone & Telegraph Co. now has a debt 6½ times prewar, and more than twice as large as 1948. I have a table giving you the comparisons. A.T. & T. was using funds beyond those provided by its current operations to make investments financed by debt. Prudent investors have bought their bonds with high confidence because they knew that the benefits gained would justify it.

Increases in the net debt of the Federal Government over time and in relation to gross product have been even more favorable. I make the point that we are here comparing A.T & T. with itself and the Federal Government with itself. I don't want to push the analogy too far. There are major differences. But it is relevant that the Federal debt relative to GNP has declined by over two-fifths from 83½ percent in 1947. So far as the benefits are concerned, a basic cut in corporate and individual taxes will raise the level of gross product we will otherwise have by something more, and probably significantly more, than 2½ times the amount of the initial revenue loss, and this will be a permanent income increase in the level of gross product we would have had, and it will increase private investment, enlarge our capital stock, reduce unemployment and step up our growth.

It seems to me it is clear that even if the Federal debt over a 2- or 3-year period were to be made larger by as much as 3 or 5 percent of its present level, the resulting larger debt in the context of a larger gross product and income base will be a sounder debt. The soundness of the Federal debt depends on the taxing capacity of the Government, and how good that is depends on the income to which that taxing capacity can be applied. Such a larger debt in this context of an improved income base will look to prudent men to be a sounder debt that a somewhat smaller debt outstanding in an economy that has higher unemployment, more excess capacity and weaker growth prospects.

In short, my answer to these two questions is that the benefits do fully justify the costs of the deficit. Notice that I regard the deficit as something to be avoided as a cost unless the benefits do fully justify it. I believe that the benefits do justify it and that the increase in the debt at this time for this purpose will be a prudent and responsible act.

I also believe that this is our best calculated risk, our best strategy, to bring our Federal budget into a more continuing balance. Certainly the record in the last year is bad. I have the first exhibit in the statement stating the fact that the Federal Government absorbed approximately 30 percent of the increase in the entire dollar market-value of all the goods and services produced, gross national product, between the trough 1961 and third quarter 1962. This is simply too big a brake on the economy. I think it is a good calculated bet that something on the order of 25 percent of a bigger figure will be larger Federal revenues, better budget balance, than 29 percent of a smaller sluggish figure.

Thank you very much, Mr. Chairman.

(The prepared statement referred to follows:)

STATEMENT OF PROF. JOHN LINTNER, HARVARD GRADUATE SCHOOL OF BUSINESS ADMINISTRATION, BOSTON, MASS.

I am very happy to have this opportunity to discuss the fiscal policy of the Government with this committee. Over the last several years the evidence has been becoming increasingly clear that the tax rates on personal and corporate incomes in this country are substantially too high. These rate structures (with the exception of the repeal of the excess profits tax on corporations and some excises) are only moderately lower than those set in World War II and the Korean emergencies. These rates were entirely appropriate not only during these war periods themselves but in the early postwar years as well. The economy at that time was bloated with a great excess of liquidity, and there were tremendous accumulated backlogs of demand—especially for consumer durable goods, housing, plant and equipment, and other construction—which added up to more demands for output than the economy could readily provide. Even as late as 1955–56 there was substantial pressure of demand, especially in the equipment industries, upon our capacity to produce output. But since 1957 the economy has operated with substantial slack even in recovery periods. My essential position is, and has been for some substantial time now, that the tax structure, which was entirely appropriate when the economy was operating under conditions of large backlog demands and excessive liquidity, is simply inappropriate and stifling under more normal peacetime conditions such as we have been having for the last 4 or 5 years.

Since the President's recommended tax program represents a fundamental—though much too long deferred—attack upon this essential problem, I strongly support the broad outlines and objectives of his proposals. The emphasis is properly placed upon a body of permanent tax legislation designed to improve the performance of the economy in more prosperous times as well as levels of activity over business fluctuations as a whole, and in the longer run even more than in the short. These tax cuts are not a quicky-dicky gimmick. And in this context of a much needed permanent change in the fiscal posture of the Government, I believe that it is very important that the tax cuts be spread across the board with at least rough proportionality, including reductions in top bracket personal income tax rates and a reduction in corporate rates, at least to 49 if not to 47 percent immediately (and hopefully lower later). Indeed, from a long-run economic standpoint, especially in view of the importance of successful unincorporated businesses and supplies of venture capital, the net reductions in rates should be more nearly proportional than the President has recommended after allowing for the limitation on deductions included in his program.

From the standpoint of accomplishing these long-run basic objectives, I am also glad to see that the cut is massive in size, amounting to roughly $10 billion when the net revenue loss is figured at present levels of economic activity. (The actual increase in the size of the deficit which we would have in the absence of tax cuts will be only a fraction of this, of course; and the amount of tax reductions now proposed must also be viewed in the context of a $2 billion increase in social security taxes which took effect on January 1, 1962.) Even the more optimistic projections of the probable performance of the economy over the next year or so indicate that the added stimulus from tax reductions of the size asked will not produce excessive levels of activity.

Since this basic change in the general level of tax rates is already substantially long overdue, I regret that it could not have been made earlier. In view of the time that will inevitably be consumed in the appropriate careful consideration of the recommended changes, I believe that every effort should be made to expedite the timing of the reductions as much as is possible. Particularly in view of the increase of $2 billion in social security taxes that has already occurred this year, I should prefer to see the annual rates of tax reduction to take effect this year increased by at least this amount. To avoid misunderstanding, let me be clear that the reason for promptness is not to offset impending recession, for this is not now the near term prospect anyway, but rather to get about our business and do the job that needs to be done as expeditiously as possible. The economy is simply in the position of an otherwise very healthy man who for some time has needed a rather major operation; the sooner he gets the job done, the healthier and more productive he will be.

Because of the unavoidable increase in the near term deficit that is involved in this tax program, it is particularly important that the efficiency of present spending programs be raised to the highest possible level—that special efforts be made to insure that the objectives of current activities be accomplished at minimum cost. Moreover, the closest scrutiny should be given to the real need for any new programs (defense, some parts of education, and perhaps space are probably the clearest priorities). But given the resulting level of Government expenditures that meet this test that "benefits really justify the costs for the economy as a whole" and the so-called "built-in" increases involved in present programs, I believe—and I believe the American public would agree—that the value of additional private spending over the next few years is clearly greater than the desirability of further increases in Federal expenditures. Given this judgment, the action required is clear: the tax burden upon both American business and American consumers must be eased. Doing so is a prudent, responsible, constructive and much needed action which will strengthen and improve the performance of the economy, release private enterprise, and raise living standards. Moreover, as I develop later, it should also at the least substantially reduce—and offers a good chance of eliminating—the chronic deficits which have been plaguing the Government. (Deficits will still, of course, be seen in recession years, but there is a good prospect this tax program will eliminate the cumulative deficit over the cycle which the present tax structure clearly involves.)

The evidence of a basic and important change in the performance of the economy since the watershed years of 1955–56 is clear, as is the fact that this record shows the need for something substantially like the tax reductions now recommended. Both the recovery in 1959 and 1960 from the recession of 1958, and the recovery in 1961 and 1962 have been inadequate and unsatisfactory. During the current recovery unemployment has not fallen below 5.3 percent (except for 1 month it has not fallen below 5.5 percent), while it fell to 5 percent during the 1959–60 recovery in a comparable period from the previous trough. Correspondingly while unemployment did not get below 5 percent in the 1959–60 recovery, it had been reduced to 4 percent or even less in previous postwar recessions. Similarly manufacturing output as a percentage of capacity in this recovery has not reached even the level of 88 percent which was attained in the previous recovery, and both are in marked contrast with the peak utilizations of 93 percent in 1955 and 96 percent in early 1953.[1] Similarly, gross corporate

[1] These utilization rates are based upon the work of Frank deLeeuw of the Division of Research and Statistics, Federal Reserve System. On the basis of responses of business firms in the McGraw-Hill surveys, manufacturers were operating at an average rate of 83 percent of capacity at the end of 1962, which is the same as the rate reported at the end of 1961, both of which may be compared with the 92 percent reported at the end of 1955.

profits (before taxes and depreciation—sometimes called "funds from operations" or "cash flow") expressed as a percentage of gross national product which has been 15¼ percent in the fourth quarter of 1955, never got above the 14.7 percent reached in the second quarter of 1959 (which itself reflected the special lift given by frantic activity in the steel mills); and in this recovery the ratio has not gotten above the 14.2 percent reached in the fourth quarter of 1961. (In each of the three quarters of 1962 for which we have data, the ratio was under 14 percent.) As might be expected from the preceding comparisons, plant and equipment expenditures in neither the 1959–60 recovery, nor in the current expansion, in real terms have not gotten back close to those in earlier periods of expansion. Private investment in producers' durable equipment and nonresidential construction has fallen from 11 percent of gross national product in 1956 to 9.3 percent in 1960 and 9 percent in 1962. The growth rate in real GNP per capita has fallen from 2.1 percent per annum in 1947–57 to 1.2 percent in the last 5 years, or by 40 percent.

In assessing the reason for the inadequacy of our last two recoveries, a very heavy weight must be put upon the fact that the fiscal posture of the Federal Government (the balance between Federal receipts and expenditures at given levels of gross national product) was heavily weighted against expansion of output. This is true even after due allowance is given to the whipsawing effects of the anticipations and experience of the major steel strike of 1959, and the drastic reversal of monetary policy in that year due at least in part to the international monetary situation, and with due allowance to the shock effects and blows to confidence associated with the steel episode and stock market break last year. The tax receipts which would have been produced by higher levels of income and employment if these had been achieved were so heavy that—in the absence of the special backlog demands of the earlier postwar years—the higher levels of income and employment were neither achieved nor sustained. Let me be specific. From trough to peak in the 1958–60 recovery period, the increase in Federal, State, and local government's tax receipts (including corporate tax liabilities on an accrued basis) was 43.7 percent of the entire increase in GNP—the total market value of all goods and services being produced at annual rates. The increase in the Federal Government's receipts alone was 31.7 percent. Corresponding in the present recovery the marginal tax absorption ratio has been 28.7 percent for all governments, and 29.7 percent for the Federal Government alone.[2] These ratios are simply too high for an economy that it operating without big backlog demands and without inflationary pressures born or excessive liquidity. (Data are in exhibit 1, p. 558.)

Some people are inclined to regard the inadequacies of these last two recoveries as a reflection of weakness on the part of the private economy. I deny the allegation. The inadequacy of the last two recoveries simply means that the private economy, lacking strong backlog demands from war-induced shortages, has been forced to run with an excessively heavy tax load on its back. A perfectly healthy athlete climbing a mountain with 150 pounds of lead in his knapsack won't make the progress that he would make with the lead removed.

Other people are inclined to doubt that the proposed tax reductions would have their intended stimulating effect. They point to the fact, for instance, that the tax reduction for a married wage earner with two children in the lowest tax bracket would amount to only a few dollars a week (depending on the exact income, etc., assumed). The suspicion is then raised that such nickels, dimes, and quarters will get lost in the shuffle and not increase consumer spending. The evidence is entirely clear that these doubts and fears are not well founded. Indeed when one is talking about changes in the tax laws which Congress and the public regard as continuing legislation, all of the evidence points to exactly the opposite conclusion. Moreover, this evidence is massive; economists and statisticians have spent more time, effort, sweat, and foundation money examining consumer spending behavior than on any other single subject. Different economists have of course developed and rely on statistical relationships between consumer spending on goods and services and their incomes which differ in details (and indeed, in ways which do make a difference in handling other questions). But to my knowledge no economist has produced any evidence that dollars not paid in taxes because of a tax reduction are treated any differently

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[2] Some of these increases are attributable to increased social security taxes, but Federal, personal, and corporate taxes alone absorbed 20.3 percent and 21.6 percent of the increase in GNP in the two recoveries; and Federal taxes other than social security absorbed 24.2 percent and 25.1 percent, respectively.

than any other increase in disposable income (personal income after tax) due to an increase in employment, wage rates, salaries or other income. Every study of consumer spending behavior has taken income after tax as the relevant income variable, and none has found any significance to the size of the tax payment as such. This does not mean that every individual or every individual family will immediately increase his (or its) spending by some fixed high fraction of his greater income after taxes, but it does mean that when we are talking about tax reductions for large numbers of people and look beyond the first few weeks or the first quarter that large fractions of the total tax savings of the group will show up in additional spending, and that the fraction spent within 6 months or a year is very large indeed.

Both the President and the Council in their Economic Reports refer to the fact that "American households as a whole regularly spend between 92 and 94 percent of the total after-tax (disposable) incomes they receive. And they generally hold to this range even when income rises and falls; so it follows that they generally spend about the same percentage of dollars of income added or subtracted. If we cut about $8 billion from the consumer tax load, we can reasonably expect a direct addition to consumer goods markets of well over $7 billion."[3] I have heard it suggested that if the range is as loose as 92 percent to 94 percent, a 2-percent reduction in consumer spending out of disposable incomes running about $400 billion could fully offset the $8 billion increase in disposable income due to tax reduction, and leave no net stimulus to consumer spending even on an economy-wide basis. A simple straightforward look at the historical record shows that this fear is also unfounded. The Revenue Act of 1948, passed by Congress in April, reduced taxes by $4.7 billion retroactive to January 1, 1948. Consumers tax liabilities were $2.4 billion lower in 1949 than in 1948 and their spending was $2,9 billion higher, and the ratio of spending to after-tax income increased 1.3 percent (from 94.2 percent to 95.5 percent). The actual spending ratios were above the 92-percent to 94-percent range common in more recent years because of the continuing effect of postwar backlog demands, but this evidence surely supports the proposition that a very high fraction of "money not sent to Washington" will be spent.

Personal income tax rates were also reduced effective January 1, 1954, with some further reduction in the Internal Revenue Code of 1954. Exhibit 2 shows seasonally adjusted annual rates of personal income, tax liabilities, disposable income, consumer expenditures and the ratio of spending to after-tax income for the period 1953: IV–1956 :I. The spending ratio increased in every quarter during the period of tax reductions on through the first quarter of 1955, and while the ratio subsequently fell off slightly it remained higher than before the tax cut as shown by both the quarterly and annual data. I am not suggesting that Congress should count on any higher fraction of spending out of tax reduction nor am I ruling out the possibility of some temporary declines, but on the basis of the record I think we can have great confidence that any such decline would be very small in size and very limited in time. To repeat my earlier observation: all the available evidence indicates that a very high fraction of any tax remission will be spent within a reasonably short period of time.

This being the case we can confidently expect that if consumers' disposable income is increased by tax reductions of about $8 billion, their rate of spending will, within a relatively short period of time, be approximately $7½ billion larger than it otherwise would have been. This increased spending means increased sales for business, increased employment, increased profits, increased tax receipts and so on and an increase in personal incomes (after taxes on these added incomes) of over $3¾ billion, which will then lead to still further spending out of these larger incomes. While it is impossible to give precisely accurate figures on what the total effects of this change would be, all of the evidence indicates that the total increase will be about $15 billion of consumer spending over and above the level it would have had in the absence of the personal tax reduction. And it must be emphasized that this is a permanent expansion in the gross national product over the levels it will otherwise have.

It should be noted that this increase in gross national product and in the sales of business, which will result from the reduction in personal tax rates, will also result in a substantial increase in corporate profits. Indeed the statistical evidence would indicate that this kind of an expansion in gross national product

[3] "Economic Report of the President," January 1963, p. xvi.

would increase the level of corporate profits before taxes by something like $3 billion (probably somewhat more in the short run and somewhat less in the longer run). The half of this left after taxes will improve the ability of business to finance new expansion, and more importantly at the present time, the increase in sales themselves will substantially reduce the substantial excess capacity which has been holding down plant and equipment outlays. The combination of increased market, reduced excess capacity and increased fund flows will lead to larger capital outlays by business which further enlarge the increase in gross national product attributable to the personal income tax cut. (It should be noted that the increase in business capital spending also increases personal incomes and leads to still further increases in consumer expenditures.) In addition, with sales volumes higher, business will be needing and producing more inventory which further swells the increase in gross product. All told, on the basis of all the evidence, it seems reasonably conservative to estimate that there will be an increase of $2½ billion in gross national product after a reasonable period of time for each $1 billion tax reduction on consumers.

So far I have discussed the expansionary impact that would follow from reductions in personal income tax rates, including both the direct increases in consumer outlays and the induced increases in business investment which they would bring about. These effects can be counted on with considerable assurance, they are sizable and they are very important. In themselves they would serve to eliminate a substantial part of the continuing sizable gap between current utilization of plant and equipment and desired operating rates (as shown by say the McGraw-Hill surveys) and between the current output of the economy and its reasonable potential—as well as making a substantial dent in the excesses of recent unemployment rates. But tax reductions are needed not merely to increase employment of the labor force in the short run, and improve operating ratios in business and bring the economy up to a better current level of operations, they are equally needed as permanent tax legislation intended to improve the continuing performance and growth of the economy over the longer pull. We must deal with the problems of shackled growth and expansion, as well as with the shortfall in current operating rates. And with these objectives in mind, the recommendations that individual income tax rates be reduced in rough proportion across the board, high bracket rates as well as low, and that the corporate income tax rate be reduced become essential parts of the program.

Excessive marginal tax rates in the higher brackets lead to an inordinate expenditure of brains and time in legal tax avoidance and lead to serious misallocations of resources and business decisions which are quite distorted apart from special tax considerations. Perhaps even more significant, these rates have great importance from the standpoint of the flow of enterprise in unincorporated businesses and the supply of venture capital in the economy. And correspondingly, while it is appropriate and desirable that the larger dollar amount of the tax reductions go directly to individual taxpayers, with rates reduced in rough proportion across the board as the President has proposed, it is also very important, I believe, that the corporate tax rates also be reduced. Although the justification for a reduction to 47 percent rather than 49 percent is somewhat weaker in view of last year's adjustment of depreciation schedules and the 7 percent investment credit, it is highly important that the Government remove itself from the position of a majority stockholder in business (the 52 percent) to that of a minority stockholder by cutting the tax rate at least 3 percentage points.

More vigorous recoveries and more vigorous growth and the prospect of continued more vigorous expansion, all depend heavily upon substantial increases in recent rates of private plant and equipment expenditures. And such outlays depend in an essential way upon the profitability of new investment outlays. Unless prospective profit rates, to the investors after taxes, are adequate to justify tying up the funds and bearing the risks and living with the capital stock, the new investments simply won't be made. The recommended reduction in corporate profits rates improves this relevant prospective profit rate on any given investment and enhances its financial feasibility. For both reasons it will lead to investments that would not otherwise be made. And I also believe that this change, together with the reduction in top-bracket personal rates, would have the further important effect of substantially improving the psychological climate, again with favorable economic effect. No very precise estimates of dollar amounts of new investments that will follow from these changes are possible, but taking all companies together the statistical evidence indicates that within a reasonable period of time there will be something more than a dollar of additional new investment for every dollar of tax reduction even with the relatively inadequate operating rates and excess capacity of the last several years, and that the increments will be larger once capacity is more fully utilized. In sum, enactment of this package, then, would substantially increase sales and the utilization of existing capacity, improve profit margins and profits, and, also of crucial importance, raise the profitability of the incremental new investment upon which the vitality and growth of the economy depend.

There are of course many people who are quite willing to grant that all these good and desirable things will follow from a tax cut, but nevertheless hold back or oppose it on the grounds that it costs too much and that we cannot afford it. They point to the fact that the budget deficit for the current fiscal year is now esimated at $8.8 billion and that the gross Federal debt is already over $300 billion and say that it is simply not responsible or prudent to deliberately increase these figures by a tax reduction, however attractive the benefits might otherwise be. I should like to make three comments in this connection. First of all, it must be recognized that the increase in the deficit attributable to a cut in taxes, even in a period as short as a single year, will be substantially smaller than the amount of the tax cut, figured at current rates of activity, because of the additional tax revenues provided by the substantial increases in income resulting from the higher levels of business activity produced by the tax reduction. I trust that this point is well understood and I shall not dwell on it, especially since others are in a better position to provide detailed estimates. But the fact remains that the deficit we would otherwise have is increased at least for a time by some amount.

At this point it is necessary, I think, to sit back and make two judgments carefully and hardheadedly: (a) are the benefits that we get from the tax cut worth the "cost" involved in adding to the deficit (note that I regard the increase in the deficit per se as a "cost"—i.e., as something to be avoided unless what we get from the tax cut makes it worthwhile); and (b) whether, even if desirable on these grounds, it is financially prudent to incur the deficit.

This question of financial prudence is sometimes answered on the easy basis that an individual who is continuously going into debt is a foolish spendthrift, and that the Federal Government should constrain itself to the same principle. But the finances of the Federal Government are very much more like the finances of an individual corporation having unlimited life than they are to an individual person. And even here it is surely true that most business firms would be properly criticized for going into debt too heavily. I believe the Federal Government should be criticized too, when it is going into debt too heavily. But corporations which have a good line of products and are efficiently managed, which are maintaining or expanding their position in their industries, and which show a solid rate of growth in sales, assets, and net income that prudent investors rather confidently expect to continue—such companies are not criticized if their total debt continues to grow over time.

In this connection I suggest that it is worth observing that the consolidated long-term debt of the American Telephone & Telegraph Co., for instance, at the end of 1961 was over 6½ times as large as at the end of 1939, and more than twice as large as at the end of 1948. It was somewhat larger than before the war as a ratio to total assets, and the company's fixed charges (largely interest on this debt) had increased to over 5½ times their prewar level and 3.4 times their level in 1948. A.T. & T. has retained its prime rating among investors throughout because of its solid position in the American economy, the strength and progressiveness of the company and its management, and on the basis of these, the assurance of investors that the future sound growth of the company in a growing economy was assured. A.T. & T. increased its debt because it needed to make outlays for facilities and equipment at various times which substantially exceeded the funds available internally from current operations. Investors have bought the bonds so issued because of their confidence that these investments would produce increases in the operating revenues of the company which would substantially more than cover the cost of the investment and the fixed charges on the debt.

I shall not dwell on the fact that the gross debt of the Federal Government is about the same ratio to 1939 as that of A.T. & T., or that it has increased only 17 percent since 1948 instead of doubling, nor the fact that the increases in the net debt of the Federal Government, i.e., excluding debt held by Government trust funds, have been smaller in both cases. Quite obviously I do not want to push the analogy too far; there are major differences between private debt and public debt,[4] and between A.T. & T. and the U.S. Government. But I do think that it is relevant at the present time to notice that the net Federal debt is about the same size in relation to gross national product as it was before the war, and that relative to GNP it has declined by over two-fifths (from 83.5 percent in 1948 to 47.8 percent in 1961). I think it is also very relevant to keep clearly in mind that the soundness of the debt of the United States rests upon the taxing power of the Federal Government, and that the value of this taxing power is increased if the strength of the economy is improved—and in particular by whatever will raise the level of business activity, increase the real GNP of the country, and improve the rate of growth in this GNP which can be expected for the future.

In the context of these observations my judgment clearly is that a basic cut in corporate and individual income tax rates now will raise the level of GNP we otherwise will have by something over 2½ times the amount of the initial rate of revenue loss computed at present levels of activity; that this will be a permanent increment in the levels of gross product we otherwise will have; and that it will increase the private investment spending in the economy, enlarge our capital stock, and significantly step up the rate of growth we can otherwise look forward to. All these are very substantial benefits. The cost of incurring them is an increase in our deficit in the short run and an increase in the size of our public debt. But my own judgment is clear that even if the Federal debt over a 2-year period were to be made larger by 3 or 5 percent of its present level, for instance, the resulting larger debt in the context of the larger GNP we will have, the lower unemployment rates and excess capacity we will have, and the better growth prospects we will have—that this larger debt in this context will look to prudent men to be a sounder debt than a somewhat smaller debt outstanding in an economy that has higher unemployment, more excess capacity, and weaker growth prospects. In short my answer to the two questions I pose is that the benefits of the tax cut fully justify the costs of the deficit and the increase in the debt and that increasing the debt at this time for this purpose will be a prudent and responsible act.

I further believe that because of the benefits which can be expected with very considerable confidence to result from this basic change in our tax rates, that this kind of a program of basic permanent tax reduction now offers our best prospect of bringing Federal finances and the budget into reasonable and more continuing balance. The Economic Report properly points to slack in the economy as a major cause of budget deficits. Even with vigorous and tightened controls over Federal expenditures, even the present high tax rates result in deficits. If the slack in the economy can be eliminated the present tax rates would produce surpluses, but as indicated earlier the marginal tax rate on increases in GNP is simply so high that the extent of recoveries is snubbed and thwarted. To have Federal receipts increase by nearly 30 percent of the total increase the market value of all production is simply too much. Our best hope of bringing the Federal budget into balance is to incur the cost of some temporary larger short-run deficits and stimulate the economy. It is very reasonable to expect that, say, 25 percent of a much larger figure will turn out to be greater than 30 percent of a smaller figure—and a figure that is smaller precisely because the 30 percent is too high. Paradoxical as it may seem at first glance, over the longer pull Federal receipts will be improved by tax cuts. As others have already pointed out, this was the record not only of the 1920's but of the mid-1950's after taxes were reduced in 1954. It should be apparent I am not here arguing the desirability of further continuing increases in the Federal debt.

Since our assignment today is fiscal policy, and monetary policy is being examined tomorrow, I shall not undertake to discuss these other matters at any length. The picture of my own views and judgments would be incomplete, however, if I did not note that I recognize that the additional deficit in the current fiscal year involved in this tax cut may put some additional pressure on our balance of payments. I believe we can rather confidently expect this added pressure to be temporary—at least after a few months' transitional period, the

[4] In particular, the ratios of private debt to total assets or total operating revenues are obviously not directly comparable to the ratio of gross (or net) Federal debt to GNP. Similarly, the ratio of gross or net interest charges to tax receipts for the Federal Government is not directly comparable to "time fixed charges earned" (or its reciprocal) for a private corporation. But the relative changes in A.T. & T.'s own figures over time are relevant to judgments regarding changes in the soundness of its debt position. Similarly, the relative changes over time in the Government's debt (and their ratios to tax receipts and the level of economic activity that supports them) are relevant to judgments regarding changes in the soundness of its debt position. Data are given in exhibit 3.

greater vigor of our economy should strengthen rather than weaken our position in these markets. But there is clearly more risk in the short run (although even here the evidence is mixed: on balance, the fact that we are taking firm action to raise business activity and employment and increase our growth may well lead to enough more funds moving into the United States to fully offset, or more than offset, any added short-term outflow induced by the added deficit). But this short-term international fund-flow problem (to the extent that it is a problem) can be effectively handled by extending further the recent actions of the Federal Reserve and Treasury. Short-term interest rates which have now reached the general level of 2.9 percent may need to be gradually increased over a period of a few months if this tax policy is adopted. This, incidentally, would be in line with recent recommendations of the Bank for International Settlements. The gradual increases in short-term interest rates over the last year have substantially strengthened our position with respect to flows of volatile short-term funds which are highly responsive to covered interest rate differentials. If extended further, they should be effective (along with the improving "basic" balance in our international accounts) in handling the flows of short-term funds which might otherwise be induced by the temporarily higher Federal deficit.[5] And the thrust of the tax cut recommended would be big enough to bring about the desired increase in domestic business activity in spite of the small drag involved in the gradual increase over a few months in short-term interest rates.

Altogether, it seems to me to be prudent and responsible—and eminently desirable—to cut income taxes in an amount of approximately $10 billion. By this action the economy can be put in a position where, with the load of excessive taxation off its back, it will much more fully achieve the levels of private output and employment of which it is capable without strain, and having done so, move forward at a faster rate of growth with vigor and enterprise.

EXHIBIT 1

Government receipts and gross national product in the last 2 recoveries

[Dollar figures in billions]

	1958:I	1960:II	Increase	Increase as percent of increased GNP	1961:I	1962:II	Increase	Increase as percent of increased GNP
Federal Government receipts:								
Personal tax and nontax receipts	$36.1	$44.6	$8.5	11.8	$43.3	$49.9	$6.6	12.1
Corporate profits tax accruals	15.5	21.6	6.1	8.5	18.3	23.5	5.2	9.5
Indirect business tax and nontax accruals	11.7	14.5	2.8	3.9	13.1	15.0	1.9	3.5
Contributions to social insurance	12.2	17.6	5.4	7.5	18.0	20.5	2.5	4.6
Subtotal	75.5	98.3	22.8	31.7	92.7	108.9	16.2	29.7
State and local government receipts [1]	35.6	43.9	8.3	11.5	45.4	50.3	4.9	9.0
Total Government receipts	111.1	142.2	31.1	43.2	138.1	159.2	21.1	38.7
Gross national product	432.9	504.8	71.9		500.8	555.3	54.5	

[1] Excludes Federal grants-in-aid.

Source: "Survey of Current Business," July 1962, p. 17, and "Economic Report of the President," January 1963, pp. 241-242, 171.

[5] This policy would be implemented by limiting the increase (or, if necessary, gradually reducing for a time) the level of member bank reserve balances, and by financing the deficit to a greater extent out of current private savings. In order to bolster short-term rates while minimizing the effect upon long-term rates (which are important for housing and, to a lesser degree, for plant and equipment expenditures) it would be important for the Treasury to increase its bill offerings and for the Federal Reserve to shift some of its portfolio holdings from bills into longer dated instruments gradually over a period of months.

EXHIBIT 2

Personal incomes, taxes, and consumers' expenditures on goods and services, 1953–56

	Personal income	Tax liabilities	Disposable income	Consumption expenditure	Spending ratio
					Percent
1953: IV	$289.7	$35.8	$253.8	$232.3	91.54
1954:					
I	287.4	32.7	254.6	233.7	91.79
II	287.6	32.8	254.8	236.5	92.82
III	289.7	32.9	256.8	238.7	92.95
IV	294.2	33.3	260.9	243.2	93.22
1955:					
I	298.5	34.7	263.8	249.4	94.54
II	307.5	35.5	272.0	254.3	93.50
III	313.8	36.2	277.7	260.9	93.95
IV	319.7	36.6	283.0	263.3	93.04
1956:					
I	323.8	39.2	284.6	265.6	93.32
II	330.9	39.8	291.1	268.2	92.13
III	334.4	40.2	295.2	270.4	91.60
IV	341.1	40.8	300.3	275.6	91.78
Annual:					
1953	288.3	35.8	252.5	232.6	92.12
1954	289.8	32.9	256.9	238.0	92.64
1955	310.2	35.7	274.4	256.9	93.62
1956	332.9	40.0	292.9	269.9	92.15

EXHIBIT 3

Selected data on long-term debts, incomes, and revenue base of the American Telephone & Telegraph Co. (consolidated) and the U.S. Government [1]

A. T. & T. [2]

[Dollar figures in millions]

Years	Long-term debt	Total assets	Ratio	Total operating revenues	Debt-revenue ratio	Fixed charges	Income available for fixed charges	Times fixed charges earned	Fixed charges divided by income available
			Percent		*Percent*				*Percent*
1939	$1,101	$5,227	21.1	$1,107	99.4	$45.4	$242.3	5.33	18.7
1948	3,408	10,001	34.1	2,625	129.8	75.3	303.4	4.03	24.8
1955	4,376	18,379	23.8	5,297	82.6	118.9	801.2	6.74	14.8
1961	7,201	30,202	23.8	8,414	85.4	255.9	1,580.4	6.18	16.2

[1] The significance of this table lies in comparisons of the trends within each half; the level of any ratio in one part is not comparable to the level of any ratio in the other. See footnote in the text.
[2] Consolidated system balance sheets and income statements.

Source: Standard & Poor's "Corporation Records."

U.S. Government

[Dollar figures in billions]

Years [1]	Gross debt [2]	Gross national product	Ratio	Net debt [3]	Ratio to GNP	Gross interest paid	Tax receipts [4]	Ratio	Net interest paid [5]	Ratio to tax receipts
			Percent		*Percent*			*Percent*		*Percent*
1939	$47.6	$91.1	52.3	$42.6	46.7	$0.94	$5.2	18.2	$0.64	12.44
1948	252.9	259.4	97.5	216.5	83.5	5.2	41.4	12.6	4.2	10.1
1955	280.8	397.5	70.6	231.5	58.2	6.4	60.2	10.6	4.9	8.1
1961	296.5	518.7	57.2	248.1	47.8	9.1	77.7	11.7	6.9	8.9

[1] Calendar years for debt and gross product, fiscal years in other columns.
[2] Gross public debt and guaranteed issues.
[3] Debt owed to all other sectors of the economy except the Federal Government proper and its agencies and corporations. Debt owed to the Federal Reserve System is included in this net debt figure.
[4] Administrative budget.
[5] On a consolidated basis, including trust funds.

Source: U.S. Treasury and Economic Report of the President, 1963, pp. 234, 239, 242, and 171.

Chairman DOUGLAS. Mrs. Griffiths, do you have any questions?

Representative GRIFFITHS. I have no questions.

Chairman DOUGLAS. Senator Pell?

Senator PELL. Thank you, Mr. Chairman.

Dr. Jacoby, I was interested in your testimony particularly because it is always stimulating to hear the critical views of a program even though we may not necessarily agree with them. I notice that among the expenditure reductions you advocate the fact that economic aid programs could be cut down, including particularly aids to Yugoslavia and Poland. I was wondering why you brought in those two countries since the last year the total amount of aid, not counting the sale of surplus food products under Public Law 480, extended to those two countries was $2.2 million. That does not seem to me to have much of an effect on our overall deficit.

Mr. JACOBY. That will still produce $2.2 million, if your figures are correct, as I presume they are.

Senator PELL. I am also talking about the sale of surplus food products under Public Law 480.

Mr. JACOBY. That is a sale, I believe, however, for their own currency.

Senator PELL. That is correct.

Mr. JACOBY. Which is of somewhat dubious value.

Senator PELL. But you feel that the curtailment of that aid to Poland and Yugoslavia, you emphasize it rather conspicuously here, would have a real effect on the deficit?

Mr. JACOBY. It is a minor factor in the totality of expenditures.

Senator PELL. What was your point in emphasizing these aid programs? You say "particularly."

Mr. JACOBY. Because I think they have been conspicuously unproductive allocations of American resources.

Senator PELL. This is, as you know, is more of a political question than an economic question, and some of us would disagree radically because we think with the dissension or loosening of fast ties that this has caused behind the Iron Curtain we have gotten more for our dollars here than with other parts of foreign aid.

In another part of your statement, you mention in connection with the depletion allowances that you have not studied the question of whether the depletion allowance should be lowered or not. I was wondering if off the top of your head you had any views whether it would be better to reduce it in a straightforward manner rather than the proposed roundabout way, or whether you still want to leave it up in the air.

Mr. JACOBY. As I said in my formal presentation, sir, I believe it would be better to reduce the 27½ percent of the gross income depletion allowance if there is, indeed, excessive tax benefits being allocated to the oil and gas industry now. I think as a general principle it is always better to move directly than by a process of subterfuge and indirection, which further complicates the tax sturucture and which would remove the privilege from the hands of oil and gas company managers of averaging their operations, a privilege that the administration proposes somewhat inconsistently now to extend to individuals in taxing their incomes. I believe the averaging principle is a good principle in Federal income taxation.

Senator PELL. Don't you think there is a difference between the averaging principle as proposed by the administration which applies chronologically in the area of time and the averaging principles that you talk about in the oil industry which is only a question of geographical area?

Mr. JACOBY. No; I don't think there is. I think the averaging principle goes essentially to a notion that embraces both time and geographical extent. The concept being that it is the outcome of one's economic activities in their totality that ought to determine tax liabilities rather than each individual segment standing on its own.

Senator PELL. Your reference to time and space here is rather like an extension of Einstein's theory of physics, like adding a fourth dimension.

Mr. JACOBY. You have elevated my idea to a very high level.

Senator PELL. Then I had one final question.

I agree with you that simplicity should be one of the major objectives. I wonder if you think it would be good to have a tax structure in which rates would be drastically reduced, with perhaps a maximum rate of 40 percent, and no deductions whatsoever?

Mr. JACOBY. I think it would be desirable. I believe that the Federal income-tax system would be simpler and more equitable, although this equity is always a highly debatable subject. But in my view it would be simpler and more equitable if we eliminated a great many of these exclusions for income, including deductions for dependents, and gave relief in the form of tax credits against taxes due.

This is what, in essence, the President has proposed in the case of the dividend credit and exclusion. He has also proposed it in the case of the aged who now will get a $300 tax credit against their taxes as against the privileges of excluding certain income from taxation. It seems the same principle could be included across the board, including the present $600 deduction of taxable income from dependents.

Senator PELL. Just to oversimplify, though, would you consider it a commendable goal to have an income tax rate between 5 percent and 40 and no deductions whatsoever, as a matter of theory?

Mr. JACOBY. I am not sure without further study that one would go to that limit. Possibly so. But I am quite sure that we can go farther in that direction than we have so far and farther than the administration has proposed.

Senator PELL. I wonder if either of the other two witnesses have any comments on the remarks of Dr. Jacoby.

Mr. HELLMUTH. I would like to endorse the line of questioning that you are following and generally Professor Jacoby's replies to that.

Senator PELL. The two lines are different, aren't they?

Mr. HELLMUTH. The idea of broadening the tax base and getting the rates down has gotten quite a bit of attention. I favor a much simpler system with lower rates and a broader base, but not to the extent of getting rid of the personal exemptions. I don't believe a person has a taxpaying capacity on income until there has been at least some minimum allowance for subsistence expenses.

One of the reasons we perhaps have the itemized deductions and the standard deductions so much before us now is that the individual exemption has become relatively inadequate, with increasing prices and with a rising standard of living, to cover a minimum of subsistence.

Mr. LINTNER. I also feel that the tax base should be broadened, and that the complexities which over a period of time have grown up to take care of specific individual situations, without proper regard for the overall pattern that has resulted, should be reduced. This line of approach is very constructive and is long overdue.

It does seem to me, however, that to go to the limit—you have heard the old gag that a little strychnine sometimes is desirable and prescribed by doctors, but too much would kill you—I think that to eliminate all exemptions and deductions would be to eliminate many features of the tax law which do appropriately in an objective analysis, not an ex parte presentation, represent substantive differences between individuals that in fairness should be allowed for. Equal treatment in an objective sense does require deductions for some that others might not at the same time be taking.

Senator PELL. Then there is a consensus that this is a desirable direction in which we are going but there is a difference of opinion on how far. Thank you.

Senator PROXMIRE (presiding). Senator Jordan?

Senator JORDAN. Gentlemen, I was impressed by your several treatments of the subject here. You have expressed general agreement on the desirability of a tax cut but you have differences as to the importance of the amount, how fast it should be done, and I think some difference as to whether a tax cut and a tax reform should be wrapped up in one package.

Dean Hellmuth, I judge from your presentation that you believe, or you would follow the package approach. You think that tax reform should be tied in very definitely with tax reduction in a package.

Mr. HELLMUTH. Yes, sir, I think this is correct. I believe that the reforms include a substantial amount of stimulation for the economy as well as an improvement in equity, and this is a consistent part of a large package to expand the economy and to get the economy moving ahead.

Senator JORDAN. The practical difficulty of implementing a package program might be considerable in the Congress. If you had to sacrifice one or the other, what would be your decision?

Mr. HELLMUTH. I would hope that abandonment of the reforms in total would not be necessary. I would be prepared to yield on some of them more quickly than I would on others if I had to vote upon this, as you do.

Senator JORDAN. Pursuing that a little further, which ones would you think would be the less desirable?

Mr. HELLMUTH. I believe as Dean Jacoby suggested also, the reforms which tend both to simplify and broaden the base, and also to stimulate the economy should be continued in the package. This would include such things as the proposals on capital gains, the repeal of the dividend credit and exemptions, and elimination of the sick pay exemptions, and smaller deductions for casualty losses. I think those would be the ones I would most like to see stay in. This does omit the floor on itemized deductions which is a big revenue item but which also may be such a controversial one that it would be the bone that would stick in the throat in trying to get the package through.

Senator JORDAN. Dean Jacoby, I would like your views on the matter of the package, and whether you regard it as highly desirable, and whether you think it might be just as well to separate the two components of the package.

Mr. JACOBY. I feel, sir, as I said in my statement, that while I would have no objection to the enactment of the package, I assign a clear priority to the need for cutting tax rates soon. If the choice has to be made between delaying the package and cutting the rates now I am quite sure that the latter is in the public interest.

Senator JORDAN. Professor Lintner, what would be your position with respect to the same question?

Mr. LINTNER. My position on this question, at least, is the same as Dean Jacoby's. In fact, that is clearly reflected in the fact that I addressed my presentation primarily to the need for tax cuts and their efficacy—the fact that a tax reduction will work, and didn't take time to discuss the reforms much as such.

Senator JORDAN. I appreciate that. Thank you.

Senator PROXMIRE. I would like to ask each member of the panel, starting off with Dr. Jacoby, to respond to this: Spending is not going to be cut. I hope it will be. I am going to work to try to cut it as many of my other colleagues, but I anticipate we will fail. You have said that this cut in taxes is wise, particularly if we can keep spending at the present level or preferably reduce it. Suppose spending is increased to the level that the President has indicated in his budget, and I expect the increase will be even greater, then in view of the effect of a deficit on our balance of payments, possibly on inflation, do you think it would be wise for us to vote for the kind of substantial cut in taxes that the President has proposed?

Mr. JACOBY. My general view, Senator Proxmire, is that it is feasible, as well as desirable, to hold down the increase in cash spending in the fiscal year 1964.

Senator PROXMIRE. I could not agree with you more. I think you have a fine analysis. I especially agree with the Yugoslavia and Poland point but all the rest of it, too. But it is unlikely that we will be able to restrain spending. Assuming it is increased by $4 or $5 or $6 billion in the coming year, would you still favor the kind of tax cut the President has proposed?

Mr. JACOBY. I would still favor tax reduction but not of the kind the President has proposed. If there is no reduction in spending as you asked me to assume, then I would say that a program of tax reduction that would be much more stimulative to economic growth, both in the short and long term, would be one that laid heavier emphasis on corporate tax reduction and somewhat less emphasis on individual tax reduction. The proposals that I made more specifically were to cut the corporate rate by five points July 1 next and by another five points July 1964. This would by itself increase in deficit. I have not gone through the arithmetic, but each five points would take off something like $2½ billion. I would recoup that $2½ billion by contemplating a somewhat lesser reduction in the individual rates than the President has proposed. I believed that this reemphasis would stimulate the economy much more than the President's program will. In fact, I think that the President's program runs a very grave risk that the stimulus will be inadequate. The reason for this belief on my part is that I think the administration has made a strategic error in believing that business investment will not occur on a broad scale until so-called excess capacity is utilized. But as I tried to point out, about half of all business investment today is divorced from the extent to which present capacity is utilized, because it is undertaken not simply to produce more of the same but to produce products at lower cost, improved products or totally new products. This kind of investment decision is unaffected by the percentage of capacity utilization.

Senator PROXMIRE. That kind of investment is being made without stimulation. Your example of Bethlehem is a decision made at the present tax level. We are talking about additional investment not being made.

Mr. JACOBY. I speak not only as an academic student of business finance but as a director of several medium-size manufacturing corporations. Every business corporation of which I am aware has a pool of prospective investment projects, some promising to yield higher returns and some lower returns. Now, the Government promises to take 52 percent of any increased earnings, so that a corporation invests only up to the point where the prospectively high-yielding investments are profitable. If you change the balance, and the Government takes only 42 percent instead of 52 percent of any prospective gain in earnings, this brings within the range of action a whole host of investment projects that are now being put aside. So you would increase business investment by increasing the incentive through a tax cut.

Senator PROXMIRE. You will certainly agree that a tax cut is not necessary to provide the cash for the investment. The record is overwhelming that cash earnings have risen from $17 to $48 billion as compared with increase in plant and equipment from $12 to $29 billion. I am talking about 1946–61. I think either in your testimony or Dr. Lintner's testimony it was pointed out in 1962 and 1963 we have had even greater cash earnings relative to investment in plant and equipment.

Mr. JACOBY. I agree that additional cash is not the critical need. The emphasis is on incentive to invest. I don't think a negative incentive such as the privilege of carrying forward losses is nearly as potent as the positive incentive of being able to keep more of the prospective earnings of an investment.

Senator PROXMIRE. That is right. I want to get to the other two witnesses in a minute. The other point is—I do not want to use slogans—but the term "trickle down" has been used with regard to the notion that if you give corporations tax relief as in 1954 it will come down to those who work for wages. Is it not true that much plant expansion investment is made because the businessman can see that the market is developing and growing and opening up? An automobile company will build more facilities, expand its facilities, if it feels it can sell more and that this is true of steel. It is true generally. There are exceptions and you have pointed to exceptions that we are getting now without any big increase in demand. But for the really big expansion you have to have an expansion in the market fundamentally. Why isn't this correct?

Mr. JACOBY. I think there is a great element of truth in this. Some business investment does occur because of the belief by the managers of the business that they need more capacity to turn out the same product or service they have been producing. So far as I can tell from the figures, that represents about one-half of business investment today. But the other half responds to different motives and incentives.

Senator PROXMIRE. If I can interrupt at that point, is it not true that it is that half, the expansion half, which is much more likely to respond to a big tax cut than the other half that involves modernization?

In other words, isn't the marginal investment that fluctuates likely to fluctuate in response to anticipated markets rather than in response to psychological feeling about investment or incentive?

Mr. JACOBY. The important point, to my mind, is that whenever you stimulate investment you are bringing to bear a powerful lever on the expansion of aggregate demand. Whenever you stimulate business investment you are increasing aggregate demand by a much larger factor than when you directly stimulate consumer expenditure. You put the investment multiplier to work. My basic quarrel with the administration's tax program is that it is assuming a tremendous and unnecessary risk of not putting the investment multiplier to work.

Senator PROXMIRE. If we look at the record, in 1954 we had a big tax reduction primarily in the area of encouraging investment. Since then we have had the investment credit designed exclusively for investment stimulation, we have had the revision of the depreciation guidelines designed exclusively for investment stimulation and now in this tax package we have about one-fourth of it designed to stimulate investment. Why isn't it true that all in all, taking the aggregate changes since 1954, tax reduction has been primarily calculated to stimulate investment and this proposal brings a balance?

Mr. JACOBY. I wouldn't agree. The investment credit was a limited device. It didn't help the company not making the money.

Senator PROXMIRE. The corporation income tax cut does not help a company not making money.

Mr. JACOBY. What it does is to increase the prospective return on any investment that is made. This we haven't yet done. The liberalization of depreciation allowances was a good thing because they had become unrealistically low. But of themselves they don't add to the incentive to invest. What a corporate tax cut would do is to augment this incentive to tip the scales in favor of making investments that are now lying on the drawing boards and files because the prospective return is not good enough.

Senator PROXMIRE. Dr. Lintner, I presume from your testimony that you would feel very emphatically that we should vote for a tax cut even if there is an increase in spending. Is that assumption correct?

Mr. LINTER. Yes, Senator. I call your attention to the final page of my prepared statement, since in your initial question to Dean Jacoby you referred to the balance-of-payment aspects, and although monetary matters are on the agenda for tomorrow, it is an essential part of my position. I feel that tax cuts are needed now. Yes, there will be some risk of temporary step-up in outflow. Consequently, I feel that the Federal Reserve and the Treasury, with the lumping of bill offerings and so on, together can raise the short-term rate if it is needed in moderate amounts. No more than moderate amounts for a temporary period should be needed. As indicated on the last page of my statement, my position is yes, while there may be some risks, these can be handled, and we should go ahead with our tax reduction. The temporary risk in the balance of payments can be hedged, if necessary, by a moderate increase in short-term rates over perhaps a 6- to 8-month period. Such an increase in the short-term rates would not seriously reduce the stimulating effect of the tax reduction.

Senator PROXMIRE. You are not too worried about the balance of payments and inflation problem?

Mr. LINTNER. I would much prefer to put it the other way. I do think our balance-of-payments problem is serious, and that it will be so for some considerable time yet. I do feel, however, that there is substantial reason for believing that if the American economy is producing at a higher level with higher profits, lower rates of unemployment, higher rates of growth, this will attract foreign investments which are not coming in now. This will also make American corporations invest a larger fraction of total domestic plus foreign capital budgets domestically rather than abroad. These favorable effects will be important beyond the shortrun transitional period which in my judgment can be hedged. I am worried about the problem. That is why I put in the final page of my statement to recognize it. My position would not be fully stated if I didn't recognize it, but at the same time to assert my judgment that the temporary aspect of it could be handled. This is not the basic balance-of-payments problem that we are worried about here. It is the temporary outflow as the proverbial Swiss banker reads about the size of an announced deficit in billions of dollars, and moves money. The shortrun volatile money does respond to interest rate differentials which are under the combined control within the limits that are relevant here of the Treasury and the Federal Reserve. So I address myself to the balance-of-payments point.

Would you like me to comment on the other questions you addressed to Dean Jacoby?

Senator PROXMIRE. A little later I would like to continue with you at some length on these monetary effects. You have some good points. I would like to ask Dr. Hellmuth.

Dr. Hellmuth, did you want to say something about the tax cut? Although we probably will have an increase in spending I presume from your testimony that you are in favor of the tax cuts although spending is increased since you seem to favor the increased spending, too, is that correct?

Mr. HELLMUTH. That is correct. My analysis of the budget is that the expenditure increases that are estimated will be slightly smaller on the average in the 1964 fiscal year than in the 3 preceding fiscal years. We have not had enough stimulation in this recent growth in Government spending. Therefore the tax cut is still needed even though there are expenditure increases forecast. Support for increased expenditures assumes that the programs are justified and that they are carried out efficiently and without waste.

Senator PROXMIRE. Senator Miller.

Senator MILLER. I apologize to you gentlemen for coming late, but I was at hearings where the problems of the poultry industry are being discussed, and I might say those problems are of more interest to them than the tax cut, because it looks like they will not have any income to pay taxes on.

Dr. Lintner, in your prepared statement, you indicate that all evidence is that we will have a total increase of $15 billion of consumer spending if we had a $7½ billion tax cut. I presume you would carry that further and we could say if we had a $15 billion tax cut, we would have a $30 billion increase in consumer spending, and if we had a $30 billion tax cut, we would have a $60 billion increase in consumer spending. Do you carry it forward that way?

Mr. LINTNER. No, Senator Miller, I would not, for reasons that I would be glad to amplify if you like.

Senator MILLER. Here is our problem. For the last 2 or 3 days we have heard a lot about multiplier effects. There is a difference between the consumer multiplier effect and industrial multiplier effect. Then you get into the matter of psychology. When some of my constituents read some of the statements that people like you make, they say: "Why stop at a $7½ billion tax cut? Why be a piker? Let us make it a $50 billion tax cut, and think of the utopia we will have." How do you respond to that? Where do you draw the line?

Mr. LINTNER. I draw the line in terms of two considerations that are most immediately relevant. The first is that in making estimates of this kind, when you are working within the ranges of changes which you have observed, your statistical estimates, so to speak, have more precision, but there is still a margin of error. But in this range we can refer to past changes in income which can give us reasonable confidence.

The other point I should make is that the desirable size of a tax cut is set by other considerations as well. We do not want a tax cut that will overheat the economy. We do not want a tax cut that will start a rate of increase in prices here that will ruin our export balance with other parts of the world, and so on. The size of the tax cut, net $10 billion, is in terms of most all projections of economic activity without tax cut, well within the margin of what the economy can readily handle. If you double it, or triple it, or quadruple it, the effects would be bad and would be undesirable. Also, they would not be in proportion.

Senator MILLER. You see, we get into this practical problem where you spread it over a period of years. Under the present program there will be a 2.9 billion cut for fiscal 1964. The witnesses appearing before this committee are not at all in agreement on that. Some think it is all right. Others think it ought to be increased considerably. So you reduce it down to a single year. The question again becomes: Where do you draw the line? At 2.9 billion, 4 billion, or 8 billion? What guidelines do we use? What guidelines have caused you to endorse a $10 billion tax cut over 3- or 4-year period rather than a $9 billion or an $8 or a $20 billion tax cut?

Aren't there many variables involved in this thing, so that under a given set of circumstances it might be better not to have any tax cut at all because we don't want to have the economy blow the lid off? There are other situations where we might even increase taxes. Why should we not increase taxes today? We need guidelines. I can't find any guidelines in any of the testimony that has been presented to us. We hear vague generalities about multiplier effects and psychology. But beyond that there is nothing to grab hold of. I would like to know how we are supposed to evaluate the amount of a tax cut. Let us just confine it to fiscal 1964. Do you think 2.9 billion is all right, or why should it not be 4 or 8 billion?

Mr. LINTNER. Mr. Miller, it seems to me that the present degree of slack in the economy provides the answer. This slack is shown by the McGraw-Hill surveys to business executives, how much of your capacity are you using now, how much would you like to be using. Business tells McGraw-Hill that they are operating at 82 percent of their capacity, and that they would like to operate well above 90 percent of their capacity. This is slack. The 82 percent, incidentally, at the end of 1962 is the same low rate as at the end of 1961. Obviously it was better than it was in the first quarter of 1961. Here, then, is one measure of the degree of slack in the economy.

It is also possible to estimate, not with precision, but as well-established orders of magnitude, the additional output, gross national product, which would be produced if unemployed resources, 5.8 percent of the labor force, were reduced to 5½ or to 5, or to 4½ percent. Obviously the increases in output and demand which would employ labor would also raise this utilization of plant and equipment. The order of magnitude of a $10 billion tax cut is an order of magnitude that this economy—a degree of stimulation, if you like—can absorb without overheating, certainly over a period of 2½ or 3 years. My judgment is that we would be safe to step up somewhat the schedule of the cuts, and I should like to see that done. But certainly the $10 billion overall cut is the right order of magnitude to raise the utilization of the economy within the limits set by the amount of its slack.

Senator MILLER. You used the phrase "raise the level of the economy." Are you translating that in terms of GNP?

Mr. LINTNER. I view the economy here in terms of gross national product in real terms, as well as our utilization of our plant and equipment, our rate of growth and our level of unemployment. I don't think that any one single figure is entirely adequate. All of them come up with essentially the same signals so far as this program is concerned.

Senator MILLER. When we are talking about GNP and the improvement in the economy, isn't there another factor that has got to be taken into account; namely, the stability of the dollar or consumer purchasing power or investor money power?

Mr. LINTNER. You will notice, Senator Miller, I mentioned that earlier in my answer to your previous question.

Senator MILLER. Then I get down to this question just to test out the principle. If we had a tax cut of $2.9 billion net for fiscal 1964, which is the latest figure I have seen, but at the same time if we go into debt $12 billion further, which is the forecast of the budget, and use this as an assumption now—nobody knows what is going to happen for sure—assume accompanying that $12 billion increased national debt or deficit we have a reduction in purchasing power of the money of our people of $8 billion; so on the one hand you give them $2.9 billion more to spend in a tax cut, but on the other hand, you take from them $9 billion in purchasing power. Isn't our economy going to be worse off?

Mr. LINTNER. I think the answer here is that you are equating an increase of the debt of $12 billion within a 12-month period to a reduction of purchasing power of the consumer of, what did you say, $8 billion or $9 billion?

Senator MILLER. Let me say this: I furnished the answer when I said please use that as an assumption. Let us go on from that assumption. I have that figure from the Economic Indicators which shows over the last 2 years' period of time, for every billion dollars you go into debt you have a billion dollars of inflation.

I recognize that this is not a precise measurement. But I do come back and ask you to premise your answer on the assumption that we are going to have a loss in purchasing power of our people's money of $9 billion concurrently with a tax cut of $3 billion.

Isn't your economy going to be worse off at the end of that 1-year period than it otherwise would be?

Mr. LINTER. If your assumption were correct, then I would agree that there would be no significant increase in consumer spending in real terms on that assumption. Consumer spending in real terms out of incomes that had been reduced in real terms by the inflation which you are assuming would not increase. However, as a matter of practical judgment of where the economy stands at the present time, and the prospects for the next 12 to 18 months, I certainly would not be making that assumption myself.

Senator MILLER. Thank you. My time is up.

Senator PROXMIRE. Mrs. Griffiths.

Representative GRIFFITHS. I would like to ask Dean Jacoby, if you had a corporate tax cut only—a 5 percent corporate tax cut—in your judgment would it increase the flight of American capital abroad for investment purposes and thus affect the balance of payments situation or not?

Mr. JACOBY. In my opinion, it would reduce the movement of American capital abroad.

Representative GRIFFITHS. Why?

Mr. JACOBY. For the reason that American capital has gone abroad not from eleemosynary motives, but simply because profits are higher from investments abroad. This can be readily documented. One of the important advantages of focusing more tax reduction on the income from domestic business is to reduce this differential, to make it relatively less attractive for American firms to invest abroad and make it relatively more attractive to invest here.

I think the balance of payments benefits to this country deriving from a substantial cut on corporate income taxes would be quite large.

Representative GRIFFITHS. If you reduced it to 47 percent, wouldn't there still be a wide differential in the profits in most European countries and that which could be made here?

Mr. JACOBY. There would still be a differential in favor of European investment, but it would be 10 percent less. My proposal was to follow up the first five-point reduction on July 1, this year with another five-point reduction in July 1, 1964. This would cut the differential by 20 percent, which I think would have a material influence in retarding the flow of American capital abroad. American businesses prefer to invest at home because the risks are less. But the differential in favor of foreign investment has been so high that many of them have gone abroad.

I think it is quite important to remember this fact: What has thrown the international payments of the United States out of balance has not been any decline in our exports or any sudden increase in our foreign economic or military aid. It has been an enormous burst of American investment in other countries. This has been in response to higher profits. Let us cut the differential by lowering the tax on profits here.

Representative GRIFFITHS. In regard to the automotive companies, would you say that one of the reasons that the automotive companies have invested abroad is to protect the American car as it is sold here; that is, they are protecting a car selling at $3,000, made longer, made wider, from the influx of cars that are smaller, narrower, and cheaper. If they actually started making a smaller car in this country, won't they really cut into their own American market?

Mr. JACOBY. I don't know the answer. I don't know what reasoning has gone on inside the heads of automobile executives in Detroit. I would suppose that the large investments that American auto companies have made abroad have been in response to their belief that foreign markets for autos are expanding, as indeed it has expanded, as incomes there have gone up.

History teaches us that the intrusion of the small, foreign car in the American market seems to have been the trigger on the production of the compact car here.

Representative GRIFFITHS. They also triggered quite a lot of investment of American companies abroad in cars.

Mr. JACOBY. Yes; possibly they did.

Representative GRIFFITHS. So they can cut down on the competition themselves.

Mr. JACOBY. Yes, I think this is true. They were seeking to protect their total profit position.

Representative GRIFFITHS. The net effect, if they are given a large corporate tax reduction, but there is no corresponding consumer demand increase, they will still be hunting profitable places to invest their extra earnings, won't they?

Mr. JACOBY. Yes; but it is a matter of degree. If the prospective return on an investment is 10 percent after taxes, it means x dollars of investment. If the prospective return goes up 20 percent, you make x plus y dollars of investment. It is that y factor, the additional investment, which generates several times the amount of increase in the aggregate demand in the economy. When you put people to work in building and equipping plant, the effect is to increase consumer spending power without any concurrent increase in consumption goods. So you immediately start putting people on the payroll of factories making consumer goods and services. You get a multiplier effect, which is absent if your strategy is simply to increase the income of the consumer in the first place.

Representative GRIFFITHS. I believe you pointed out in your statement that there is available a large amount of investment money even for small business groups. So actually if the demand were present there is not any real reason to assume that any company in this country couldn't borrow sufficient money to build a factory to supply the demand.

Mr. JACOBY. In my judgment, the credit apparatus of this country is quite adequate to supply both equity and credit to businesses that have any reasonable plan of expansion.

Representative GRIFFITHS. Now, I would like to ask you this: You suggested cutting the spending. Would you please tell me either now or supply the answer, if it is all right with the committee, how much you would cut the spending and the taxes to reach a balanced budget, and what the effect, in your judgment, would be upon the country upon unemployment or employment, what it would be upon growth or bankruptcies, and how much taxes would have to be increased or how much you could decrease them?

Mr. JACOBY. That is a rather involved question.

Representative GRIFFITHS. I would like to tell you, the Budget Director is going to answer this question, too, for the record. If you would like to answer it for the record, I would be pleased to have you answer it.

Mr. JACOBY. What I have proposed—and I hope this is responsive to your question—is that the increase of $5.7 billion in Federal cash payments in the fiscal year 1964 which the President has proposed be cut in half. Instead of increasing payments by $5.7 billion, increase them by only half that amount. This would release, in effect, something approaching $3 billion that could be used to expand tax reduction without increasing the prospective deficit. I accept the deficit of $10.3 billion which the President has proposed as a reasonable one.

Senator Miller asked the question, why is a debit of $10 billion reasonable rather than $20 billion or $5 billion? Professor Lintner answered this. I would like to supplement his answer.

The analysis of the Council of Economic Advisers is that the U.S. economy falls about $40 billion short of a full employment gross national product. Therefore, a tax reduction is needed of the order of magnitude of $10 billion. If you take into account all the direct and indirect multiplier effects of this increased spending on aggregate demand, there is a total multiplier of about four. Thus a $10 billion tax reduction would ultimately generate some $40 billion of production which would bring the economy up to full employment.

Obviously, nobody knows precisely what these multiplier effects are, but I agree with Professor Lintner that four is a fairly good order of magnitude.

Mr. LINTNER. I was using less, as a matter of fact.

Mr. JACOBY. You used less, sir, but you branded your estimates as conservative.

Mr. LINTNER. That is right; to be conservative.

Representative GRIFFITHS. My time has expired, but would you answer for the record if you feel that a $10 billion deficit is supportable and what do you think a balanced budget would do to the economy? You can answer it afterward, if you like.

Mr. JACOBY. I am willing to answer it now.

Representative GRIFFITHS. Very well.

Mr. JACOBY. In my judgment, an effort to balance the Federal budget in the fiscal year 1964 would run the risk of producing an economic recession. It would be an undesirable goal.

Representative GRIFFITHS. Would each of the others of you say yes or no, that he is correct?

Mr. HELLMUTH. I would agree fully with Dean Jacoby's statement.

Mr. LINTNER. I would say that the tax increase that would be required to balance the budget within a period as short as 6 or 12 months certainly would turn the very modest increase that is now in prospect without a tax reduction into a downturn.

Representative GRIFFITHS. Thank you.

Senator PROXMIRE. Mr. Curtis.

Representative CURTIS. I want to pick up one point that was brought out in the interrogation of Dr. Lintner by Senator Miller.

You were referring to the McGraw-Hill estimates of plant utilization. In my opinion, these companies all say they want to replace some of their obsolete equipment producing goods that the public no longer wants.

The question is, though, what is the market? The market has changed. The steel industry, which was operating at less than 80 percent capacity, spent $1 billion last year increasing its production for thin sheets.

Dr. Lintner and Dr. Hellmuth began their papers with a premise with which I fundamentally disagree. It is the same premise used by the Council of Economic Advisers and most of the economists who have testified that since 1957, the economy has operated with substantial slack, even in recovery periods. This is on the first page of Dr. Hellmuth's statement, which says that disappointing experiences of the last 5 years made reforms in the economy long overdue and that we have had a sad economic performance in the period since 1957. I don't think that the Economic Report documents that. It tries to. That is its thesis. It is time someone came in ready to discuss this, instead of presuming it. I have been trying to point out for several years that this so-called slack occurs because 1952 had been the takeoff point. I don't know anyone who makes a good case for using 1957 as a proper takeoff point. I have asked Dr. Heller and others why they pick 1957. I wish we had time to study this here. In my judgment, this is the issue. This is one of the areas in which the statements have devoted a great deal of time. I would have liked to interrogate a panel on this subject.

Let me refer to Dr. Jacoby's statement on the same premise. He says that it seems quite evident that our economy has too large a margin of unemployed resources, resulting from an overall sluggish growth of demand and an insufficient flexibility in adaptation to technological change. I think that consumer demand today is for more leisure time. If the consumer is getting it, and I think he is, we actually have had amazing economic growth. The economic growth, gentlemen, in my opinion, has been so rapid. that it has created serious growing pains. In my judgment, this growth should not be considered sluggish by those who advocate this theory.

Those theorists should be ready to document and rebut the arguments of other economists who have disputed this theory. Dr. Burns disputed it in two excellent papers. Whether he was successful is subject to further discussion. But here is where the debate should begin. I was very happy that Dr. Jacoby discussed expenditure policy. We need to study this issue of expenditure policy in great detail. Agriculture has been pointed out as an area which needs great reform. I could not agree more. We are badly damaging our economy by this and other expenditure policies. We fail to discuss expenditure policies which would stimulate the economy by stopping what is wrong or by cutting down the deficits. Dr. Lintner, you are the first witness to discuss debt policy in your statement. I thought it was most unfortunate, as a coincidence, that when you reached that part of the paper, the chairman of the committee, Mr. Douglas, asked you to stop reading.

This was the first time that one of the witnesses was going into the problems in debt policy. Actually, I shouldn't say the first time. Yesterday afternoon, Dr. Burns projected these other economic policies and theories of deficit financing. Using his assumptions, we would not have a balanced budget until 1972. That led me to ask questions about debt policy. How sizable should the debt be? When we measure its size, should it be in relation to gross national product, national income, or some capital asset in the Federal sector?

Dr. Lintner, you introduced the subject, but you didn't deal with it in depth. I have urged this committee to hold hearings on this question of debt policy. One subject that is not discussed at all is the problem of debt management. I am on the Ways and Means Committee. When we fail to raise the revenues through taxation, which we are discussing here, it behooves us to figure out how we are going to market the subsequent debt. Last August, when we were discussing a $10 billion cut to stimulate the economy, I asked Dr. Heller where he would market this additional debt. He agreed that if it were done in the private sector, a great deal of the stimulus would be taken away. He expected it to be handled, to a degree, in the Federal Reserve System.

When Mr. Martin testified, he reiterated the fact, that he could not handle any sizable amount. So we, who are not economists, must grapple with this problem of debt management with no guidance at all. To this day, no one has come prepared to discuss those issues. Our national debate is moving at a very creaking pace. We have not even reached the point where we can interrogate witnesses intelligently.

I would like you gentlemen to prepare documentation on why you think the economy has had a sad performance since 1957, and why you used 1957 as a starting point. Why do you think this slowdown has occurred, in spite of other evidence such as increased leisure time, and the great shift to new goods and services. The actual shift is in the services, although all the discussions of gross or aggregate figures concentrate on the manufacturing sector. Thirty percent of the goods and services on the market today were unknown 5 years ago, and that rate is increasing. Fourteen percent is the corresponding rate for the coming 2 years. The increase by groups in income, houses, transportation, power, and so forth indicates an amazing suburbanization. In a society of that nature theorists studying aggregate statistics say our economy is tired, sluggish, and suffering from tired blood. I disagree, and may be wrong, but at least I would like to see some debate in this area.

I want to discuss dividend credit and exclusion which Dr. Hellmuth refers to on his paper and Dr. Jacoby in his. In my opinion, there was a complete lack of understanding of the theory behind the dividend exclusion. I was on the committee when we wrote a paper on this subject and I know the arguments. The issue is the financing of the economic expansion of a corporation. There are three possibilities: retained earnings, debt, or new equity. We felt that present tax laws heavily favor retained earnings and debt financing over equity.

When we studied this, our first thought was to examine the corporate level to equalize the tax incidence. Many of my colleague, however had tried this with retained earnings or undistributed profits and advised against a similar study. So, we attempted an examination at the personal level.

As you may recall, what went into the law in 1954 was only one of three steps in order to accomplish this. Dr. Hellmuth uses the argument that it has proved unsuccessful. He says dividend credit and exclusion have failed to serve their stated purpose, which was to increase the percentage of funds raised through equity instead of through debt. He might have also added through retained earnings because there are the three ways. It is hard to prove this but from the studies I have seen, it seems to me that without the dividend credit and exclusion we probably would have had a greater imbalance in financing by debt and retained earnings.

Dr. Jacoby does not discuss the theory of financing corporate growth. My question is this: Were we in error in feeling that the corporate financial structure should have a broad base, as broad as possible, of equity financing, and then retained earnings and debt? Were we wrong in thinking we had an imbalance of a heavy debt at the base and the equity financing at the top?

I think we were correct. For social reasons, it is desirable to spread the equity base to as many stockholders as possible. If ever I have seen a tax structure that is favoring vested interests, it is in this area. It favors those who presently have the corporate holdings, who gain through retained earnings, and those who gain through bond holdings, at the expense of those who might want to come into the market. It is doubly favorable because the wealthy person, who gains advantage from the 25-percent capital gain, can build up the price of the common stock that is available because he can hold it for the growth and only be taxed at 25 percent, while the small investor, who usually needs the dividends as a return for his living and his income, of course, can't pay as much. I have developed only one of the many tax reforms I have felt were badly needed for a long time.

These reforms are needed no matter where the economy is on the business cycle. They are necessary regardless of the economic picture because they would give us a better tax structure and stop impeding economic growth. In the President's message, there are many reforms that need similarly careful study.

I don't know how to emphasize the need for reason and intelligence. These reforms have been thrown into the political arena and have become the subject of demagogues. One of your papers says that the President's economic message educates the country.

In my judgment, it propagandizes the country. It doesn't seek to grapple with the issues. Neither have the economists speaking on this subject and testifying before this committee been hitting at the issues or really trying to help us grapple with these major problems. Of course, the record is open to answer. This was more a statement on my part rather than a question.

Senator PROXMIRE. I think before I ask questions, if you gentlemen would like to comment I think it would be fine. Shall we go in alphabetical order, Dr. Hellmuth?

Mr. HELLMUTH. With respect to the question on dividend received credit, I fully agree with Representative Curtis that the encouragement for more equity financing is most desirable. I tried to follow the development of the 1954 law and approved of the objective of encouraging equity financing. I have always questioned whether or not the dividend received credit was the most effective way to move toward that objective.

Representative CURTIS. Do you think we might have done it at the corporate level?

Mr. HELLMUTH. I would have preferred that. The dividend credit was much more needed when rates were high; assuming that the proposed rate reductions are enacted, the need for the dividend received credit will be much less pressing. That would be one of the small items I would be happy to do away with in order to make possible the more broad, sweeping rate reduction made possible by giving up some of the items that do cost revenue. We are concerned with the size of the deficit. If there cannot be an unlimited deficit, the broad rate reduction that is proposed here can be held to a $10 or $12 billion deficit figure only if some of the reforms are included, too.

Senator PROXMIRE. Dr. Jacoby.

Mr. JACOBY. I agree with you, Representative Curtis, in your espousal of the divided credit and exclusion in the past. I was a member of the President's Council of Economic Advisers at the time it was enacted. I supported it then. I believe it has performed a constructive purpose. I disagree with President Kennedy's statement that it failed to accomplish its objectives. He says the proportion of corporate funds secured from new equity financing has not increased. Of course, it might have diminished without this additional incentive. The fact that the number of individual direct owners of American corporate stock has risen from some 5 million in 1954 to 17 million or more today is not an accident. I believe that the incentive offered by this dividend credit and exclusion helped to spread the ownership of American corporate equity, and was quite an important and constructive thing. The only fault with it is that it was an indirect method of doing what in my view could better be done directly; namely, to cut the corporate tax outright and to start modifying the Federal penalty that our tax system now imposes on dividends, on the returns on the ownership of equity.

Mr. LINTNER. I would quite agree that I would prefer a reduction in corporate rate as a substitute for the combination of credit and exemption. I might comment at the same time on two of your other comments, if it is appropriate.

The first is that I did have a page and a half at the first of my statement on evidence of changes in performance. I would like to say that 1957 is simply the year in which business turned down the third quarter. There is nothing sacred about 1957. I myself would be as happy, in fact some respects prefer, to look at 1956 or even 1955 as a base.

I might comment also that while a business executive would always like to use more capacity, we do have at least four or five different approaches with independent sets of figures that get at much the same thing as the McGraw-Hill question. This other evidence does support the sort of conclusions I was drawing, on the basis of the McGraw-Hill evidence and indexes prepared at the Federal Reserve Board.

Representative CURTIS. You may know that one of our subcommittees went into this question of plant utilization.

Mr. LINTNER. Yes. I have the report right here.

Representative CURTIS. I want to thank my colleagues for their patience and understanding. I might add, for the benefit of the witnesses, that my comments were the result of lengthy hearings, not just now, but last August in both the House Ways and Means Committee and the Joint Economic Committee. Each time I tried to study the issues, but I didn't seem to get very far.

Mr. LINTNER. If I may, I might also say I regretted that, even though I left out several pages at the start. I didn't have a chance to cover all the material I had included on the debt question. As far as the shift from goods to services, services are included in the gross national product and we do have declines in rates of growth both for real gross national product and for per capita real gross national product since 1955, 1956, or 1957. So that the shift to services is covered in the data I used.

Representative CURTIS. It would be interesting to get into a debate. Have we had rapid economic growth or has it really been a sluggish period?

Senator PROXMIRE. I would like to ask Dr. Jacoby a question corresponding to the one that Mrs. Griffiths asked. She asked what economic effects would flow from a tax increase big enough to balance the budget. The answer was disastrous, as I understand it. Now I ask how much of a spending cut, how much of a reduction in expenditures, do we need to balance the budget and with what effect on the economy?

Mr. JACOBY. If we accept the President's figures for fiscal year 1964 we would need something like a $10.3 billion reduction in cash expenditures to balance the budget. I personally believe that it would be unfortunate to try to cut spending by that amount. I don't think it is feasible.

Senator PROXMIRE. Do you want to give me a period of years in which we can feasibly do it?

Mr. JACOBY. I am not sure we can ever do it.

Senator PROXMIRE. You are saying we can never balance the budget?

Mr. JACOBY. No. I am saying we cannot wisely cut spending by this amount.

Senator PROXMIRE. This is most discouraging from the one member of the panel who is specific and who also advocated some reduction in spending below the President's increase.

Mr. JACOBY. Yes. Of the order of $3 billion.

Senator PROXMIRE. You would say you would doubt if we could ever reduce spending below the present level because we have a growing country and growing problems?

Mr. JACOBY. Barring some basic change in our international position and in the Communist bloc. If we were able to bring about total and universal disarmament we would be confronted with quite a different basic situation.

Senator PROXMIRE. I am asking a little different question. If in Congress' judgment we could cut spending greater, would it have a bad economic effect or would it be a healthy economic effect?

Mr. JACOBY. I think it depends on the kind of spending that is cut. There are some kinds of expenditure reductions that I feel would not reduce aggregate domestic demand either because the spending is being done abroad or because the reduction of Federal expenditure would result in a current expansion of State or local or private expenditure. I think that expenditure reduction efforts should be focused on that kind of spending. In my paper I outlined several areas.

Senator PROXMIRE. Then I presume you feel that if we could cut spending, and if we did make wise choices in the spending we cut, we could have a balanced budget without economic misfortune or without adverse economic effect.

Mr. JACOBY. What did you have in mind? I don't think we could do it wisely in fiscal 1964.

Senator PROXMIRE. No; I understand that. Within the next couple of years?

Mr. JACOBY. Yes. I see no reason why prudent holding of some expenditures and cuts in others, coupled with the kind of tax reduction that will really stimulate aggregate demand, would not make it possible. I do not see why it would be impossible to bring the budget into balance in the fiscal year 1966. It is too much to hope that it can be done in fiscal year 1965.

Senator PROXMIRE. Dr. Hellmuth.

Mr. HELLMUTH. I would agree with Dean Jacoby that we could restrain increases in spending and if the economy is moving ahead in the private sector to generate additional tax revenues that we then would be able to look for and to hope for a balanced budget within the next 3 or 4 years.

Senator PROXMIRE. Surely, if the economy is moving ahead. The question is whether or not a reduction of spending to balance the budget would permit the economy to move ahead to an extent that would enable us to balance the budget. Is this within the realm of possibility within 1965, 1966, or 1967?

Mr. HELLMUTH. I don't believe this is likely if the private sector of the economy doesn't move ahead more rapidly than it has in the last several years.

Senator PROXMIRE. Do you tend to agree with a distinguished public official who recently said, and was criticized by a distinguished Member of the Senate, if we balance the budget by reducing spending it might have a disastrous effect on our economy?

Mr. HELLMUTH. Yes; I think I would agree with the public official. I think it would be possible to reduce Federal spending and avoid a recession but this would require a larger tax cut than what we have been talking about and a more active and larger private sector. But that is going off in a different direction than your question.

Senator PROXMIRE. Dr. Lintner?

Mr. LINTNER. Senator Proxmire, in my statement I tried to make clear that public expenditures should be minimized in cash cost to accomplish any objective. The objective of public spending should be to accomplish things that either can't be done in the private sector or can't be done as efficiently in the private sector. Critical appraisal of needs and costs is the benchmark. Fluff in Government spending is bad. I agree with Dr. Jacoby's remarks with respect to agriculture and several aspects of the veterans' program, although I suspect that may be from you gentlemen's point of view an even more delicate area. But in any case in my view, there is no justification for any excessive costs in Government programs. The Government programs must be justified on what they themselves accomplish in relation to their costs and not—underscore, please—from the standpoint of the stimulation to the gross national product that the spending program would have. It is only the spending programs that are desirable on their own ground that should be included. That being done, we should then have a tax structure which will give sufficient free play to private enterprise and consumer spending to put the economy on an appropriate level of performance.

Senator PROXMIRE. I would like to ask you two quick questions, Dr. Lintner. You make the absolute assumption that the multiplier works very precisely and that it is almost unarguable that a reduction in taxes will inevitably translate itself into a far greater increase in spending. Dr. Burns gave me the impression that these things are pretty indeterminate. That we are dealing with business psychology and consumer psychology and the spending response may fluctuate quite erratically. Nothing in economics is quite as precise and predictable and sure as you say this is. I must say I am inclined to share that cynicism about what economics can predict about what is going to happen in the future with a tax cut. Do you really feel that the multiplier is this sure and this precise and that it is bound to be 2.5 times or more?

Mr. LINTNER. I also have a great regard for Arthur Burns and value my associations with him. It is certainly true that no economist can give a pinpoint projection of something 12 months in the future that is accurate to a tenth of a billion dollars. The two and a half figure for the multiplier is a minimum figure of a range. If you were to ask me to give a figure as to what it will be more probably than any other single figure, the figure would be higher.

Senator PROXMIRE. The difficulty is this: We have had such unfortunate experience with economists. They are all fine people and wonderful people. But they make great errors in their predictions. Year after year, I suppose the economists are consulted before the Budget Director and the President of the United States make a prediction on what kind of a deficit or surplus we are going to have. Last year with the best available technical economic advice they predicted a surplus of half a billion. We ended up with a deficit of 8.8 billion. In some years in the past it has been far worse than that. If the economists cannot predict what is going to happen to our budget any more closely than they have in the last 6 or 7 years where they have been off every year, how can we rely on a prediction that a tax cut is sure to induce this amount of spending and improvement in the economy?

Senator MILLER. If the chairman would yield, possibly the economists who were making those predictions are not as well qualified as they should be.

Senator PROXMIRE. These are competent economists who made predictions in the Eisenhower fiscal 1959 year which was far off and Kennedy fiscal 1962, off but not quite as badly. It is a nonpartisan error.

Mr. LINTNER. May I make two comments. In my paper I addressed myself particularly to the question raised by those who say the nickels, dimes, and quarters won't work out. All of the evidence is consistent with the fact that they will. The two and a half is a lower range.

Here I would like to draw a distinction. In forecasting what the gross national product, total business, will be 12 months ahead, anything that changes State and local expenditures, business expenditures, attitudes toward inventory, international developments, or makes government expenditures different from what 12 months ago they were expected to be—any of those changes in other conditions will throw off that kind of a forecast. On the other hand, what is involved in the two and a half figure that I used is, how much different would the figures look at the end of a 12-month or 18-month period than they would have looked with government expenditures turning out to be what government expenditures turned out to be, State and local expenditures, and so on. It is a what-would-have-been-if comparison. On that basis economists are on much sounder ground.

Senator PROXMIRE. The point is we can never check up on them because other conditions will never be the same.

Mr. LINTNER. Here I do reiterate that while I have confidence in the two and a half because it is the lower figure of a range of estimates on what would have been if, on a comparison basis. This is what, I would suggest, this committee and the Ways and Means Committee and the Congress need to consider in appraising whether or not a tax reduction would help the economy and raise it above the level it would otherwise have. In this context, the two and a half is, I think, a conservative figure, a more probable judgment on the basis of substantial bodies of statistical analysis would be somewhat higher.

Incidentally, statistical analysis over past periods is much more directly useful for what-would-have-been-if comparisons to forecast because of the kind of output you get. All of this evidence suggests that the two and a half times is a conservative value to put on this ratio for planning purposes.

Senator PROXMIRE. I would like to ask one more question over my time. I would like to ask, briefly, Dr. Lintner, if it is true that you and Keith Butters made a historic study some 20 years ago, maybe as a doctoral dissertation. You look so young I can't believe it could have been 20 years ago.

Mr. LINTNER. My age is 47, if it is relevant.

Senator PROXMIRE. In that study you contended that no firm today could possibly grow to become a big important factor in the American economy with present corporation income tax rates. You said it was mathematically impossible that you couldn't do it because you could not reinvest enough earnings. You didn't mention this kind of thing in your paper today. You are very modest. I am asking you if you still hold this view and if the proposal of the Kennedy Administration to reverse the corporation income and make it 22 base and 30 percent surtax is not a very important contribution to the economic growth of the smaller corporations.

Mr. LINTNER. I didn't get into this matter because, as I indicated earlier, I thought that the primary recommendation to make to this body was to get on the business of the tax cut even if the arguments over what reforms should be made would lead to slow up other structural changes. I did join, as a full coauthor, in this book that you have referred to favorably. I am sure that both Professor Butters and I would still affirm the position that we took then. We both would favor the reversal of the 30–22 percent as an aid to small business. I will speak for myself in the next sentence because I have not checked this p oint with him recently, although I know him very well—his office is still across the hall and we have lunch together perhaps half the time. I certainly would support and I think he would support the recommendation made in that study 15 years ago now that a higher exemption be included in the corporate income tax in favor of small business. If you would like to pick up that ball or catch that fly and run with it, I am sure that neither of us would feel that you were being imprudent.

Senator PROXMIRE. Thank you very much.

Senator Miller?

Senator MILLER. Dr. Lintner, in your paper you refer to serious misallocations of resources and business decisions which are quite distorted, apart from special tax considerations. Could you give us some examples of what you have in mind?

Mr. LINTNER. Yes, sir. For instance, the acquisition of real estate, applying the depreciation schedule as fast as possible, charging such depreciation to current income, accepting a large part of the current cash flow as income to the investor not subject to the current income tax, and selling off the property where the two lines on the graph cross. You need to sell it to another fellow because that tax advantage has been milked so far as the original investor is concerned, but another fellow can buy it and start the process all over again. I made the description in rather colloquial terms. I am sure you are familiar with what I am referring to. I think many of the decisions, whether or not business firms will or will not merge, and whether or not owners of individual enterprises will or will not sell, also frequently turn on tax considerations, as Professor Butters and I in another book only about 10 years ago documented in some detail. The list is very long. Your own staff and other tax experts, I am sure, could document it with convincing illustrations of cases and a list of instances that would cover several pages.

Senator MILLER. May I say that I do realize that there have been many transactions in which the tax factor has been a very controlling factor. But I still have found it rather difficult to find businessmen who were willing to enter into a transaction just because of the tax angle unless there were some economic benefit attached to it. Otherwise there would be no tax factor. Particularly in the case of the real estate matter that you refer to. Don't you really get down to a definition of what is a "distortion" or a "misallocation." People who derive the benefit or the profit from that probably utilize that for increased investment. Might it not be that these tax angles most of which have been deliberately put on the books by the Congress and deliberately kept on the books by the Congress have been put there and kept there because of the benefit to our economy? Do you say that the motives that prompted their being put on the tax books in the first place or prompt keeping them on there are unsound economically?

Mr. LINTNER. I am not imputing bad motives to anyone. I am simply looking at the tax structure and saying that some things are done in view of tax differentials for doing them rather than other things, and that these decisions would be different if—and this is I suppose comparing heaven and earth—there were no taxes, or if tax considerations were genuinely neutral. It seems to me that the simplification and elimination of some of these differential effects is a very respectable and very important objective of tax legislation.

Senator MILLER. I thank you very much, Doctor. I might say that I was not concerned about my own position in that matter. I was thinking of people like Congressman Curtis who have been working directly on these committees. When you use the word "misallocation" and "distortion," I was somewhat concerned. If, as a matter of fact, the real point is that the tax motive has predominated or been a very controlling factor, then I would have no quarrel with you at all. I do point out to you that these laws have been put on the books and they have particularly been kept on the books for reasons which probably the authors or those in charge of the operation have not felt were misallocating or distorting the economy.

You talk about a minimum cut of three percentage points so that apparently the idea is to have Uncle Sam be less than a full partner. I am intrigued by this concept. However, I suggest that you ought to carry it to its real conclusion, and that is that we ought to change the tax structure so that the impact on the actual investor and the corporation combined will be less than 50 percent. Do you go that far?

Mr. LINTNER. If we are speaking of the best of all possible worlds, I do, but I think also that the practical realities of our immediate and prospective situation certainly make this a rather visionary goal for any short-run and foreseeable future.

Senator MILLER. But you would, as a target at least, seek to obtain a tax situation so that the combined corporate and individual tax would not exceed 49 percent?

Mr. LINTNER. As an ultimate objective that has much to commend it, if and when it becomes feasible in terms of all of the other considerations that have to enter into these matters.

Senator MILLER. In your paper you talk about an increase in real GNP. I invite your attention to page 2 of the Economic Indicators for January 1963. I believe the copy is in front of you. At the bottom of the page are the statistics relating to GNP and in the second column it says total gross national product. We note that the total has gone from 1960 in the amount of 503.4 billion to the third quarter of 1962 in the amount of 555.3, which is 51.9 billion difference. How much of that would you consider to be an increase in real GNP?

Mr. LINTNER. If you will look, Senator Miller, to the preceding column you will find that if you use 1961 prices as a base, that the increase has been 37.7 billion over that period. Is my arithmetic correct? I believe it is. So that the first column would be the one that I would use in speaking of increases in real GNP. The other is a current dollar measurement.

Senator MILLER. In other words, the first one, the increase of 51.9 contains some $14 billion in inflation, is that correct?

Mr. LINTNER. In terms of 1961 price levels, over a 2-year period.

Senator MILLER. December 31, 1960, prices, if we could obtain them, would be more precise. We are trying to peg the increase for the 2-year period.

Mr. LINTNER. All right. Although this would not affect the relative size of the price increment significantly.

Senator MILLER. Now, in other words, what you are really saying is, subtract out the implicit price deflator difference and we have real GNP. Dr. Burns yesterday gave us some examples in which the input—the dollar input—might result in a loss or a worthless gesture. For example, a tremendous amount of work on some product which has no market, and so the whole venture is lost. This would indicate that you could have situations where your input might result in a worse situation than you were at in the beginning. This was in answer to a question of mine regarding GNP and how valid it is as a measurement of our economic well-being. I assume that the only item you would subtract out of this would be the inflation portion. In view of what Dr. Burns has said, would you have any comment on that?

Mr. LINTNER. Mr. Miller, I have studied these figures in some detail and I could give you references to a library shelf of studies of other people. I think the fact is that gross national product is simply the best figure that we now have. It is not perfect. The decimal points and often the units are not accurate as reported. It does include a price factor, but by statistical work, you can get that out to a reasonable accuracy. Personally, I attach considerable significance not simply to GNP but to gross national product per capita and various other figures. I would not assert and I don't know of any reputable economist who would assert that these figures are perfect. There is a lot more work to be done to improve them, but they are the best we have. I think for the sorts of comparisons we are making here that they are reliable as orders of magnitude.

Senator MILLER. Let me give an example of what I am getting at here. Suppose we subtract out the inflation portion and we end up with a $37 billion increase in this period. If as a hypothetical that increase was made up entirely of the national defense figure under "Federal," would you consider that a healthy increase in GNP? Would that come within your idea of what is a real increase in GNP? Or would it be as much of an increase in real GNP, in your opinion, as if all of this occurred over in the personal consumption area?

Mr. LINTNER. I think the answer to that is that so far as it being an increase in GNP, it is because gross national product by definition is the current market value, using fixed prices or current prices, whether you are talking the current value or real value—the gross national product is the market value of the aggregate output of goods and services. Our hardware, our rockets, and so forth, are part of our current output of goods and services. Hence they belong in. Frankly, as a citizen I feel more comfortable with improved nuclear deterrents, and conventional forces that give us a conventional capability so that we won't be faced with the do-or-die choice of nuclear war or capitalization.

That is merely a lay citizen's reaction, but defense outlays do belong in the GNP in any case. My concern with consumer expenditures and with business investment I think is fully evident in my paper.

Government expenditures also on goods and services belong in the gross national product because your salary is the payment for your services to your State for sending you to the U.S. Congress, and to the country. These also are part of the products of goods and services at the time.

Senator MILLER. As I suggested, if the increase was all in the personal consumption area, or if the increase was all in the national defense area, which would be better from the standpoint of our economy. I am asking you from the standpoint of economic theory, not from the standpoint of adequate national defense or deterrent and all that. Use that as an assumption. I am asking you from the standpoint of economic theory.

Mr. LINTNER. From the standpoint of economic theory I will have to answer in terms of a series of "if" statements. If the additional defense outlay is needed in the judgment of the American people, and I suppose that comes down to the combined judgment of the Congress—or perhaps I should enlarge that to the Congress and the Executive—that these are needed, that we are taking imprudent risks without them, then that is good. I would be very much worried, to answer your question in terms of a hypothetical situation, if defense for expenditures had been really frozen at a current dollar figure of $40 billion and held there in spite of the changes in what our potential adversaries are doing and the more advanced and expensive technologies involved in an adequate defense. If our defense expenditures had been frozen at $20 billion and the additional $13 billion we are now budgeting were put on consumer expenditures, I, as a citizen, would be worried. But you see what is happening is that I am bringing to bear a judgment of the relative importance of the categories in terms of how worse off we would be without them. In other climes, if peace should be breaking out all over, it would be wonderful to face different problems and it would be terrible to continue to increase our defense outlays. If we had rockbound guarantees of peace, guaranteed by the Lord himself, then we would be utterly foolish to be spending money on defense establishments. I would like to see some part of the money put in urban development, some part in education, and hospitals and a good deal of it in consumer expenditures that each of us would have our own control over. I would also like to see quite a lot of it in future business, plants and equipment and bricks and mortar, highways, and so forth.

Senator MILLER. Thank you very much.

Now I would like to ask one final question, if I may, of any of the panel or if all of them would answer I would appreciate that. We have been talking about a tax cut across the board. Now, it seems to me that if our objective is to provide an incentive to growth that we ought to reward growth, and that individuals and businesses which don't grow should not receive the reward of a tax cut. If that assumption has some justification, I wonder what the panel would think of having a tax cut in the area of growth income as far as individual and corporate taxpayers are concerned. I am talking about a real good tax cut, possibly 50 percent of the rates, so that a corporation that made a hundred thousand dollars for calendar 1962 and makes $150,000 for 1963 would be taxed on the $50,000 of increment or growth at 26 percent instead of 52 percent. The same approach to be extended across the board as far as other types of taxpayers are concerned such as individuals, professional men, and the like. I recognize that there would have to be safeguards to prevent whipsawing and all that but these could be drafted. I was wondering whether this approach might not have a far more stimulating effect in encouraging growth than a tax cut willy-nilly across the board.

Mr. JACOBY. It seems to me that the amount of profits or net income that an individual or business enterprise earns in any year is in part a product of opportunity which is more or less haphazardly distributed and in part a product of managerial skill, effort, and productivity. Any scheme of taxation such as you suggest would in effect distribute rewards not exactly in proportion to effort exerted. It seems to me that the best scheme of tax reduction is one which is more or less neutral in this regard. An outright cut in the tax on business income is neutral, and would not of itself tend to give unduly large rewards to people who might be fortunate to have been located at the right place at the right time.

Senator MILLER. We originally devised the excess profits tax to be an incentive against excessive profits. If we reverse it, why wouldn't it be an incentive to make more profits?

Senator PROXMIRE. If the Senator would yield on that point the administration proposed in their original investment credit proposal that the benefits would go primarily to incremental investment, that is, growth. And Congress modified it with greater neutrality and provided that investment, whether growing or not, would be equally rewarded.

Senator MILLER. That is precisely the point I was getting at. As the Senator from Wisconsin has well pointed out, the investment tax credit is not a uniform proposition. It is directed to those people who want to go into something to a greater extent. It has no particular value to some business that is not making any profits. It will have a selective, possibly discriminatory impact. But nevertheless Congress thought well enough to pass it. Why not go a little further and do it in the tax rate structure as I have suggested?

Mr. JACOBY. As I have said, the basic fault in the proposal is that it distributes rewards in the forms of tax reduction partly on the basis of chance and not on the basis of productivity or demonstrated skill in managing resources. I think there is another fault in it, and that is that if you progressively cut the taxes of a set of businesses in an industry that happened to be in the process of expansion, it is very likely that you would encourage an excessive investment in that industry and get a distortion in their allocation of resources.

An across-the-board cut in corporate tax rates is neutral in the allocation of resources. Any plan of gearing tax reductions to past growth in income would be inferior to it.

Senator PROXMIRE. Dr. Hellmuth.

Mr. HELLMUTH. If I may comment on this, I think the idea or principle that Senator Miller suggests is excellent but we would get into a thicket of administrative problems in trying to administer it. It would be necessary to differentiate the fortuitous increases in income and profit from those that were attributable to unusual effort or industry or foresight. We still have, I think, cases in the courts from the excess profits tax of World War II as well as the Korean war.

We would have even more administrative difficulties in trying to differentiate these types of increases in income and profits. It would make our present tax laws seem relatively simple by comparison.

Senator MILLER. If the morass could be reduced to a workable level, then what would be your position?

Mr. HELLMUTH. I would see quite uneven effects between different companies, between different industries, between different geographical areas, depending on whether or not things they could control or they could not control were changing in their favor or against them. I would be very much concerned about the aggravation this might have for the eastern railroads or that it might have on some of the depressed areas. It would also have uneven effects on people in different stages of their life cycle; ordinarily for the first 20 or 30 years of your working cycle you anticipate some growth and this is normal. To differentiate the normal growth from the abnormal growth would be quite difficult.

Mr. LINTNER. I would agree entirely. As I understand the record, it was a combination of inherent complexity and inequity and administrative unfeasibility which led to a modification of the initial investment credit—which was, as Senator Proxmire noted, geared to incremental investments—that led to a cutback to the much simpler 7 percent across the board, except for utilities and so forth. If you are talking about increases in income, individual and corporate, it will be impossible to distinguish between those that reflect normal growth from those that reflect exceptional growth, and between those that are gratuitous or fortuitous, as distinct from the appropriate planned reward for added effort and enterprise, imagination and skill. It seems to me that if the other is administratively unfeasible, this would be administratively impossible.

Senator MILLER. I would like to ask Dr. Hellmuth, how would this adversely affect the railroads? I believe you said this would have a possible adverse effect on them. I was wondering how it would be.

Mr. HELLMUTH. This was not for all railroads but for the railroads that are already in financial difficulty. It would make much less likely any chance for recovery, as I would see it, since the best they may be able to hope for is to stabilize at a break-even point or a modest profit rate compared with the more attractive profit opportunities that would exist in other types of transportation and in other possible outlets for investment.

Senator MILLER. Maybe you did not understand the premise. Take a railroad that is in difficulty and improve its position, at least to the point of making a profit, it has the incentive of making this improvement, making its growth and having a very substantial cut in tax rates applicable to the growth. Of course, in the case of a railroad that is in a loss position, a tax cut will not help one way or another—take a railroad that is earning 1 percent on its investment but is in a profit position, and I would think that would be a railroad for which this would have a particular incentive.

Mr. HELLMUTH. I accept your correction on my position. I was thinking more of something like the New Haven situation where there is already a large deficit. Unless the Government was willing to share with them in any reduction of this deficit it would be a long time before they would be gaining from this suggestion.

Senator PROXMIRE. Dr. Lintner.

Mr. LINTNER. I might make one further comment. I think Senator Miller properly referred to this as an excess profits tax in reverse. I am sure that he and this Committee and the House Ways and Means Committee and the Senate Finance Committee are aware of all of the horrendous administrative, equity, and legal problems involved in getting the base from which you would compute excess profits taxes. If you were to have 1 year or 2 or 3 years as the base increases in income over such a base being taxed at a low rate, for instance 26 percent, then it might well be profitable to have one very bad year or two or three very bad years and then restore your earlier profit position simply to get the benefit of the tax saving conditions later, and so on. The problem of what is an appropriate base and how it is figured—whether on assets, earnings, this, that, and the other thing—is administratively almost hopeless in this context.

Senator MILLER. Doctor, that prompts a story. I recall hearing about a course in excess profits that was set up at your university early in World War II. At the beginning of the course I understand there were 13 students and the professor. It was a 1-month course. At the end of 2 weeks there were only six students. At the end of the 4 weeks there was only one student and he flunked the course.

Senator PROXMIRE. In view of the fact that we have an excess of hunger at this hour, I want to thank this panel for its great patience and for its very fine performance. I would like to ask you gentlemen—I hesitate and I apologize for asking a final question so late. Tomorrow we are having a monetary policy discussion and it is our last session of these hearings. Two of you gentlemen at least implied that one reason why we cannot have a somewhat more expansionary monetary policy is because of the inhibition of the balance of payments. Both Dr. Lintner and I am sure Dr. Hellmuth implied that. We have had two very excellent studies which contradict this, one by Dr. Robert Gemmill and one by Dr. Philip Bell. They say that speculation, not interest differentiation, is the predominant factor. If either of you gentlemen know of any studies that contradict this view, I would be delighted to have them. I challenged the Chairman of the Federal Reserve Board. He doesn't seem to have any. The Secretary of the Treasury does not have any. Yet they are operating on this assumption which does not seem to be based on any study but a contradiction of studies that have been made.

Do you know of any, Dr. Lintner?

Mr. LINTNER. International finance is not my primary interest, but I am quite sure I will be able to supply something on this. I will certainly look into it.

Senator PROXMIRE. I would like to have it.

(Mr. Lintner later supplied the following for the record:)

FEBRUARY 11, 1963.

Hon. PAUL DOUGLAS,
Chairman, Joint Economic Committee,
New Senate Office Building, Washington, D.C.

DEAR MR. CHAIRMAN: When I appeared before your committee during the recent hearings on the President's Economic Report, I was asked by Senator Proxmire to supply references to evidence indicating that short-term capital movements, such as might be induced for a time by the larger deficit occasioned by the tax cut, would be responsive to interest rate differentials. This letter is in response to that request.

Such evidence is given in the testimony of Frederick H. Klopstock (manager, research department, Federal Reserve Bank of New York), and Peter B. Kenen (associate professor of economics, Columbia University) in the hearings before the Subcommittee on International Exchange and Payments, of the Joint Economic Committee, December 12–14, 1962. It should also be noted that Prof. Philip W. Bell (of Haverford College) at the same hearings recognized that such short-term speculative movements are especially subject to changes in interest rate differentials. Some confusion may have arisen because elsewhere in his testimony (as well as in his major paper on "Private Capital Movements and the U.S. Balance-of-Payments Position" which appeared in the compilation of studies "Factors Affecting the U.S. Balance of Payments" prepared for the same subcommittee and published in connection with these hearings) Bell explained most of the actual movements in terms of other considerations, but as I understand his position and conclusions he also believes that speculative financial transfers, unconnected with commodity movements and long-term capital investment, are responsive to these interest rate differentials.

Dr. Roy Reierson, senior vice president and chief economist of the Bankers Trust Co., New York City, took the same position strongly in a paper read at the annual meeting of the American Finance Association on December 27, 1961, which is published in the Journal of Finance, May 1962. (Unfortunately impressive charts of the relevant figures which Dr. Reierson had included in his original address were not published, but are doubtless available from him directly.) I might add that I myself have been impressed by the fact that economists closest to the actual dollar movements, namely Dr. Klopstock and Dr. Reierson, have taken particularly strong positions that these short-term speculative fund movements are quite responsive to interest rate differentials, especially if allowance is made for the cost of "cover" for the foreign exchange risk.

Sincerely,

JOHN LINTNER.

Senator PROXMIRE. Dr. Jacoby?

Mr. JACOBY. I don't recall at the moment a study squarely on the point, but I seem to have a recollection that the Commission on Money and Credit looked into this matter at some length. I will review my files and if I find something, I will send it to you, sir.

Senator PROXMIRE. Thank you very much.

Dr. Hellmuth?

Mr. HELLMUTH. I would like permission also to follow this up later and submit some statement to you.

Senator PROXMIRE. Very good.

Thank you, gentlemen, very much. Tomorrow at 10 o'clock we will hear from three distinguished economists on monetary policy.

The committee will stand adjourned.

(Whereupon, at 1:20 p.m., the committee was recessed, to be reconvened Wednesday, February 6, at 10 a.m.)

JANUARY 1963 ECONOMIC REPORT OF THE PRESIDENT

WEDNESDAY, FEBRUARY 6, 1963

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

The committee met at 10:05 a.m., pursuant to recess, in room 1202, New Senate Office Building, Senator Paul H. Douglas (chairman of the committee) presiding.

Present: Senators Douglas, Proxmire, Pell, Miller, and Jordan of Idaho; Representative Reuss.

Also present: James W. Knowles, executive director; John R. Stark, clerk; Roy E. Moor and Donald A. Webster, economists.

Chairman DOUGLAS. The committee will come to order.

We are very glad to welcome our panelists to the final session. We have Professor Chandler of Princeton University, Prof. James S. Duesenberry of Harvard University, and Prof. Allan H. Meltzer of the Carnegie Institute of Technology.

We have arranged the panelists in alphabetical order, so we will ask Mr. Chandler to lead off.

STATEMENT OF LESTER V. CHANDLER, PROFESSOR OF ECONOMICS, PRINCETON UNIVERSITY

Mr. CHANDLER. My statement will focus on monetary policies though it will necessarily touch upon several other related topics. To conserve the time of the committee, I shall be as brief as possible, but I shall, of course, be glad to elaborate on points as you wish. Also, I shall limit myself largely to issues that we are likely to face during the next year or two and shall have little to say about proposals for long-term monetary reforms.

I shall not attempt an original evaluation of the existing economic situation. But to put my comments in proper perspective I should say that I do not take important exception to the analysis and prognosis in the President's Economic Report. Most relevant are the continuing deficit in our balance of payments, the present excessive amount of unemployment and unused capacity, and the prospect that in the absence of explanatory fiscal-monetary policies both unemployment and excess capacity are likely to rise rather than fall, not necessarily because of an actual recession but because of a failure of aggregate demand to grow as fast as the labor force and the productive capacity of the economy.

My first main point is that we cannot expect an expansionary monetary policy to be the prime mover or principal force in an effective program to stimulate employment and growth. This is not

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to say that monetary policy is unimportant; I shall later contend that it can be an important auxiliary or supporting measure for an expansionary fiscal policy, but it cannot be the primary force under present and prospective conditions. With excess capacity already existing in many industries, there is doubt that an expansionary monetary policy alone could quickly and effectively raise investment spending and aggregate demand even if the degree of monetary ease were not limited by balance-of-payments considerations. Starting from present conditions, even a highly expansionary monetary policy accompanied by very low short-term interest rates and a marked decline of long-term rates would be likely to operate only slowly and after a considerable delay.

But to discuss this possibility further would be only academic, because considerations relating to the balance of payments exclude the availability of such a highly expansionary monetary policy. It may be true, as some contend, that we could have a somewhat more expansionary monetary policy and a somewhat lower level of interest rates without inducing an accelerated outflow of short-term funds and without creating new doubts as to the future exchange rate on the dollar. My own impression is that if such a margin for further monetary ease does exist at all it is at best very small, and certainly not great enough to permit the high degree of monetary ease that would be required if this instrument were to become our primary means of raising aggregate demand. In this connection it should be noted that our success to date in limiting outflows of short-term funds while maintaining interest rates around present levels has depended in part on cooperation by several European countries, this cooperation taking such forms as lowering their own interest rates, cooperating in foreign exchange operations, and otherwise discouraging inflows of funds. If we were to drive for much lower interest rates, at least some of these countries might find it more difficult to cooperate—especially those now facing inflationary pressures. We shall be fortunate if some of those countries do not find it necessary for domestic reasons to raise their rate levels. It is for reasons such as these that an expansionary monetary policy cannot be a prime mover in an effective program for raising domestic output and employment, thought it can play a useful supporting role. Our primary reliance must be on an expansionary fiscal policy.

My second main point is that the proposel expansionary fiscal policy throught tax reduction is modest indeed when compared with the increase of aggregate demand that will be required if we are to achieve substantial reductions in unemployment and excess capacity. Even if all the tax reductions proposed by the President were enacted in full and on schedule, the result would not be the creation of excess demand for output and inflationary demand pressures. More likely, we would still be faced with a deficiency of demand. This remains true even when we take into account the projected $4 billion increase of Federal Government expenditures, and a like increase of State and local government expenditures.

The Council of Economic Advisers has estimated that actual GNP in the fourth quarter of 1962 at an annual rate of $562 billion was $30 to $40 billion below the level that could have been produced if unemployment had been as low as 4 percent. On top of this, the capacity of the economy to produce will undoubtedly continue to rise during 1963, owing to the increased labor force, new investment, and continuing increases in productivity. A very conservative estimate would be 3½ percent, or about $20 billion. Thus by the fourth quarter of this year the economy could, with a 4 percent unemployment rate, produce a GNP at least $50 billion above the level actually prevailing a year earlier. And this is a conservative estimate. I see no likelihood that the proposed tax reductions will induce increases in aggregate demand in anything like these proportions. It is not unreasonable to expect that the proposed $6 billion tax reduction to take effect July 1 would induce a rise of consumption demand of about $12 billion, though some of this increase would probably be delayed beyond the end of the year. It is also reasonable to expect that this will stimulate some private investment spending, which will in turn stimulate further consumption. But one would have to be optimistic indeed to expect that all of these effects together would add up to anything like $50 billion. The further $4 billion of tax reduction proposed for 1964 and 1965 would add further to demand for output, but it should be remembered that in the meantime the capacity of the economy to produce will continue to rise, presumably at a rate of more than $20 billion a year.

These estimates need not be very accurate to support the point that I want to emphasize: That far from creating inflationary excess demands for output, the proposed tax reductions are so modest as to leave us in a state of continued insufficient demand, with continuing excess unemployment and unused capacity.

This leads to my third main point: That the major domestic function of monetary policy in the foreseeable future is likely to be that of stimulating, as much as it can within the limits imposed by balance-of-payments considerations, private investment spending. Its prospective domestic problem is not that of preventing or offsetting an excessive rise of demand emanating from tax cuts or other sources. Rather it is to support and reinforce an expansionary fiscal policy that has been overlong delayed and is overly modest. And in the foreseeable future, the effective limitation on the degree of ease should be not domestic considerations but considerations relating to our balance of payments. In coming months, credit should be kept as available and interest rates as low as is consistent with our balance-of-payments objectives.

It would be quite unwise to try to specify the particular types or amounts of monetary actions to be taken. This is primarily because monetary policy, as the most flexible of all the stabilization instruments, must deal with all the residual problems left by the more inflexible instruments, such as tax policy and Government expenditure policies. It must try to compensate as best it can for their errors and omissions, and be ready to deal flexibly with unforeseen developments, both domestically and abroad.

One more specific thing may be said, however. This is that some expansion in the money supply will be desirable in the coming months. Though there have recently been significant increases in the money supply and even larger increases in the total liquid assets of households and business, there does not seem to be such an excess of liquidity as to be embarrassing as the economy recovers. We are not likely to see a sharp rise in the velocity of money. In fact, if the money supply were not increased, the rise of incomes, increased Government and private demands for credit, and increased needs for money for transactions purposes, would tend to increase interest rates and thus hinder the desirable expansion of spending. But the appropriate rate and amount of increase in the money supply cannot be determined in advance by formula; they will have to be determined as events unfold. And we face the possibility that the degree of monetary ease will be limited by the balance of payments.

My final main point is this: The most important contribution that the Congress and the President can make to the cause of promoting stability, employment, and growth is to use fiscal policies more flexibly and adequately. It is not only possible but even likely that for some time to come fiscal policies will have to bear a larger share of the burden. For about 3 years now the use of monetary policies to promote domestic growth has been inhibited to some extent by balance-of-payments considerations. The balance-of-payments deficit is still with us, our net international reserves continue to decline, and no one knows when this process will end. In the absence of important basic changes in monetary arrangements it may be a long time before we recover the degree of freedom to follow expansionary monetary policies that we enjoyed for so long before 1960. The Congress and the President could, of course, enhance this degree of freedom by devaluing the dollar or by adopting a system of flexible exchange rates, either of which would present major issues. But in the absence of such unlikely actions, we should recognize that our national program to promote employment, stability, and growth is likely to suffer if fiscal policy is not used more in a more timely, flexible, and adequate manner.

Chairman DOUGLAS. Thank you, Mr. Chandler.

Mr. Duesenberry.

STATEMENT OF JAMES S. DUESENBERRY, PROFESSOR OF ECONOMICS, HARVARD UNIVERSITY

Mr. DUESENBERRY. Our subject today is monetary policy but, of course, we cannot discuss monetary policy except in the context of the economic outlook and the other dimensions of economic policy.

We are faced at this juncture with some very difficult choices. Our domestic economic situation is unsatisfactory. We have had too much unemployment for too long. I do not need to expound to this committee the economic and social costs of unemployment. The declining rate of return on capital and the stationary rate of business investment are costly to us in terms of economic progress. In the short run, high unemployment and low capacity utilization may help to hold down prices and improve our international position. But an economy characterized by excess capacity and high unemployment, is likely to develop hardening of the arteries in the form of restrictive trade practices and wasteful work rules. In the end a chronically slack economy is in danger of falling behind in race for technological development and cost reduction. Whether we view the situation in terms of our output of goods and services or in terms of the human problem of the unemployed, we need to do something to step up the pace of economic activity.

At the same time we must recognize that we have not really licked the inflation problem. True prices of goods have been stable for nearly 5 years—though service prices have continued to rise. But that price stability has been possible only because unemployment has been high and capacity utilization low. The real problem is not to achieve price stability but to achieve price stability and a satisfactory level of unemployment and capacity utilization at the same time. We do not know how much upward pressure on prices and wages will develop when we return to say 4 percent unemployment and a good level of profits and capacity utilization.

Finally, we still have a deficit in the balance of payments. Our international economic position is improving but much remains to be done. We cannot conduct our domestic economy policy, as we used to do, without reference to our balance-of-payments position.

With those considerations in mind, let me briefly comment on the domestic outlook and the impact of the administration's budgetary and tax proposals on the three problems of unemployment, inflation, and the balance of payments.

THE OUTLOOK

Most of the forecasters who have made projections for the coming year appear to have reached about the same conclusion. As usual, we may be wrong, but we'll all be wrong together. The consensus, briefly, is that in the absence of a tax reduction GNP will grow at a very moderate pace during 1963. The only clearly visible expansionary force is the increase in Government expenditures at both Federal and State and local levels. Of course, some expansionary force which we have not recognized may come into play. But it is equally likely that some forms of demand may contract rather than expand. Though the best estimate of the outlook is that GNP will expand slowly, there is substantial risk that output will actually decline.

In the circumstances, measures to stimulate an increase in demand are clearly in order. The monetary situation is already fairly easy. Other considerations aside, no action by the monetary authorities is likely to generate by itself any substantial increase in demand. A program of tax reduction seems to be the only answer to our domestic problems. However, as I have already indicated, we cannot neglect the balance of payments and inflation problems in our calculations.

It seems to me that the tax reduction proposed by the administration is predicated on certain expectations and hopes as to its impact on prices and the balance-of-payments problem. In my opinion those expectations are fully justified but, as we know, any prediction of economic events is likely to go awry in one way or another.

Most forecasters agree that a tax reduction on the proposed scale should increase demand sufficiently to eliminate the risk of any decline in economic activity. And if things work out well, it should generate a sufficient growth of output to bring about some reduction in unemployment and capacity utilization. But it is not considered likely that the tax reduction will set off a big boom. All things are possible but we have worked off so much of the postwar backlog of investment opportunities that a spectacular investment boom is relatively unlikely.

Any improvement in employment, profits, and capacity utilization is likely to produce some upward pressure on wages and prices but we may expect that those pressures will be mild.

On the international front some increase in imports will result from an expansion in the economic activity. Any rise in domestic price will, of course, tend to reduce exports and increase imports. The resulting adverse effect on the balance of payments may be partly offset by an improvement in the attractiveness of investment at home relative to investment abroad. Again, it is expected that the expansion stimulated by the tax reduction will have only a small adverse effect on the balance of payments. The idea is that the tax reduction will not solve the balance-of-payments problem but will not make it any worse.

Meanwhile, a variety of other measures coupled with continued growth in the rest of the world and inflationary pressures in Europe may bring about some further improvement in the balance of payments.

If everything works out according to calculation then the prescription for monetary policy is "the mixture as before"—a continuance of an easy reserve positon for the banking system coupled with continued efforts to maintain a relatively high level of short-term interest rates by manipulating the composition of the publicly held Federal debt. But the really difficult problems of monetary policy arise if things don't work out according to expectation.

THE UNCERTAINTIES WE FACE

There are a good many if's in the outlook as I have outlined it.

We don't expect a very rapid rise in economic activity as a result of a tax reduction but if it should occur, monetary policy would provide us with a useful backstop. A really substantial rise in the pace of economic activity leading to rapid return to full employment, pressure on industrial capacity, and rising profits and wages would justify a policy of monetary restrictions. The favorable effects of rising interest rates might go far to offset the balance-of-payments losses from increasing imports and decreased exports.

However, unless the boom is so strong that we want to check it from a purely domestic point of view, monetary policy should be conducted in such a way as to produce a maximum effect on interest rates and a minimum effect in terms of rationing. That means, one, that ceilings on mortgage rates should be eliminated or promptly raised to keep pace with market rates; two, FNMA support operations in the mortgage market should be used; three, the Federal Reserve should move in the direction of less rationing at the discount window and correspondingly larger increases in the rediscount rate.

The object of these measures is to emphasize high interest rates rather than credit availability. That will maximize the effects of a restrictive policy on international capital flows relative to the effect on domestic economic activity.

The other contingencies we face are much more difficult to prescribe for. It is possible that without more than a mild domestic expansion prices should rise rapidly and cause balance-of-payments problems. Or developments in the common market might cause further balance-of-payments difficulties for us. In those circumstances, monetary restriction might be necessary as a stopgap measure. But since such a policy would be in conflict with the objectives of domestic policy a more fundamental attack on the price and balance-of-payments problems would be necessary.

Indeed the difficulties and uncertainties we face should serve to emphasize the need for measures to strengthen our international position and achieve price stability and full utilization of our resources at the same time.

We must step up our efforts to reduce price pressures by improving the matching of the labor supply in terms of skill, education, and location with the requirements of demand for labor. We must encourage investment and the ready acceptance of technological advance by labor and management. We must find ways to reflect the national interest in price stability in collective bargaining agreements. And, in the international sphere, we must make our trading partners see that they cannot pursue restrictive trade policies while expecting us to bear the bulk of the burden of military expenditures and foreign aid.

It is only by a fundamental attack on many fronts that we can escape the dilemmas and uncertainties of policy choices which we now face.

Chairman Douglas. Thank you very much, Mr. Duesenberry.

Mr. Meltzer.

STATEMENT OF ALLAN H. MELTZER, CARNEGIE INSTITUTE OF TECHNOLOGY

Mr. Meltzer. Thank you, Mr. Chairman. I have a somewhat longer statement than the others, so I would like to summarize it and point out the conclusions.

(The prepared statement of Mr. Meltzer is as follows:)

Monetary Policy for 1963[1]

(By Allan H. Meltzer)

The current Economic Report of the President and the Annual Report of the Council of Economic Advisers argue the need for a reduction in tax rates. Both reports devote much attention to the effects of Government fiscal policy on the economy, to the stimulus to consumption and thus to investment that would be provided by lower tax rates, to the higher level of income and employment that would ensue if tax rates are reduced. Substantially less attention is devoted to the question of an appropriate monetary policy for 1963 or to the method of financing the deficit which is expected in the current calendar year. Yet the broad record of the economy for the past 60 years suggests that decisions about monetary policy and the means of financing the deficit are at least as important for income and employment as the size of the deficit and the decision to reduce tax rates.

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[1] This paper is based on the research on monetary theory and monetary policy conducted under the joint responsibility of Karl Brunner and the author. The author is responsible for the views expressed.

In this brief statement, I shall not attempt to provide the detailed analytic foundation from which the conclusions are drawn. These are presented elsewhere.[2] But I would like to survey the major findings about the role of money and its relation to the pace of economic activity during this century before turning to the recent record of the economy. I will then consider the question of monetary policy in 1963 and will briefly discuss the problem of the gold outflow.

THE RELATION OF MONEY TO ECONOMIC ACTIVITY

Economists have studied and discussed the relation of money to current national income for a long time. As presented, the idea was relatively straightforward. An increase in the quantity of money raises the level of income and a decrease reduces it. Indeed this idea was sufficiently simple and appealing that the relationship between money and income, known as the quantity theory of money, came to be regarded as an almost mechanical principle. Associated with the widespread acceptance of this theory, was a belief in the power of the central bank, the Federal Reserve in our country, to halt inflation or to raise income from depression or recession lows by altering the quantity of money.

The prolonged depression of the thirties sharply reduced the extent to which many economists continued to adhere to the quantity theory of money as a useful framework in which to analyze the current or near-term future state of the economy. Optimism about the power of the central bank to regulate the economy by changing the quantity of money was replaced by a markedly pessimistic approach toward the power of monetary policy to change the level of income. In its simplest form, the revised view suggested that monetary policy could increase the amount of bank reserves, but it couldn't get banks to expand the quantity of money if the public did not want to borrow. And if the public did not want to borrow and spend, increasing bank reserves would have little or no effect on income or employment.

Just as the simple mechanical connection between money and income asserted a relationship that was more exact than the evidence justifies, the reaction against the role of money denies too much. Recent theoretical work and examination of the evidence for a number of different time periods suggests that monetary policy does indeed influence the pace of economic activity. But the relation is much less mechanical than the earlier optimism suggested and much stronger than the pessimistic views lead us to believe.

Chart I shows a comparison of the actual and predicted values of net national product (in current dollars) for 39 years. The predicted values were obtained from an approximate macro theory based on the demand and supply for money. Money is defined as the sum of currency and demand deposits. The theory, unlike its mechanical predecessor, views the demand for money as dependent on interest rates, asset yields, and wealth. It attempts to take account of the response in the private sector of the economy—by individuals, business firms, and banks—to changes in economic conditions whether initiated in the public or private sector.

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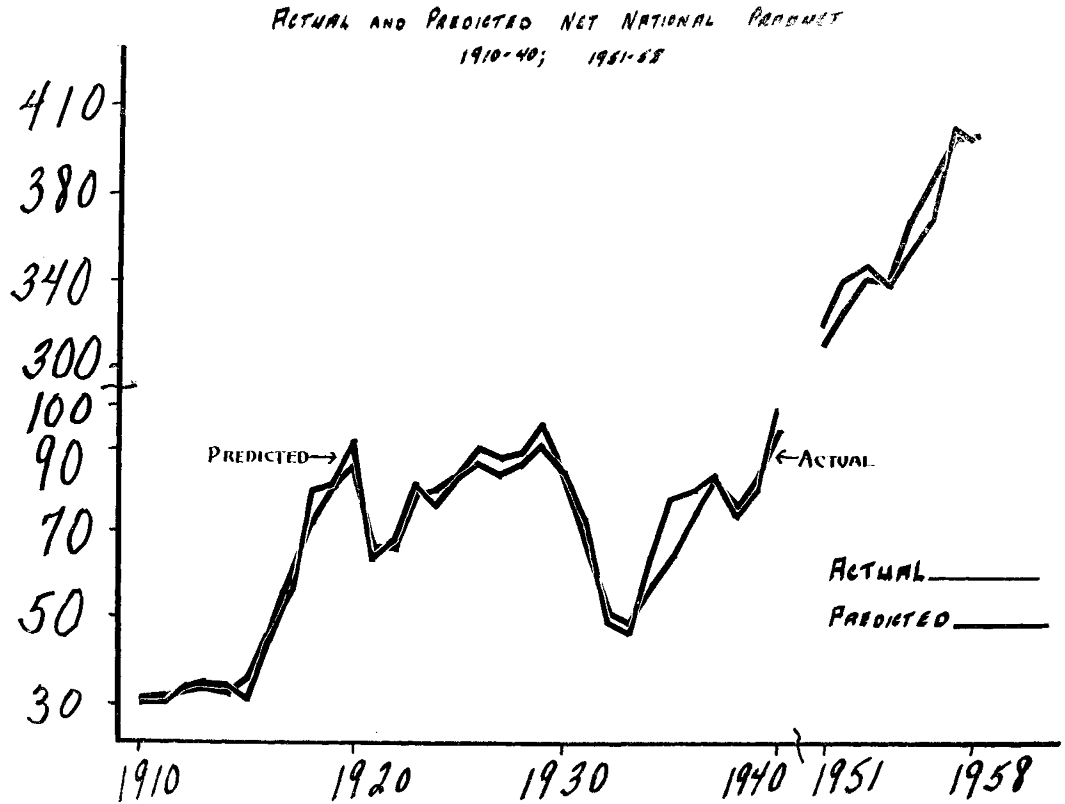
[2] Karl Brunner and Allan H. Meltzer, "The Place of Financial Intermediaries in the Transmission of Monetary Policy," American Economic Review, May 1963; ibid., "Predicting Velocity: Implications for Theory and Policy," Journal of Finance, May 1963; Karl Brunner, "A Scheme for the Supply Theory of Money," International Economic Review, January 1961; Allan H. Meltzer, "The Demand for Money: The Evidence From the Time Series," Journal of Political Economy, forthcoming 1963; M. Friedman and D. Meiselman, "The Relative Stability of Velocity and the Multiplier," prepared for the Commission on Money and Credit, Prentice-Hall, 1963.


ACTUAL AND PREDICTED NET NATIONAL PRODUCT
1910-40; 1951-58
410
380
340
300
100
90
70
50
30
PREDICTED→
←ACTUAL
ACTUAL
PREDICTED
1910
1920
1930
1940
1951
1958

The close correspondence between the actual and predicted values of income during this period of social, political, and economic change has meaning for present economic policy. First, in terms of the theory, the stability of the demand function for money is a necessary condition for relating changes in the supply of money to changes in output or income. The evidence persuasively suggests that the posited demand function for money has remained relatively stable. This permits us to focus on the relation of the quantity of money to income or output. The data suggest an association between periods in which monetary policy permitted or encouraged increases in the supply of money and periods of rising income. Thus the decade of the twenties, when the supply of money increased from $37.3 billion in 1921 to $54.8 billion in 1929, was a period of rising income while the period 1929–33 during which the stock of money fell by $14 billion was a period of falling income. Again during the fifties, the seasonally adjusted money supply rose annually from $111.2 billion in December 1949 to $136.9 billion in December 1956, a rate of growth in the neighborhood of 3 percent annually. Since that time the stock of money has pursued a somewhat erratic course but for the period from December 1956 to December 1962 as a whole, the growth rate of the stock of money has been in the neighborhood of only 1.1 percent per annum. I will return to a discussion of the recent period below.

A second conclusion to be drawn from the chart is that if there has been any change in the relation of predicted to actual income, it has been in the direction of a closer correspondence between predicted and actual values. This may only reflect the improvement in the underlying statistical series used to develop the prediction. Whatever the reason may be, it is worth noting that the percentage error is approximately 2.5 percent for the most recent decade. This again suggests the close correspondence between money income and the demand for and supply of money.

The third point which can be observed directly from the chart is the striking correspondence in the direction of movement between the predicted and actual series. For the 39 years shown in chart I, the change in predicted value and the change in the actual value were in the same direction in all but 3 years. Thus the changes in the predicted series based on the supply and demand for money correspond to changes in actual income at all or most of the turning points for which the analysis has been made. Moreover, the predicted series does not indicate turning points in income which did not occur.

The close correspondence between predicted income and actual income at turning points increases the confidence that can be placed in the underlying explanation which focuses on the role of money in the analysis of national income during business cycles. It serves to emphasize that the association which we observe is not simply a matter of common trends over long periods of time. Rather it suggests that when monetary policy permits or encourages an increase in the stock of money during recessions or periods of slowly rising income, there is a major stimulus to output and employment. In other words, the longrun evidence suggests that the demand function for money has remained remarkably stable during a period of important changes in political, social, and economic institutions. The stability of the demand function is a necessary condition for relating changes in the supply of money, or in monetary policy, to changes in income as I have noted above. The fact that the demand function has remained stable leads us to focus attention on changes in the supply of money during recent years.

RECENT MONETARY POLICY

During the past 5 or 6 years, the rate of increase in the stock of money, currency and demand deposits, has been sold by historical standards. This period has seen a slow rate of growth in income, a rise in the unemployment rate and relative stability of the index of wholesale prices. But the rate of change in the supply of money has not been uniform throughout the period, and it is useful to observe the changing pattern.

TABLE 1.—*Percentage changes in seasonally adjusted money-supply, December 1956–December 1962*

Year	Annual percentage change	Comment
1957	−0.7	Recession started.
1958	4.0	Recovery.
1959	.5	
1960	−.5	Recession.
1961	3.9	Recovery.
1962	1.5	Slowdown in the recovery.

Some additional points should be noted. First, the money supply was the same in December 1960 as in December 1958. On balance no growth in the stock of money took place during these 2 years. Second, all of the increase in the seasonally adjusted money supply in 1962 came in the last quarter of the year. During the first three quarters of 1962, the seasonally adjusted money supply declined slightly. Finally, we note that most of increase in the money supply for the entire 6 years is concentrated in 1958 and 1961. In both years, recovery was stimulated.

It is well known that the Federal Reserve does not directly control the quantity of money. To attempt to change the quantity of money it operates on the reserve base through open market operations, changes in reserve requirements, and other policies. The action of the central bank affects the decisions of the commercial bankers and the public and from their decisions and others the actual quantity of money emerges. But when allowance is made for the behavior of commercial banks and the public, a close association between changes in monetary base and changes in the money supply can be isolated in a number of different countries and a number of different time periods. It is therefore appropriate to look at Federal Reserve policy during recent years and to consider the extent to which monetary policy has contributed to the slow growth of the money supply.

I do not wish to examine the details of Federal Reserve operations during this period or to discuss at length the particular policy actions taken. But it should be noted that the contraction of the money supply in 1957 was the result of Federal Reserve action which more than offset an increase in the gold stock. Had the increase in the gold stock not been offset by a contractionary monetary policy, the money supply would no doubt have increased with stimulating effects on output and employment. Moreover, we should note that during the period since the end of 1957 the monetary gold stock has declined by approximately $6.5 billion. Reserve bank credit outstanding, a major vehicle for supplying reserves to commercial banks through open market operations, has risen by approximately $6 billion. The net effect of these two operations has been in the direction of a contraction in the reserve base. In fact, member bank reserves were lower at the end of 1960 than they had been in December 1956. In the last 2 years they have risen slightly owing primarily to a change in regulations which permitted member banks to include currency and coin as a part of their reserves. But at the end of this past year, member bank reserves were lower than they had been a decade earlier.

Thus Federal Reserve policy appears to be closely related to the slow rate of growth in the stock of money since 1956–57. My study of the evidence for the recent period suggests that it is quite consistent in broad outline with the results for other periods in this century. It again points to the conclusion that the behavior of the monetary base and the money supply are highly relevant for an appraisal of the pace of economic activity and the rate of employment.

POLICY FOR 1963

The most commonly advanced rationale for the policy of slow growth in the supply of money is of course the potential increase in the international outflow of gold that would ensue if the money supply is permitted to increase and the short-term interest rate is permitted to fall. Before commenting on the gold flow problem, I should like to first comment briefly on the fiscal policy which the President and the Council have recommended.

At the outset, let me point out that I do not oppose the proposed tax reduction in principle. The evidence does suggest that tax cuts have some stimulating effect on the economy although the precise magnitude of the effect on income of a given tax change in the absence of monetary change is open to question. In the light of my discussion above, I am concerned about the failure to consider the monetary effects which could accompany the increased deficit. In fact, I am concerned about the failure to give adequate attention to the effect of increasing the quantity of money whether or not the deficit is increased by a reduction in tax rates.

The broad results of the past 6 years suggest that if the quantity of money had been allowed to increase at a rate of 3 percent per annum, the rate which in fact prevailed during the early fifties, the money supply would now be larger by more than $15 billion. The study of the determinants of the money supply suggests that the $15 billion increase in money could have been achieved by an increase in the monetary base of approximately $6 billion. This amounts to an annual increase of only $1 billion on the average. During the 6 years, the total increase in the monetary base was only $500 million. The cumulated deficit on income and product account for the past 6 years, the sum of the surpluses and deficits for the period, was almost $15 billion. And we now face the prospect of a new and larger deficit.

Monetary theory suggests that if $6 billion, an amount equal to only 40 percent of the deficit which in fact occurred, had been added to bank reserves, the money supply, the level of income and investment would have increased at a much faster rate and the unemployment rate would be lower now. Indeed, analysis suggests that had the additional bank reserves been provided as $1 billion annually, the increase in the level of income would have added to tax revenues so that much of the deficit which in fact occurred would have been avoided.

Let me make clear that just as I am not opposed to a tax cut, I am not opposed to a deficit per se. But I do believe that we should attempt to make effective use of the deficits which occur. In practice this means that if we are willing to allow bank reserves to increase, the same increase in income can be achieved by means of a smaller deficit.[3] This conclusion follows from the analysis of the relation of money to economic activity to which I have referred and the much discussed sensitivity of tax collections to the level of income.

The Council's report discusses this relation of tax receipts to income in some detail. Some of their discussion helps to clarify the relatively small effect on income that is likelv to ensue from a continued deficit which is not accompanied by an increase in the monetary base. They note (p. 30) that as a result of the rising ratio of personal tax collections to personal income, the ratio of disposable personal income to personal income has fallen by 1 percent during the past 5 years. One percent of 1962 personal income is approximately $4 billion. If we assume that all of the $4 billion had been spent and assign a multiplier of 2.5 to the spending, income would have been $10 billion higher. Using the Council's estimate (p. 26) this would have reduced the unemployment rate to about 5 percent. Unemployment would have remained above the target rate and the combined deficit of the Federal, State, and local sector would have been increased. Yet the ratio of consumption to income would have been near its 1948 level. This seems to suggest that a stimulus to consumption of the magnitude proposed will not restore high level employment in the absence of monetary expansion.

I do not wish to belabor this estimate. It merely points out again that failure to permit an increase in the quantity of money has deleterious effects on the unemployment rate. These effects can be removed in a number of ways by monetary and fiscal policy: (1) by a relatively large deficit and no increase in the monetary base; (2) by a smaller deficit and an increase in the monetary base; (3) by a balanced budget and a relatively large increase in the monetary base. These policies represent a range of the monetary-fiscal choices before us. The long-run record of the economy suggests that choices (2) or (3) offer the most promise of success in returning the economy to a high level of employment in 1963.

[3] In fact the Council's report recognizes this. See p. 54. They dismiss the idea by noting that "no one seriously contemplates" it.

THE GOLD PROBLEM

Should we be prevented from increasing the quantity of money by fear of a loss of gold? There are two aspects of this problem which I wish to discuss. They can best be considered separately. One is the effect of an increase in the quantity of money on the short-term interest rate. Other things equal, an increase in the quantity of money will lower interest rates, particularly short-term interest rates. A fall in U.S. short-term interest rates will lead foreigners and Americans to invest short-term funds abroad and add to the outflow of gold, other things equal. But a rise in the level of income to high employment levels stimulates investment, by raising the return which businessmen receive or can anticipate, and is accompanied by a rise in both short- and long-term interest rates as investors compete for funds in the money and capital markets. If my interpretation of the long-run record of the economy is correct, a gradual increase in the qauntity of money in 1963 will temporarily reduce interest rates—particularly rates on short-term obligations—but will stimulate the economy to a high level of output and thereby lead to a rise in the short-term interest rate as increased demands by borrowers appear on the money market.

Our experience in the recession of 1958 and the recovery of 1958–59, bears on this conclusion. Treasury bill rates fell sharply from late 1957 to April 1958. By the third quarter of 1958, bill rates were well above 2.5 percent and a year later, they were above 4 percent. Thus while the increase in the money supply will cause some holders of short-term dollar securities to seek investments abroad, this effect is a temporary effect which will be reversed as interest rates rise and short-term balances are reinvested in the U.S. money market.

The second part of the gold problem results from the rise in income itself. As the Council notes the rise in income is likely to act as a stronger stimulus to imports than to exports in the short run. The longer run results depend on how successful we are in achieving both relatively full employment and relatively stable prices. The Council's report adequately discusses the probable effects of a rising level of income on the outflow of gold. The discussion need not be repeated here.

The policy of expansion in the monetary base through Federal Reserve policy and the policy of reducing taxes without monetary expansion are not equally effective in raising the level of income. If they were equally effective, we would no doubt prefer to avoid monetary expansion and the additional loss of gold which will result from a temporary drop in the short-term interest rate. This only amounts to saying that at the present time we prefer a larger gold stock to a smaller gold stock at the same level of income. But I do not believe that the long-run record of the economy justifies the belief that fiscal policy of the magnitude contemplated in the next year or two will restore high-level employment in the absence of monetary expansion. Therefore I do not believe that the choice is between a higher and lower gold stock and the same level of income and employment.

In my judgment there are four principal dimensions to the choice. The Federal Reserve and the administration policy appears to lead to a larger deficit, a smaller change in income and employment than could otherwise be achieved, a small or zero expansion in the quantity of money, and a slightly larger gold stock. I suggest that if monetary expansion of approximately 3 percent accompanies or precedes the tax cut, we can achieve a higher level of income and employment and a smaller deficit at the expense of a temporary increase in the gold outflow.

Finally, I would like to point out that a 4-percent expansion in the stock of money in 1958 was accompanied by an outflow of gold and convertible currency of $2.3 billion. At that time, short-term interest rates fell well below 1 percent at the trough of the recession as I have already noted. Our economic position today is stronger than it was in the recession of 1958. While I hesitate to suggest a precise magnitude for the gold loss that will accompany a 3- or 4-percent expansion in the money supply; in 1963, I do not think that our short-term interest rates will decline to the level of the recession trough. The 3.9 percent expansion in the quantity of money in 1961 did not force Treasury bill yields below 2 percent and did not result in a large gold outflow.

The evidence from our long-period studies of the economy suggest quite strongly that monetary expansion stimulates economic activity. This in turn stimulates demands to borrow and invest and is accompanied by rising interest rates. I find no reason to believe that a fundamentally different set of responses should be expected now.

Mr. MELTZER. The current Economic Report of the President and the annual report of the Council of Economic Advisers argue the need for a reduction in tax rates. Both reports devote much attention to the effects of Government fiscal policy on the economy, to the stimulus to consumption and thus to investment that would be provided by lower tax rates, to the higher level of incomes and employment that would ensue if tax rates are reduced. Substantially less attention is devoted to the question of an appropriate monetary policy for 1963 or to the method of financing the deficit which is expected in the current calendar year. Yet the broad record of the economy for the past 60 years suggests that decisions about monetary policy and the means of financing the deficit are at least as important for income and employment as the size of the deficit and the decision to reduce tax rates.

I have prepared a chart which shows a comparison of the actual and predicted values of net national product which I would like to exhibit. [Pointing to chart.] (See p. 597.) This chart is based on an effort that Karl Brunner and I made to predict the net national product since the year 1910——

Chairman DOUGLAS. Gross national product?

Mr. MELTZER. No, net national product.

Chairman DOUGLAS. And it is minus transfer payments?

Mr. MELTZER. No, it is not; it is minus depreciation.

Chairman DOUGLAS. Are transfer payments included in it?

Mr. MELTZER. They are not included in it.

Chairman DOUGLAS. Transfer payments are included in it?

Mr. MELTZER. No, they are not included in it.

I won't go into the theoretical basis on which this was developed, but simply let me summarize it very briefly by saying that this looks at the economy in terms of a very approximate theory which concentrates on the demand for and the supply of money. The only relations which have been used to predict income are the demand for money in velocity form and the supply of money. And the method by which we have constructed this chart is to make a prediction for velocity or income, for example in 1910, and then compare that to the actual velocity in that year. When velocity is multiplied by the money supply for a particular year, we get the income for that year.

Now, what we see is that the actual movement of income or net national product during this period is shown by the red line. And the predicted movement of income for this period is shown by the black line. It is quite clear from looking at the chart that there is a striking correspondence between the movements of actual net national product and the movements of the predicted net national product.

What this suggests very strongly is that money—since this is based largely on an analysis of money—that money is an important causal factor in an analysis of income.

To give the committee some idea of the importance of this, we can look at the period, for example, of the 1920's, which had some ups and downs, but which had generally rising economic activity. During this period from 1921 to 1929 the quantity of money increased by something in the neighborhood of $17 billion.

During the following 4 years, the years of the massive depression in the thirties, the quantity of money fell, from 1929 to 1933, by some $14 billion.

So our explanation of the movement of income over time works apparently as well during periods in which income is rising or periods in which the pace of economic activity is upward as it does during periods in which the pace of economic activity is falling.

And what it again suggests is that changes in the stock of money, measured in this case by currency and demand deposits; that is, the amounts of money which individuals have in their possession, very closely corresponds to the changes in the national income. Money represents, in short, most of the causal factors—not all of them, but most of the causal factors which are at work in the economy.

Representative REUSS. Would you be good enough to repeat that?

Mr. MELTZER. What I said essentially was that the chart very strongly suggests that most of the causal movements, those things which are determining income, are summarized in the behavior of predicted income. Income is predicted from an analysis of the demand and supply for money. The demand and supply for money gives us a very close approximation to the level of national income.

And what the chart, in very brief form, suggests very strongly is that in the absence of monetary change, there will not be a rapid expansion in the level of income. In the presence of monetary change, there will be a rapid expansion in the level of income.

Let me add to that one final statement. What this chart seems to show is that we do have something called a stable demand for money, that we can predict the demand for money very closely, and that therefore because we can predict it very closely, we can concentrate on the relation between the supply of money and the level of income. The amount of money which through Federal Reserve action and the response of business, banks and the public, actually gets into the hands of the public guides us in predicting national income. The stability of the demand for money is a necessary condition for permitting us to do that, and the chart suggests that it is a useful thing to do.

Now, if we look at the turning points in income, we find that all the turning points with very few exceptions are called by the theory. There are few turning points in the level of income either when it rises to a peak or bottoms out at a trough, which do not correspond to the predicted values.

There is one exception, I believe, in 1924, and another one in 1914. The predicted value is either 1 year late or 1 year early. But by and large most of the major movements of the economy are predicted very well, including turning points.

What this suggests is that we are looking not simply at common trends in the stock of money and the level of income; what it suggests is that we are looking at an important causal factor in the determination of the level of income. And this has some bearing on our policy in 1963.

It is worth noting, for example, that during the fifties—from the end of 1949 until the end of 1956—the stock of money rose at a rate of approximately 3 percent compounded annually. From the end of 1956 to the end of 1962, the stock of money rose at a rate of about 1.1

percent compounded annually. And it was during the latter period that the rate of growth has fallen, and the level of unemployment has risen.

Again what the chart seems to suggest is that in the absence of monetary change it will not be possible to bring the level of the economy back to a high level of employment in 1963.

I have a few more remarks on the current period which I would like to make. What we have seen is that periods of recovery and growth correspond to periods in which the stock of money has been increased. Since 1956, the end of 1956, Federal Reserve policy has been relatively tight. The amount of bank reserves is smaller now than it was at the end of 1952. The change in Reserve bank credit, which reflects fully the open market operations of the Federal Reserve, has been smaller than the change in the gold stock since 1957.

What this means is that the gold stock has declined by about $6.5 billion and has had a negative effect on the quantity of money since the end of 1957. Reserve bank credit, reflecting the open market operations of the Fed, has increased by only $6 billion. There has been a net reduction in the Fed's willingness to supply reserves to the banking system.

This has been offset in part by changes in reserve requirements or by changes in regulations which permit the banks to hold a certain fraction of their reserve requirements in the form of money in the bank's own vault.

Senator PROXMIRE. What period are you discussing when you say there has been a net reduction?

Mr. MELTZER. The period in which there has been a net gold outflow, essentially since the end of 1957—the beginning of 1958 to the present period, 1963.

Again we see the importance of the stock of money as a major causal factor pushing the level of income, and the absence of a change in the money stock as a major deterrent to the rise in the level of income and a fall in the unemployment rate.

I would like to make clear that I do not oppose the proposed tax reduction in principle, but I think our policy in 1963 should be one of trying to make effective use of the deficit that is going to be incurred. From the testimony of the Secretary of the Treasury before this committee, you know that the balance of payments will not be balanced, or it is not his expectation that the balance of payments will be balanced in 1963 without additional loss of gold. Nor will there be a sizable reduction in unemployment, according to the testimony of the Council of Economic Advisers.

The long-term record of the economy very strongly suggests that deficits which are incurred in the absence of monetary change are not as effective as deficits which are incurred in the presence of monetary change. The monetary and fiscal policies boil down to those within the following range: We can have a tax cut alone, we can have an increase in the quantity of money accompanied by a tax cut, and we can have an increase in the quantity of money alone.

My study of the economy and my analysis of the short-run situation suggests to me that coupling the tax cut with an increase in the quantity of money, or increasing the quantity of money alone, will be more effective in the present context than a deficit and the tax cut alone.

I would like to turn very briefly to a discussion of the major factor which is used to oppose an increase in the quantity of money at the present time; namely, a problem posed by the balance of payments and the current international position of the United States.

There are two effects which we want to concentrate on. One is the immediate effect of an increase in the quantity of money on the short-term interest rate. This effect will undoubtedly reduce the short-term interest rate, and lead those who lend their money in U.S. money markets to take their balances to countries where there will be higher interest rates. This will aggravate the present gold outflow. But I don't think that we ought to devote a great deal of attention to that particular problem. If my longrun analysis of the economy is correct, the increases in the quantity of money will stimulate the economy.

We have seen from the chart that the turning points in the level of activity predicted and the actual level are approximately the same, which means, or at least suggests very strongly, that the increases in the quantity of money were effective in raising the level of income within the year.

Therefore, if very soon; that is, within the first quarter of the year, we have a return to an active expansionary monetary policy, we can expect the level of income to rise in 1963 by a much larger proportion or much larger amount than we could expect in the presence of the deficits alone. The rise in income will be accompanied by a rise in short-term interest rates as well as long-term interest rates, as investors and borrowers compete in the market for money and capital.

Therefore, the transitory effects of a decline in the interest rate will be offset later in the year by a rise in the interest rate. The money that flies to foreign markets which promise higher rates of interest will return to be reinvested in the United States.

The second or intermediate effect of a rise in the level of income is, of course, that imports will rise relative to exports. This will also aggravate our balance-of-payments situation. But this is true of any policy which will raise the level of income as is clearly pointed out by the Council. The effect on the balance of payments of a rise in U.S. national income depends ultimately on the relative rise of prices in the United States and the rest of the world.

I agree with the Council's analysis that to say that we cannot afford to have an increase in our imports relative to our exports as we return to higher employment levels is simply to say that we cannot afford to return the U.S. economy in 1963 and 1964 to a high level of employment.

Let me conclude my remarks by reiterating what I have said before. The longrun record of the economy suggests that expansion of the stock of money is a primary means of obtaining an increase in income. Monetary policy in 1963 should seek expansion of the money stock.

Chairman DOUGLAS. Senator Proxmire?

Senator PROXMIRE. I must say that I am delighted by this testimony by Dr. Meltzer.

I would like to ask Dr. Meltzer and also Professor Duesenberry and Professor Chandler, each of you in turn, if you feel that the emphasis on interest rate differentials is justified in considering the balance-of-payments problem.

Now, I asked the economists who were here yesterday, I have asked the Secretary of the Treasury and the Chairman of the Federal Reserve Board to show me any study that shows that a fall in the interest rate here is likely to result in capital outflow. And I called their attention to a study by Dr. Robert Gemmill, which I have in my hand, which I put in the record last year, and a study by Dr. Philip Bell, which was submitted to this committee last year, a very comprehensive study, right on the point, which shows that there is not much correlation between fluctuations in interest rates, a differential in interest rates between this country and the other countries and capital flows, that the main reason for capital flow was speculation, not interest rate differentials.

I will ask Mr. Meltzer first if he is aware of any documentation of the theory which assumes that capital would flow out if our interest rates were lower.

Mr. MELTZER. Let me answer the question in the following way:

I know the studies to which you refer, and I generally know what their conclusions are.

Let me say first that I think it is a very difficult problem for anyone to study. The specific factors which affect the outflow of short-term capital funds are undoubtedly many and varied.

My own inclination is to believe that despite the studies, there would be some short-term outflow of funds if interest rates fell. But I do not believe that this is a reason for not stimulating the economy in 1963. If my analysis is correct, when our short-term interest rates rise relative to those abroad, those short-term funds will flow back into the United States.

So it is really a matter of balancing the short-term outflow of gold which we may very well expect against the later return of that gold as investors choose to repurchase securities in the American money and capital markets.

This committee has had a long experience with pegged rates and took a very active interest at one time in the problem of pegging the Federal Reserve bond rates back in the late forties. We now have a situation in which we are pegging the rate, but we are pegging it from the other side; we are trying to keep it higher than it would otherwise be if we returned the market to its free course. And we should be as opposed to keeping the interest rate up at this point as your committee was in 1950 to keeping it down.

Senator PROXMIRE. Assuming that you would agree that we should only rely on restrictions on capital exports as a last resort, how would you feel about Governor Mitchell's proposal to this committee that we might consider a moderate tax on capital exports to restrain them and permit us to keep our interest rates lower for a longer period of time and make it a little more stimulating?

Mr. MELTZER. I only know Governor Mitchell's statement from the press account of it. What I saw of that statement I am sure was not a complete statement. I would think that as a last resort we may have to go to that, if it is the only feasible way that we can begin to solve the present unemployment problem of the United States.

Senator PROXMIRE. I would like to ask Dr. Duesenberry to comment on interest rate differentials and capital flows.

Mr. DUESENBERRY. As you know, this shifting of funds is a very complex matter. As as you know from more general knowledge, the power of economic statistics to reveal the truth is somewhat limited.

My own feeling here, and my judgment in looking on all this, is that there are two classes of factors in our capital exports.

On the one hand, we have had a big increase in the attractiveness for Americans to lend abroad because of the shift to convertibility on the part of European currencies. And if it is possible for Europeans to borrow here, for Japanese to borrow here, our market is very attractive, not only because it is a very cheap market, but because it is a big market in which it is very easy to float large amounts of securities.

I think those are very important factors. And probably to shift the convertibility is much more important in accounting for the change in our capital export position in the last few years than any change in relative interest rates.

In other words, if the relative interest rates had stayed exactly the same now as they had been in 1955, let's say we would still expect, because of convertibility, to have a great deal more capital exports.

Nonetheless, I think the attractiveness for foreigners to borrow here is increased by the fact that our rates are relatively low, and I think the interest in investing in securities in foreign countries, particularly by the large international companies, is increased by the difference in interest rates.

Now, I could not possibly give you any estimate of how much you would save in the balance of payments if you reduced the interest rate differential by one point or half a point; I simply don't know.

I think you would do something, but I just couldn't tell you how much.

Senator PROXMIRE. As one of the handful of outstanding monetary authorities in this country, then you know of no empirical study which contradicts the findings of Bell, which it seems to me are awfully persuasive. And yet the main objection to an easier monetary policy for both you and Professor Chandler is that such a policy may worsen our balance-of-payments situation.

Mr. DUESENBERRY. If I may make one more comment, I think this is like so many of our other problems, a matter of gain. We don't know how much effect the interest rate differential has on the balance of payments. We also don't really know exactly how much effect we will get from an increase in the degree of monetary ease. So what we——

Senator PROXMIRE. At the same time, Mr. Meltzer has given us a fascinating correlation here, I suppose you could attack it, but after all, it is a pretty precise correlation and it is mighty persuasive. And there is a lot of logic behind it.

Mr. DUESENBERRY. If I had a nickel for every persuasive correlation I have seen which didn't work, I would be rich. I think that there are a great many complications in these statistical affairs, and I think it would be very dangerous to base the policy on any simple formula.

Senator PROXMIRE. Let me ask if this isn't pretty persuasive, however, that if you are going to have the tax cut to expand the economy, that we should certainly emphasize monetary ease, monetary expansion to the greatest extent possible. If we have a tax cut to ex-

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pand the economy, and at the same time follow the policy that was at least hinted at, suggested in the papers, of letting interest rates rise rather quickly in 1963 and 1964, not expanding the money supply, we wouldn't be using this deficit, as Mr. Meltzer puts it so well, as effectively as we should to get economic expansion.

Mr. DUESENBERRY. I agree with you absolutely there, Senator. I certainly would not suggest any support for the notion that interest rates should be allowed to rise quickly during 1963 and 1964, or that the money supply should not be increased.

Senator PROXMIRE. Do you see any argument that the money supply should not be allowed to rise in 1963?

Mr. DUESENBERRY. If the outlook works out anything like the expectations, then I would be for a policy which involves an increase in the monetary supply. Like Professor Chandler, I would not want to say in advance how much, I would say the general criterion should be that there is no excuse for any rise in long-term rates, and there is no excuse for any intensification of rationing at banks.

So I would like to see the reserve policy conducted in such a way as to keep the reserve position of banks fairly easy, as I think it is now, and to offset any tendencies for long-term rates to rise.

Senator PROXMIRE. Do you feel that the sale of half a million FNMA mortgages might have an adverse effect in driving up mortgage rates?

Mr. DUESENBERRY. Right now it would, yes. I think that the "twist" operation, on the other hand, is a worthy operation. I think we can gain whatever is to be gained on the international market——

Senator PROXMIRE. The twist is still in fashion.

Mr. DUESENBERRY. Yes. I think we can gain something on the international front, we don't know how much, but we lose relatively little on the domestic front by shifting the distribution of the debt. But I would certainly be opposed to any notion that we should restrict the money supply or encourage a rise in interest rates during the coming year.

Senator PROXMIRE. Mr. Chandler, would you comment on that question?

Mr. CHANDLER. I want to make it clear at the outset that I am in favor of an expansion of our monetary policy in the next year or so if we can possibly get away with it.

But that brings us to the question of the effective interest rate differentials on international capital movement. One thing is very clear. Interest rate differentials are not the only determinant of capital flow. So the question is, how much marginal difference does it make. I sincerely believe it makes a large marginal difference. I distrust statistical studies which show otherwise. I distrust them on two bases. First, I do not think the statistical techniques used can isolate the total effect of interest rate differentials on the capital flows. My own reading of 1960 will illustrate what I mean.

We had a situation that year in which the general tendency was for European rates to go up and ours to go down after the recession started here. I am quite convinced that the initial accelerated capital outflow was a purely interest rate differential. But it seems almost equally clear that what started as a flow in response to interest differentials generated a change in confidence. By the end of that year and early in 1961 we witnessed the phenomenon of dollars flowing uphill, in effect, to Switzerland, where interest rates were even lower than they were in the United States.

I do not think there is any statistical technique that can isolate all the effects of the initial interest rate differential on the subsequent flow and the change in the confidence factor.

So I distrust the statistical techniques that have been used.

My second reason for distrusting the conclusion is based on my knowledge of institutional arrangements. As you know, in 1958, most of European limitations on capital movements were removed. So capital movements, and especially short-term capital movements, became freer than they had been, since the late 1920's. And there is some reason to believe that they were as free as they ever have been.

On top of that, many new methods and techniques have been worked out. The Euro-dollar market has developed, people are now operating on extremely small margins, I understand, than characterized the prewar period.

The forward exchange market has developed very rapidly in this new period of freedom.

So both because of my distrust of the statistical techniques—and Professor Duesenberry and Professor Meltzer are more competent than I in this area—and because of my knowledge of the institutional changes, I believe that the interest rate differentials do have large marginal effects, and that these are capable of being transformed into confidence factors, and relatively quickly.

Senator PROXMIRE. Thank you, Mr. Chairman. My time is up, but I want to come back to this.

Chairman DOUGLAS. I may say to the committee that a live quorum has been called in the Senate, and I shall have to ask to be excused.

Senator Jordan?

Senator JORDAN. Professors Chandler and Duesenberry, both of you gentlemen have used the phrase "excess capacity" as many have before you and as most economists do. Would you elaborate on that somewhat? How much is our excess capacity in plant in productive capacity in the country today? Is it marginal or obsolete, or to what extent do you take those matters into account when you calculate excess capacity?

Mr. CHANDLER. There is probably no trickier concept in economics than that of capacity and I wouldn't want to try to estimate how much it is.

I think we have to rely on much rougher types of guides, such as the McGraw-Hill questionnaires to businessmen, asking them at what percentage of capacity they like to operate, at what percentage they are presently operating. This gives the businessman's own subjective judgment on how much excess capacity he has in terms of what he considers an optimum rate.

Then there are some other studies of the relationship of actual operations to capacity. But I think we have to rely on these somewhat unreliable guides, to put it honestly.

It seems to me that almost every bit of evidence that we have indicates that there is considerable excess capacity, and not just in the sense that it is extremely high cost, obsolete, or standby, but that this is capacity which the businessman would prefer to operate if he saw what he considered adequate demand.

Senator JORDAN. Do you know that in my western part of the country in the lumber industry, for example, a lot of the lumber capacity is not presently being utilized, but if we get down to taking an inventory of that fact, we find that the best producing capacity is being utilized, because it is possible to make a profit from modern plants.

So if we find a sawmill that is not operating now, perhaps it could only operate at a profit if the price structure was much higher.

And the same thing, I understand, is true in the steel and the metals industry. The modernization of plants has brought about a great change in the fabrication of steels, and so forth.

So that was my question, if there is any way—and I realize it would be changing, a new process comes in, and it would be changing, the margins would move, it never would be stable. Would you comment on that?

Mr. CHANDLER. May I make one more comment on it?

Senator JORDAN. Yes, please.

Mr. CHANDLER. I think your points are quite valid. We do have one more indirect piece of evidence on this, and that is the lagging expenditures by business on new capacity. It seems to me that there is every reason to believe that if they felt that they had inadequate capacity of a modern type, they would be adding to it at a much more rapid rate than they have been for several years now.

Senator JORDAN. And, of course, businessmen are reluctant to cast aside and destroy when they would have their depreciation recovery, and oftentimes that might influence their judgment as to how much longer they should repair or stay with the old plant rather than putting the capacity in the new operation.

Mr. Duesenberry?

Mr. DUESENBERRY. We have one that is comparable with the quality, and that is the age distribution. We always have in existence the capacity that just opened yesterday and equipment that is 25 or even 30 years old. And the normal state of affairs in many industries is that there is a certain margin of obsolete or spare capacity which is still kept around for extreme need. I think it is typical—in the steel industry I think it used to be somewhere around 80 percent of rated capacity.

You will find industry building new capacity. So at 20 it is sort of marginal capacity.

Now, we get some idea of whether there has been any change in the proportion of marginal capacity by looking at the age distribution. I don't have the figures right handy. But my recollection is that we have had since about 1956 a small increase in the average age of industrial equipment.

But it is of the order, the average age is around 16 years, and the changes of the order of perhaps a year over that interval, which would account, so to speak, for something in the order of maybe 5 percent.

So that maybe we have now an amount of excess commodity capacity which would equal about 5 percent of the total, which is more obsolete capacity than we had, say, in 1956. So I would say you might shave the rated capacity estimates a little bit on that ground.

But still that leaves, I think, quite a lot of excess capacity generally. And I think that what Mr. Chandler said about the McGraw-Hill estimate is relevant here.

Senator JORDAN. Turning now to another point, Professor Chandler, I understood you to say that the proposed tax reductions alone are too modest to accomplish the objective, the overall increase in the gross national product, and so on, that you feel would be necessary. And you pointed to the necessity for private investment and spending as being more important, possibly, than tax reductions. And that would depend upon appropriate and favorable interest rates. And you went on to say, I believe, that this interest rate could not be predetermined, that they sort of had to play it by ear as the various forces were brought to play on that.

Would you expand on that a little bit? I think you have a very good point there.

Mr. CHANDLER. I don't have the optimism that Mr. Meltzer has about our ability to forecast the demand for money balances. That is one reason why I find it difficult to use a predetermined formula for an expansion of the money supply.

Furthermore, I was making essentially a negative case in my paper; namely, that the increase of consumption together with the investment that would follow from the tax cut would still leave us with unused capacity. Of course, I could be wrong, and we could get into a situation in which demand responded much more favorably than I would expect in my most optimistic moments.

Therefore, I think we need to keep flexibility to move in either direction. That is my point.

Furthermore, I think that the limiting factor on the expansion here is the fall of rates, and I don't know how low rates we can stand in terms of our international balance-of-payments position. That is the reason that I had to emphasize the flexibility.

Senator JORDAN. I think I agree with your position.

Mr. Meltzer, that is quite different from your position. Would you take issue with that statement?

Mr. MELTZER. Let me say that in my paper I do go into some of the analysis on the deficiency in demand, and so on. It isn't commonly recognized that 1962 was in fact a fairly good year for consumer spending, purchases of durable consumer goods increased; I think the increase was the second largest dollar increase we have had since 1955. Consumption is holding its relatively stable relationship to disposable income. The Council's analysis says that as a result of the increase in the tax burden from the State, local, and Federal Governments, the American consumer now pays in taxes about 1 percent more of his personal income than he did 3 or 4 years ago.

If we translate that back into dollars, how much does it affect consumption?

If we assume that he spent all of the additional amount of money, that would mean that he would spend $4 billion more. Multiply that by a multiplier of approximately 2½, which I think is way too high in the absence of monetary change. We get a $10 billion increase in GNP. If we had been spending that 1 percent which is now being taken away in additional taxes for consumer goods, durable and nondurable, at most we could expect that one-quarter of the Council's estimated gap in GNP would be eliminated. That would have a very small effect on unemployment. The estimate in my paper is that we would probably be able to cut the unemployment rate, assuming all these things, back to about 5 percent, which is inadequate in terms of the Council's goal. They say that they are aiming to get us back to a 4-percent rate. We could all agree that 5 percent would be inadequate.

That leads me to believe that analysis in terms of these expenditure items, the expenditures of consumers, is not the answer to the problem we have. Of course, if the consumer spends all his income, undoubtedly that would be very stimulating. But our record doesn't give us any indication which would lead us to believe that the consumers are going to spend more than 93 or 94 percent of the income they receive. That is what they have been doing.

We have to find a way of raising their income. And what I am suggesting is that again, in the absence of some monetary change, we will not get that income up high enough to really make much difference in the level of GNP.

Senator JORDAN. My time has expired, Mr. Chairman, so I will answer the quorum call.

Representative REUSS (now presiding). Thank you.

Gentlemen of the panel, I am much taken by your testimony. There are some differences between you. But it seems to me that you all agree that an expansive monetary policy has, though it is not the only role to play in our recovery, an important role to play.

I don't misstate any one of the three of you, do I?

Mr. CHANDLER. I agree.

Representative REUSS. I would like to pursue two lines of inquiry. First of all, when we had the head of the Federal Reserve System before us a week ago, I inquired, "What is your monetary policy, or what was it last year?" I pointed out that the President in his Economic Report covers all aspects of the economy except those aspects of monetary policy which are in the province of the Federal Reserve. The President does so by January 20 of every year so that we can get our report written by March 1 and so that we can intelligently examine the witnesses who come before us. Yet the Federal Reserve refused to tell me and the other members of the committee what their monetary policy had been last year, in 1962. They have for some years had the habit of bringing in their report on March 6 or 7, about 6 or 7 days after we have to get in our March 1 report on the state of the economy of the year before. And I am very regretful that I am unable to cross-examine you three experts intelligently this morning on what the Federal Reserve has done, because I don't know what they have done, and they won't tell me.

I have every reason to hope that they will decide that they should be part of the Government of the United States, and will shortly file, with this committee, their report on Open Market Committee meetings for last year so that we can tell what they did.

However, I have strong reason to believe that last November or December the Federal Reserve System, by its solemn mandate, decided to tighten money and to decrease the free reserves of the Nation's banking system which, for a number of years now, has been around the level of half a billion dollars. I believe that the Federal Reserve Open Market Committee, by some sort of mandate to the managers of the Open Market account, said—in what words I know not—"let's change this; let's tighten money."

Now, if that is what they did—and we are going to know before we write our report—if, in November or December 1962, the Fed took steps to tighten money, was this wise policy or unwise policy? I would like each member of the panel to comment on that. I hate to give it to you in terms of a hypothetical assumption, but since the Fed won't tell us, that is the only way I can give it to you.

Mr. Meltzer?

Mr. MELTZER. I have found very useful a document, published by the Federal Reserve Bank of St. Louis, twice monthly, which contains a little statement on bank reserves and money. It is a reasonably accurate guide to what the Federal Reserve is doing. During 1962, the first three-quarters of the year, they allowed the money supply to decline. In the last quarter of the year, largely as a result of the reduction of reserve requirement on time deposits, they allowed the money supply to increase. Current information seems to suggest that they are once again looking askance at the policy of late 1962, and I think that is a very serious mistake.

Representative REUSS. Mr. Duesenberry, if they did what I suspect they did, was it wise or unwise?

Mr. DUESENBERRY. I would say it would be unwise to tighten money at this point. I can't see any reason why it should be done.

I would like to add that there is a lot of complication as to the use of free reserves in the whole picture. As I confess it to you in my statement, it is certainly one of the most important factors in the picture, but there are a lot of complications about the free reserve position, and it does happen that bill rates have not been moving very much one way or the other. So I don't see that there has been a very strong tightening, but I will agree certainly on the "iffy" proposition that if they can tighten money, it seems to me that that is a wrong thing at this time.

Representative REUSS. I am not so much talking about the level of free reserves, as I am about an assumed order given by the Federal Reserve Open Market Committee in November or December to the money manager saying, "We are changing the policy, we are now proceeding to do some tightening." If this is so—and, as I say, I have only a suspicion of it, and my suspicion awaits confirmation—is this wise or unwise? I gather that your testimony, like that of Mr. Meltzer, is that unwise, Mr. Duesenberry?

Mr. DUESENBERRY. That is correct. As I say, I wouldn't jump to the conclusion that anything happened because of one month of free reserves.

Representative REUSS. I wasn't asking you to make a conclusion from that evidence. I was asking you to answer a hypothetical question. If, when we get the record, as I hope we will within a few days, it turns out that they did issue a directive in the direction of tightening the money supply, was that wise or unwise. And your testimony is quite clear, it is unwise.

How about you, Mr. Chandler?

Mr. CHANDLER. I think it was an unhappy day when the net free reserve figures came to be taken very seriously, because one can get a decline in net free reserves for at least two reasons: One, because reserves are taken away from the banks, and the other, because banks expanded credit and increased their required reserves. The President's Economic Report, page 228, indicates that from November to December the required reserves went up by something like $460 million, indicating an expansion of the deposits against which reserves had to be held. This obviously isn't a full explanation, but it indicates one important reason. A decline of net free reserves for that kind of reason is very different from one resulting from an absolute decrease of bank reserves. I don't know what the events actually were. I would say that if they are moving significantly toward a tighter policy, it is unfortunate.

Representative REUSS. Let me pass to another problem. On the question of the extent to which this Nation has to have recurring recessions and stagnation and a high rate of unemployment because of the supposed constraint of the balance of payments, Mr. Meltzer makes the point that there are two ways whereby this country can have a set of higher interest rates tending to keep short-term capital here, to the extent that interest rates, in fact, influence capital flows. Method No. 1 is to have a full employment economy at home which will bring about higher interest rates. And Mr. Meltzer thinks that is a good way of doing it. Method No. 2, which I certainly think is a bad way of doing it, is to have a recession, stagnation, and unemployment at home, but nevertheless, to raise interest rates, which is apparently the way we are doing it now. What about that, Mr. Duesenberry and Mr. Chandler?

Mr. DUESENBERRY. I feel, most strongly, that we have to get out of the box which we have been in, and I think this means that we have to take action on other fronts besides the monetary and fiscal ones. That is, we have to do something which is going to help our basic international position.

Now, I suggested very briefly in the last paragraph of my paper that there are lots of things that we can do which will give us a better mix of prices and wage changes and employment.

As I said, I don't know what would happen if we got back to 4-percent unemployment, but I am not at all convinced that because we had price stability in the last few years, we will have it when we got there. I think we have to do some work in the structure of our labor markets in many different directions to improve our price competitive position.

I think we also have to work in a lot of different directions on the international front itself. I think we all agree that we want to avoid flexible exchange rates or devaluation until we are clear that that is necessary.

But if we become convinced that the difficulties of our balance of payments are not going to be repaired by the measures which have been underway in the last couple of years, then I think we must think very seriously about that, although I would, myself, like to see much firmer negotiations with our European partners on the sharing of the international burdens. I think if we had those, we might be able to manage the balance of payments without drastic measures.

Representative REUSS. On this last point I would like to get quite specific. My time is about up, so I will just raise the question and then leave it with you three gentlemen. Perhaps we can return to it.

The Joint Economic Committee and the International Exchange and Payments Subcommittee have for more than a year now been pointing to the way out of our dilemma—a way in which we can have full employment without inflation at home, yet avoid the so-called constraints of the balance of payments that come about through the possibility of short-term capital moving around because of the interest rate differential. That proposal by the Joint Economic Committee is that the countries of Europe be asked to do for us and each other what they did with our help for each other in the 1950's when they set up the European Payments Union. We have suggested an adaptation of that device which would say in effect that where short-term capital moves from country to country among the convertible currency areas of the Western industrialized world for innocent reasons—that is to say, not due to fiscal immorality or bad practices, but due to the simple fact that money will sometimes go where it obtains the highest interest rate—our proposal is that these movements be subject to compensating credits by the industrialized country to which the short-term capital deposits move.

Our allies, for some reason known but to God, have never been asked by this country to do for us what they did for each other in the 1950's, and the question I leave to you, and I want to return to it, is:

Should not the U.S. executive branch starting tomorrow make a firm and dignified demand upon France, West Germany, Belgium, the Netherlands, Luxembourg, Italy, Great Britain, Japan, and several other industrialized countries to enter into the kind of adequate, semiautomatic payments agreement which would free us from the absurd shackles of the balance-of-payments constraint?

There isn't time for you to address yourselves to that, but on my next round I would like to pursue it further.

Chairman DOUGLAS. Before I call on Senator Miller, let me say that the committee has been pressing the Federal Reserve Board for some time to make available the record of the Open Market Committee policy actions for 1962, and during the course of the morning I have had information which makes me hopeful that such a consent may be given this afternoon, and that we may have the record within 10 days.

I don't want to make a definite statement on that because there is many a slip 'twixt cup and lip, but at the moment the prospects are very hopeful and if this is done, we hope it may constitute a useful precedent for the prompt publication of explanations of actions of the Open Market Committee.

I am always taking the position that the Federal Reserve Board is the agent of Congress, and they take this position when they are in trouble with the Executive. They plead to Congress for protection when they have trouble with the President or the Secretary of the Treasury, but when conditions are calm on that front, they then plead independence.

But I hope we will have during the course of the afternoon the beginning of cooperation on the part of the Federal Reserve Board, and that this may lead to even more fruitful cooperation in the future.

Senator Miller?

Senator MILLER. Mr. Duesenberry, you state that the real problem is not merely to achieve price stability, but rather, to achieve price stability at a satisfactory level of employment or unemployment and capacity utilization.

Why have you chosen to use the phrase "price stability" rather than "dollar stability"?

Mr. DUESENBERRY. I was speaking here about—there is a balance-of-payments problem. There is also a domestic inflation problem. A few years back before we had a balance-of-payments problem, everybody was crying about inflation just from purely domestic considerations.

Now, these two go together and, in my opinion, we can stand from a purely domestic point of view more inflation than we can stand when we take the international position into account.

But when I spoke about price stability, I meant it both from the standpoint of domestic matters just as this price stability for its own sake and price stability for the sake of international competition.

Senator MILLER. But if you don't have dollar stability, you are not going to have price stability, are you?

Mr. DUESENBERRY. By dollar—I am afraid I don't have the reference.

Senator MILLER. Dollars with stable purchasing power.

Mr. DUESENBERRY. Same thing. Price stability and stable purchasing power are the same thing stated different ways.

Senator MILLER. Well, I am glad to say my hopes have been fulfilled because I was hopeful you and I would be together on this point so that as far as you are concerned, we could just as well say that the problem is not merely to achieve stability in the purchasing power of the dollar, but to achieve stability in the purchasing power of the dollar and a satisfactory level of unemployment and capacity utilization.

Is that correct?

Mr. DUESENBERRY. Absolutely.

Senator MILLER. Now, I thought it important to bring this up because I seem to get the impression from your remarks that we do have a problem with respect to wages, and it seems to me that we can't really blame labor for asking for higher wages if they are being squeezed as a result of actions taken by Congress which lead to the instability of the dollar. Would you agree with that?

Mr. DUESENBERRY. I suppose I would, yes. I don't know what I am working into here, but I will agree with that.

Senator MILLER. I assure you I am not trying to trap you on anything. I am just trying to draw out your opinion.

Now, Mr. Meltzer, would it be possible for you to transform this chart over here so that it would reflect real value of the dollar? I must say that I am very unimpressed when I see charts that talk about great increases in dollar flows. I am more interested in the purchasing power that is involved.

Have you attempted to do this or can you do it?

Mr. MELTZER. Let me answer you in this way: I heartily agree with you about the importance of emphasizing all of our commitments in the Employment Act or the implied commitments in the Employment Act. Price stability is often interpreted as being one of those commitments.

To translate this chart into real dollar flows, let's say again this chart is suggestive simply of the relationship between money and income that shows up either in the rise of the level of income, real income, or rise in the price level or, more often in both. I would agree it is very important to get this to the point where we can predict the real level of net national product. Professor Brunner and I are in fact working on that problem, but the problem is a much more complicated problem because we have to specify several other relations, the real relations of the system, in order to be able to separate a rise in real income and a rise in the price level.

But if you look at the chart you will see that during the twenties we did have rather stable prices and a rather consistent rise in the level of real income. We had some dips around 1924 and so forth, but we had a rather stable price level during that period and a rise in the level of income, real income.

During the fifties we had a somewhat different situation. We had a rise in level of real income and a rise in the price level. During the thirties, the early thirties, we had a fall in the level of income and a fall in the price level. So prices and real income have tended to go together somewhat. The relation is neither close nor exact, and it is one which causes us a great deal of difficulty at the present time in our theoretical work.

Let me say though, that I am not advocating that we avoid or abandon—if this is the intent of your question—that we abandon price stability. It is probably true that expansion of the quantity of money, by say 3 or 4 percent next year, would have some price effect. At the same time it would have a strong real income effect. If inflation begins to develop that would lead me to conclude that 3 or 4 percent would be too large. I don't want to pin down the dollar amounts of increase in the quantity of money. I am not advocating that we set ourselves a target and say that we are going to increase the money supply by so much a day. If we find we are running into serious problems of rising prices, then I think that means we are probably putting too much money in the system.

One of the great advantages of monetary policy that has been preached for so long is that it is reversible.

Senator MILLER. Are you saying that a reduction in the purchasing power of our dollar, or as some people define it, inflation, is necessarily accompanied by an equivalent amount of real income increase?

Mr. MELTZER. No, sir. What I am saying is that we should convince the Federal Reserve to increase the quantity of money in 1963. Let us say that we find in late 1963 or 1964 that part of that increase in the quantity of money is raising our price level and thereby not only causing some domestic inflationary problems but probably hurting our balance-of-payments position because we become a more expensive place to buy. At that point we should begin to think about not eliminating, as we have very largely done in recent years, the increase in the quantity of money, but we can reduce it from the rate of 3 percent to 2½ or 2¾ percent.

Monetary policy is a flexible tool. If we find that prices are rising at a rate which we don't think we can afford, then we want to cut back on the increase in the quantity of money, not eliminate it but simply reduce it, so that more of the rise in money income will go into real income.

Senator MILLER. Then would it be your recommendation that the increase in the amount of money be held to such a level that will preclude a decrease in the purchasing power of the money?

Mr. MELTZER. I would like to add to that, I can accept the statement, but I would like to add this qualification:

As this committee knows, because they have done some investigation of the problem, we have difficulty in measuring what we mean by price stability. We have quality changes, as has been often pointed out. Quality changes mean that for a given dollar expenditure, the consumer gets a larger car with more horsepower or a larger refrigerator, and so forth, for the same price or a slightly higher price. We have to take these quality adjustments into account. They probably mean that a slight rise in the price level as recorded by the index is not always the same as an actual rise or decline in the consumer's purchasing power.

With that proviso I can say yes, we should be actively on guard against inflation at all times. At the present time we should also be trying to reduce our unemployment, solve some of our unemployment problem.

Senator MILLER. All right.

Now, with respect to financing the deficit, as I understand it, you would propose to do what we call monetizing the debt, rather than financing it out of private investment. But hasn't it been shown on previous occasions when this has been done that this is almost always, if not always, accompanied by a reduction in the purchasing power of our money?

Mr. MELTZER. This largely depends on the circumstances in which it is done. Again, I want to point out that to the extent that we have a very large increase in the quantity of money, it will undoubtedly have a larger price effect. There is a trade-off that we have to worry about.

We now have to worry about a tradeoff in three different directions: Price stability, the international value of our currency or our international balance-of-payments situation, and our unemployment level. What I am suggesting is that I think that we have pushed our policy in one direction only. We are experiencing the effects of our policies in unemployment. I would like to see more attention paid to the unemployment problem and if price stability or price instability becomes a problem, then I think we have to pay more attention to that.

Let me try to answer the question in a quantitative way. My best estimate, which is subject to some qualifications, is that had we increased the amount of bank reserves during the last 6 or 7 years, since the end of 1956, by the amount of $1 billion a year, then we would probably have an inflation problem.

That would have been too large an amount for us to add to bank reserves. We probably would have had a money supply of something like $15 billion larger. We may well have had inflationary problems at the present time. All that says is that the quantity of money would have stimulated the economy and at the same time would have raised the price level. Had there been too large an increase in the quantity of money, I would be here testifying before you that what we need to do is have a little bit of monetary restraint.

Senator MILLER. Let me pinpoint it to the precise period. During the last 2 years the President's Council of Economic Advisers has given this committee statistics in the form of economic indicators which indicate that we have suffered a loss in the purchasing power of our money of approximately $16 billion. That is about $8 billion a year. I would like to refer to it as inflation tax. It is equivalent to about a 12-percent increase in the taxload that has been placed upon the American people.

Now, inasmuch as we have this inflation of $16 billion during the last 2 years, would you say that our policy, our monetary policy with respect to the increase in the quantity of money, has been proper? Has it been excessive, or has it been too little?

Mr. MELTZER. I simply question the figures that show that there has been a rise in the price level during the last 2 years.

Senator MILLER. May I ask you to take that as an assumption because we have the figures that the President's Council of Economic Advisers have given us, so if you disagree with the figures, that is all right. But let us just take that as an assumption.

Mr. MELTZER. All right.

Senator MILLER. Assuming the President's Council of Economic Advisers is correct and that we have had this inflation of $16 billion in the last 2 years, would you say that the monetary policy with respect to increasing the amount of money has been sound or unsound, or would you be neutral on this?

Mr. MELTZER. I am at a loss, Senator, to answer the question, largely because the monetary policy in the last 2 years has really not been aimed at increasing the quantity of money. All of the increase in quantity of money last year came in the fourth quarter of the year. During the rest of the year, the quantity of money declined. So I find it difficult to believe that—well, to accept the Council's estimate.

But given your figures, which is what you are asking me, I would say if we were having inflation now, then I would say our dilemma at the moment would be even more serious than the present one. I feel fortunate that I cannot accept the Council's conclusion, and therefore I do have the trade off between reduction in unemployment and some rise in the price level to work on. I prefer at this point to view the current situation as one in which the price level has not really been rising. Therefore I think we should concentrate on the other aspects of the Employment Act which seem to be left dangling in the air.

Senator MILLER. You say you would prefer to do it and I would, too, but Mr. Meltzer, you have to face the facts of life, and if the facts of life—if the President's Council of Economic Advisers tell us that we have had $16 billion in inflation in the last 2 years and you find those figures—I will show them to you after we adjourn here—then we have got to go on from there and I am trying to elicit from you your opinion as to whether or not we might have avoided this by a change in our monetary policy, or whether we should change our monetary policy to see that it doesn't happen in the next 2 years.

Mr. MELTZER. Yes. Well, my answer, then, if I have to give a categorical answer, I would say that if a 1½-percent rise in the consumer index is inflationary, inflation is not more than the economy can bear at the present time, given our other problems.

Chairman DOUGLAS. If I may comment on my colleague's statement, I would like to point out that so far as wholesale prices are concerned, they have been almost completely steady in the last 5 years. In 1960 they were 100.7, December 1962, 100.4.

It is true that the increase in retail prices has been from 103 in 1960 to 106 in November of 1962. But if you break that down, you find that the great proportion of that is due to the increase in the prices of services which seem to be more attributable to localized causes than to monetary policy, and that in the case of commodities as well as in the case of services, there might well be quality changes, as Senator Miller suggested, which means that the price index cannot be specifically relied upon. I remember during the hearings during the Eisenhower administration, the change in the quality of goods was emphasized a great deal by the Council of Economic Advisers to indicate that no increase in prices had taken place.

Senator MILLER. Might I make a comment at that point, Mr. Chairman?

Chairman DOUGLAS. Certainly.

Senator MILLER. I recognize that along Mr. Duesenberry's thinking, the price of goods as distinguished from the price of services has remained relatively stable, but the point is that if we have this inflation of $16 billion during the last 2 years and if it is attributable primarily to an increase in the cost of services, it seems to me that it is very easy for one to conclude that labor is to blame for the whole thing and what I am trying to point out is that we cannot blame labor for asking for an increase in the cost of their services or the selling price of their services, if Congress is taking actions which chip away at the purchasing power of our money.

Now, if we can avoid the chipping away by proper monetary policy, I would like to get the recommendations. Mr. Meltzer seems to think that an $8-billion-a-year inflation, which as I pointed out, is about a 12-percent increase in the taxload on the American people, is nothing to worry about.

I am deeply concerned about it. I think it is intolerable. I am seeking ways and means so that we don't have any of it. And if any of the other members of the panel would care to counsel us on monetary policy that would help this situation, I would certainly welcome it.

Mr. DUESENBERRY. Sir, if I might make a comment, I think we have to put it this way, that allowing for whatever may be said about the qualification about services, if we were to try to stabilize the consumer price index as it is now computed, we can only do this by producing some reductions in wholesale prices.

I think the basic situation is that wages and services are rising at a rate which is more or less like the rate in goods, but productivity in services is rising more slowly. And if we want to achieve stability in that index, for what the index is worth, that would mean that we would have to drive down the prices of goods and slow down the rise in money, wages, throughout the system.

We seem to be able to achieve 1.5 percent increase in the consumer price index with 5 to 6 percent unemployment. It would seem to me that the only way we could expect to get stability in that index would be to go to a still higher level of unemployment with the present structure of labor markets.

Now, I do think some things can be done which will give us better labor markets, give us better productivity increases and slow down the rate of price increase for any given level of unemployment, but those things are not essentially monetary, not essentially fiscal, either.

They are things to the basic structure of the economy. The basic structure now is one which puts us in a position where we have to make a choice of whether we want to have 1.5 percent rise in the CIP with 5 to 6 percent unemployment, whether we want to have stability in it with 8 percent to take a figure out of the air, whether we want to have a litle faster rise with a little lower level of unemployment.

I would expect if we were to get down to 4 percent unemployment, again I don't know what the figure would be, but it would be a little faster than it is now, and we have that range of choices and we have two things.

On the one hand, we must right now make a choice in terms of conditions we face. On the other hand, we must do everything we can to get a basic structure for the economy which makes those conditions a little bit more favorable so that the dilemma doesn't seem to be so painful.

Chairman DOUGLAS. The argument advanced for the tax cut even with a budgetary deficit with the administration is the contention that it will stimulate the economy. Obviously the justification depends in large measure upon the amount of the stimulation. If the stimulation were confined to the amount of the tax cut and the deficit, I think it would be very difficult to justify it or to get the public to accept it.

There is one thing that can justify it, if it has a multiplier, and I would like to ask two questions, two very simple questions:

Do you all agree that a reduction of $8 billion in tax income at present rates will have a multiplied effect on the economy so far as aggregrate demand is concerned?

Mr. Chandler?

Mr. CHANDLER. Yes, I certainly do. I see no reason to believe that consumers would not use this addition to their disposable income in about the same way that they have used additions to their disposable incomes in recent years. And as the chain of spending goes on, I would expect the same thing to happen.

Chairman DOUGLAS. Mr. Duesenberry, I gather from your statement that you agree with that?

Mr. DUESENBERRY. I do.

Chairman DOUGLAS. Mr. Meltzer? Do you agree?

Mr. MELTZER. May I ask, sir, would this be in the presence or absence of monetary changes?

Chairman DOUGLAS. If the monetary system didn't stymie the whole proceeding by keeping the quality of monetary purchasing power constant.

Mr. MELTZER. I see. That is no increase in the quantity of money at all, is that right?

Chairman DOUGLAS. No. Assuming an increase in projected money which would permit the expansion to take place.

Mr. MELTZER. I see. Then the answer is "Yes."

Chairman DOUGLAS. The answer is "Yes"?

Mr. MELTZER. Yes.

Chairman DOUGLAS. In other words, you all three believe in what is known as the multiplier?

Mr. DUESENBERRY. Yes.

Mr. MELTZER. Yes.

May I qualify my statement by saying that I think it is much smaller in the absence of monetary expansion than it is in the presence of monetary expansion.

Chairman DOUGLAS. I understand. Let's assume adequate monetary expansion?

Now, the next question is, What is the magnitude of this multiplier? There are at least two factors, it seems to me, in the magnitude of the multiplier. The first is the direct multiplier, so far as consumption is concerned. The second we can call a secondary effect through stimulation of investment with its constant feedback in consumption, and the rest.

Mr. Duesenberry, I notice that you fixed the primary multiplier somewhere around 2. Is that right?

Mr. DUESENBERRY. Yes. I would say it is a fairly safe bet that it is somewhat greater than 2, but——

Chairman DOUGLAS. Somewhat greater than 2.

Mr. DUESENBERRY. But it surely is between 2 and 3.

Chairman DOUGLAS. You want to be conservative, so you fix no figure.

Mr. DUESENBERRY. Yes. I am trying to play safe.

Chairman DOUGLAS. We have got Roy Moor to make an estimate. He was trying to be conservative, too, and he came out with a primary multiplier of 2½.

Have either of you other men made rough computations on the primary multiplier? And then we will come to what I call the secondary multiplier later.

Dr. Chandler?

Mr. CHANDLER. I would feel a little insecure about a multiplier much above 2. When one takes into consideration the various leakages of additional tax collections, additional retained corporate earnings, additional purchases of imports, and additional personal savings, I think the leakages add up to about 50 percent on each round.

Chairman DOUGLAS. Well, if it is 50 percent, that would give a multiplier of 2, wouldn't it?

Mr. CHANDLER. Right.

Mr. DUESENBERRY. I might say, Senator——

Chairman DOUGLAS. Because the formula is the reciprocal of the percentage of leakage?

Mr. DUESENBERRY. I might add, I made on the plane coming down a quick calculation of the multiplier over the last couple of years, the period during which there has been an increase in Government expenditures, and rather small change in other elements, the other nonconsumption elements, and it worked out to 2.4 if you take the second quarter of 1960 to the fourth quarter of 1962.

Chairman DOUGLAS. Do you have those working papers with you?

Mr. DUESENBERRY. Well, all I did was to take the figures on the first table of the Council reports, if I can find it here.

Chairman DOUGLAS. Well, would you be willing to submit a brief statement on this?

Mr. DUESENBERRY. Yes. I have it right here. This is a 1-minute calculation. GNP——

Chairman DOUGLAS. While you are looking this up, may I ask if Dr. Chandler will get together with Dr. Moor over the lunch hour and if you will check his working papers, because he made these very deductions that you mentioned, and see if you agree, and if you either agree or disagree, you can make a statement for the record.

Mr. CHANDLER. Be glad to.

Chairman DOUGLAS. Mr. Meltzer?

Mr. MELTZER. My own conclusions come very close, although they differ in some details, with those in the only really detailed study of this problem that I know. That is the study by Professor Friedman and Professor Meiselman. Their estimate puts the multiplier somewhat lower than these other gentlemen have. Most important of all, they show it is highly unstable; that it, it floats around quite a bit.

At the present time my own best guess would be something below 2. I use the estimate of 1½ for my own calculations.

Chairman DOUGLAS. And would you check Dr. Moor's figures? And I believe there are some more figures coming in from one of the other witnesses. I forget who.

Now, the next question comes on the secondary effects, sometimes called the accelerator, and sometimes called the secondary multiplier, et cetera.

How much of, (*a*) a stimulation to investment, and this is what I wish to speak of, not savings but investment; and (*b*), how much of a feedback would this have on the consumption factor? Have you any—have any of you worked on that?

Mr. DUESENBERRY. I worked on it a good deal, but you know there is a great deal of controversy, both about the impact of the changes in corporate profits on investment and the impact of capacity utilization. I feel safe in saying that you get some substantial effects there, but it is very hard to get exact measures.

I might refer you to a study which was done for the Joint Economic Committee by Mr. Gary Fromm in the inventory series, where he had made some calculations of the impact on investment, and I think it is safe to say that there are numbers which should be—which should not be neglected. They add a substantial amount to the consumer impact, but it would be hard to pull a figure out.

Chairman DOUGLAS. Well, as I remember, in John Clark's classic article on this subject which was published 40 years ago, he pointed out that slight changes in the total volume of production on consumer goods as well as an increase in demand caused magnified changes in the production of durable goods.

In other words, that changes in dx produce changes in x, or a sort of differential calculus. That is substantially true, is it not?

Mr. DUESENBERRY. Yes.

Mr. CHANDLER. I would be a little worried that the accelerator effect might be a little delayed in taking hold.

Chairman DOUGLAS. Certainly. Of course it would be delayed.

Mr. CHANDLER. I would certainly expect there to be one. It would be positive and significant. It seems to me the timing would depend in part, at least, on whether business anticipated the rise of demand or waited until demand was actually forcing them towards capacity level.

Chairman DOUGLAS. Of course that is true.

Now, then, if the direct consumption multiplier is from 2 to 2½ then this would then mean that the total multiplicative effect would be appreciably in excess of this figure, isn't that true? Mr. Chandler?

Mr. CHANDLER. Yes, it would.

Chairman DOUGLAS. And I emphasize "appreciably."

Mr. CHANDLER. Yes.

Chairman DOUGLAS. Mr. Duesenberry, do you agree?

Mr. DUESENBERRY. Yes. Only a question of timing.

Chairman DOUGLAS. I understand.

Mr. DUESENBERRY. Spread out in time.

Chairman DOUGLAS. Certainly.

Mr. Meltzer?

Mr. MELTZER. I'm sorry. I think I would like to point out instead that my own work on this problem and some work which is being done under my direction seems to suggest that the main impact of what has been called the accelerator effect comes through what we prefer to call the yield on private capital. That is the rate of return which businessmen experience. There is some delay in this effect but by and large the estimate suggests that a 1-percent rise in the rate of return on real capital and a 1-percent fall in longterm interest rates have about an equivalent effect on the demand for private investment.

Chairman DOUGLAS. Isn't it true if you get an increased consumer demand, that is an increased volume of production of goods, that this increases the profit margin, and indeed by more than the increase in output since you have a fixed cost to be deducted prior to profit?

Mr. MELTZER. Yes. I am not disagreeing. I simply prefer the formulation which we use.

Chairman DOUGLAS. Now, we witnessed for many years the inability of the economics profession to convince the American public of the advantages of low tariffs. For generations the economists of the country preached the advantages of lower tariffs. There was a lag in public acceptance of about 60 years. Now the economic profession seems to be united in believing in the multiplier. But I must say in reactions from the general public, the general public does not seem to be impressed with the multiplier, and as one who shortly must go out and face his constituents, from the letters I receive I think I am going to face a great number of doubting Thomases who don't believe in the multiplier.

Now, is there anything that you gentlemen can do to reduce the gap between economic knowledge and popular acceptance?

Mr. CHANDLER. May I make a comment on that, Mr. Senator?

Chairman DOUGLAS. Yes.

Mr. CHANDLER. It seems to me large numbers of the American public refuse to believe that they do what they do. In other words, every time they get an increase in income, they spend a major part of it to increase their consumption, and yet when they come to generalize about it, they deny their own individual behavior.

Chairman DOUGLAS. Well, now, the public is not composed of fools. The public tends to have a lot of commonsense. Why is it——

Senator PROXMIRE. The best evidence of that is our presence in Congress.

Chairman DOUGLAS. Well, I wouldn't urge that necessarily. There is always some dissenting opinion on that score.

Mr. CHANDLER. I think one reason for that is that after a household spends the dollar, it doesn't know where it went, and is in no position to follow it through the successive rounds.

Chairman DOUGLAS. I was exposed to the ire of one member of the committee the other day in saying that the science of economics had undergone changes similar to the science of physics when Rutherford pointed out that matter was not solid. It opened up a whole new field of investigation. Fortunately Rutherford did not convince the public that matter was not solid because the ordinary man could just slam his hand down on the table and the table sounded very solid, and it felt very solid.

Do you have any suggestions as to what you can do or what present Members of Congress can do if the multiplier is real? If it is not real, we shouldn't talk about it. If it is not appreciable, we shouldn't talk about it. We should drop the whole thing. But if it is real and appreciable, what are you going to do?

Mr. Meltzer. I think in the way in which it has been presented it is somewhat mechanical. It is presented as something of a mechanical relationship just as the old quantity theory was presented as a mechancial relationship. The public is perhaps aware that we do not have a stable multiplier and that therefore its effects are not something that we can directly count upon. The magnitude of the so-called budget multiplier is not something which we cannot count upon with great precision.

Chairman Douglas. Let me say this. If there is not an appreciable multiplier, and the public cannot become convinced of it, there will neither be a case for a tax cut or budget deficit nor can you ever get it over nor can the public ever accept it in God's green world. It must both have to be correct and it must have to be in such a form as to be appreciated and understandable because we are really asking that people change their economic opinions, inculcated by generations of economists who always said that when all the labor is employed, and production is at a maximum, any increase in the money supply will spill over in an increase in prices.

I talked to Professor Thompson, with Harvard for years, and that was the standard practice in all the economic tests. Now you ask us to reverse the field.

My time has expired. I wish you would ponder that before we break up.

Senator Proxmire?

Senator Proxmire. I would like to pursue Professor Chandler on this again. Your distrust of statistical techniques—incidentally, this ties in very well with the multiplier. After all, if you are going to distrust the techniques that have been compiled by scholars showing the modest influence, I should say secondary influence really of interest-rate differentials on capital flow, I think there would be the same mistrust on statistical series showing a multiplier. Not that it does not exist, but showing any precise or definite figures of the multiplier.

Mr. Chandler. The statistical studies of the multiplier fit in perfectly well with what we know from everyday experience and from theorizing.

Senator Proxmire. Let me pursue this, then. The fact is I quoted two outstanding scholars, two recognized monetary experts. Now let me quote the principal monetary official in this country, William Martin, who testified before us in February of 1962, a year ago, and said:

> By and large such difference as did develop in 1961 between money rates here and abroad do not appear to have been a primary determinant of capital movements either from or to the United States.

I have quoted briefly from Robert Gemmill's study. He said:

Our examination of the practices of foreign countries has shown no evidence that the official reserves are shifted from dollar assets to gold or vice versa in response to short-term variations in interest rates.

Then the study by Mr. Philip P. Bell, who is another very competent scholar, and Gemmill, as you know, is one of the top economists on the Federal Reserve Board staff and acknowledged as a very objective, competent person. If the Federal Reserve Board were looking for an ax to grind, it would be on the other side.

Here is what Bell said, and, based on a study covering 5 years, not just in 1960 but 5 years, 1957 through 1961, on capital outflows relating it to interest rates. I think this is so important because that is the crux, according to every single one of you gentlemen, that this is what inhibits a more expansionary monetary policy.

Dr. Bell and Dr. Gimmell have made studies we seem to have available. Bell told this committee:

This study does not lend support to those who attach great importance to the role of interest rates in inducing short- or long-term capital flows. The data do not suggest that no importance should be attached to interest rates or, more generally, to the degree of looseness or tightness of money markets. They suggest that interest rates play a relatively minor role in and of themselves, although under certain circumstances when interest rate differentials favorable to the movement of the capital are combined with more influential considerations such as speculation, the role of interest rates may be more significant.

Now, it seems to me that if we are going to contradict this and say we reject these statistical studies, we ought to have other studies which are more authoritative or other studies which are at least equally authoritative, and there are no studies.

Mr. Chandler. I would like to make clear my attitude toward Profesor Bell and his studies—he is a former colleague of mine, a very close friend of mine, a man for whom I have the highest respect. I just happen to think in this particular case the statistical techniques were not adequate for the purpose, and furthermore, I will put a great deal of emphasis upon one point that he made toward the end of the quotation which you read, namely, that interest differentials in conjunction with speculative movements may have considerably more importance.

I think another subject that is worthy of study with respect to 1961 and 1962, or the cooperative efforts between the Federal Reserve and the Treasury on this side and quite a number of central banks and finance ministries on the other side, which involved a considerable amount of cooperation, moral suasion, and otherwise to prevent the interest differentials from ending up in gold flows.

There is a tremendous number of transactions of that sort. I am in no position to estimate their volume.

And then there is the question as to what would happen if the differentials should move in such a way that U.S. short-term rates were very much lower relative to those abroad.

Senator Proxmire. Yes, but after all, what is there to prevent, if we raise our interest rates, the European governments from doing exactly the same thing?

They have a certain reason for doing it. They have an inflationary situation which is really threatening. They have a shortage of labor. They have much more rapidly rising prices. They have every reason to raise their interest rates above us, and it seems to me if we raise ours, then they have the—the differential is likely to be maintained.

I don't see how we can win on this unless we do get cooperation of the kind we got in the past, and I think we should continue to get in the future, which should enable us to keep our interest rates low.

Mr. CHANDLER. I would like to make one point to clarify my position. Earlier I made the point that because of the balance-of-payments considerations we could not lower interest rates enough in this country to be a major factor in the domestic recovery.

Now, may I turn this thing around? I do not think that——

Senator PROXMIRE. Let me just interrupt at this point to say that what we are arguing for, at least what I am arguing for, is not that we lower interest rates but that we maintain them, and this isn't just a theoretical dragon we are slaying. This is a fact which has been reported. The Secretary of the Treasury sat in the same seat you do and told us he would consider it pretty good news if interest rates rose in 1963 or during 1963, and that the notion of raising the saving bond rate from 3¾ to 4 percent was under consideration.

Now——

Mr. CHANDLER. This leads to the point I wanted to make which is symmetrical with the one earlier I do not think that rises of interest rates can be a major, or even one of the major, methods of solving the balance-of-payments problem. And I was very happy to hear Mr. Reuss say that he was considering other things. And just as in the domestic sphere, fiscal policy has to be brought in to help and to be relied upon primarily, so in the balance-of-payments sphere we must find some other way of solving the major part of the payments problem.

We are just as badly licked there as we are domestically.

Senator PROXMIRE. We can make exactly the same argument, it seems to me, only I think with more force, against a tax cut as we can against monetary policy as far as the balance of payments is concerned.

The tax cut stimulates our demand, stimulates our purchase of imports. The tax cut that the administration has recommended, the most sensible kind of tax cut in my judgment, will not reduce the costs of our production significantly, and therefore this tends to make our balance of payments adverse.

You can make the same argument against pursuing that policy to the exclusion of monetary policy as you can in reverse. It seems to me you have to have both policies working in harness. The only two economic weapons that the Government has to stimulate our economy it seems to me should work together.

Mr. CHANDLER. I think there is only one difference. Both of these policies to the extent that they raise our income levels, will tend to increase our imports and worsen the balance of payments. Monetary policy has the additional disadvantage of pushing up capital flows, whereas one would hope that if the fiscal policy really caught hold, it would raise investment demand in this country enough so that at some subsequent time, we could live with something like the present level of interest rates.

Senator PROXMIRE. All right. Now, isn't it true that every one of you gentlemen—I think even Dr. Meltzer—would feel that in the event we move into an inflationary period, prices begin to rise, you cope with that not by increasing taxes again, not by cutting Government spending, but by raising interest rates, and don't we therefore get into a situation in which you raise interest rates to stem inflation, you cut taxes and increase Government spending to stimulate growth economy, so the national debt and interest rates rise ad infinitum. You postpone the burden, the cost of the stimulation, to future generations? If you economists are going to tell us that this is the thing to do, for us politicians, that is Nirvana, wonderful, cut people's taxes, increase their services, and let the future take care of itself.

Mr. CHANDLER. I am afraid I can't say anything to make you very happy because I serve notice right now that if we get back into an inflationary period, I might well want to come before this committee and say that I want to see fiscal policy used in a flexible and adequate manner to deal with the inflation, just as truly as with the deflation. I am very much frightened by the kind of record that is being built this year by people who say that the purpose of the tax cut is to remove the drag on incentives, the implicit conclusion being that you can't push taxes back up again because you would kill incentives.

I think this argument has been much overused and I think the emphasis should be upon increasing purchasing power. I say this because I do not think that you should always use fiscal policy to ease and monetary policy to restrict.

Senator PROXMIRE. I am very glad to hear that but, of course, I don't know how many heroes there will be in the House and Senate to push those taxes up. It is one thing to push them down and be that kind of a hero, but when you push them up, that really requires an explanation.

Mr. DUESENBERRY. One thing that might clarify this matter, the reason there has been some tendency for us to speak in terms of the use of monetary policy in the event of a deflationary period is simply because of the flexibility. In the short swings monetary policy is the instrument which you can use without a lot of these hearings. You can do something with reasonable speed, although I don't believe——

Senator PROXMIRE. You see, that is the difficulty. That is why we are being pushed into a policy of higher interest rates and looser fiscal policy.

Mr. DUESENBERRY. There is no substitute for doing the right thing. If the Congress is willing to only go in one direction on taxes, then we are bound to have trouble, but I agree entirely with Mr. Chandler that the right thing is to use a mix of monetary policy, expenditure policy, tax policy in a flexible way to meet the problems as they come, not to try to bank just on one instrument as the solution to all of our problems or one for one problem and another for another problem.

Senator PROXMIRE. My time is up.

Chairman DOUGLAS. Senator Miller?

Senator MILLER. I would like to pursue this multiplier concept a little. As I understand it, all three of you gentlemen agree that a cut in taxes would have a multiplier effect. Mr. Meltzer seemed to want to qualify his answer, at least to the extent of saying that if there is a corresponding increase in the supply of money, there will certainly be a multiplier effect. But with all three of you, particularly since Mr. Meltzer has already covered himself on that point, would you, Dr. Chandler, and you, Mr. Duesenberry, agree that the multiplier effect will be greater if there is more money released than if there is less money released?

Mr. DUESENBERRY. Yes.

Senator MILLER. Would you agree, all three of you, that you would have a multiplier effect if the tax cut is not accompanied by any increase in money?

Mr. DUESENBERRY. I would expect that you would have in the present circumstances—this is something which varies with the circumstances—in the present monetary conditions I would still expect that you would have some effect. I would not—a smaller effect, surely, than you would have in the event of an increased money supply which would maintain the level, present levels of interest rates, present banking position, but still they would have—it would have some multiplier.

Senator MILLER. Do you think—yes, sir?

Mr. CHANDLER. I am virtually certain that you would have some multiplier effect. Perhaps the 2 to 2½ times the tax cut on consumption. A failure to increase the money supply would bring into question the second thing that Senator Douglas mentioned; namely, the induced rise of investment. Here you would have two forces operating, the rise of consumption would probably tend to increase the profitability of investment a little bit, but the accompanying rise of interest rates would tend to offset it, and I wouldn't want to guess which one would predominate as far as the induced change of investment would be concerned, but I would expect at least the primary multiplier effect.

Senator MILLER. All right.

Now would you, Mr. Chandler, and you, Mr. Duesenberry, agree that an increase in the money supply accompanying a tax cut could to some extent be had without reducing the purchasing power of the dollar?

Mr. DUESENBERRY. I don't think it is a question of the money supply; I think if we get a reduction in unemployment, in fact even if we hold at the present level of unemployment, I would expect to see the consumer price index go up 1 percent next year.

If we get an improvement in the employment situation, I expect it would go up a little bit more. I put it that if we do nothing, the unemployment situation is likely to get a little bit worse.

Senator MILLER. Are you saying, Mr. Duesenberry, that we can't possibly cure this or reduce the unemployment rate to a desirable figure without reducing the purchasing power of our money at the same time?

Mr. DUESENBERRY. I guess that is what I am saying, with the present structure of the labor markets. I think there are forces working on wages, not only trade relations. I think the fact is that we have a labor market in which there are lots of people who are in the wrong place, who have the wrong skills, wrong training. That means that if we try to reduce the unemployment, we are going to have shortages in some markets while we still have surpluses in others.

Now, that means that to cure that we have to do two things at once. We have on the one hand to increase the availability of jobs and on the other hand we have to do a lot of work to try to match the people who are available with the jobs that are available.

Now, I don't think you can do one without the other because I think a lot of training programs and depressed-areas programs moving programs, just won't be worth anything as long as there is overall unemployment. I don't think you get people to participate in training programs if they have no prospect of getting jobs out of them, or get people to move if there is no prospect of getting a job.

I think if you do both, then you will be able to reduce the so-called structural unemployment problem and get into a situation where you can have 4 percent unemployment without having a lot of labor shortages.

Senator MILLER. But why must we do it in a context of reduced purchasing power of our money? Is it inevitable? Must we be fatalists and say you can never cure our unemployment situation without reducing the purchasing power of our people's money, without bringing great hardship upon people living on a fixed income, living out of their savings, people relying upon social security pensions?

Must all of these be harmed if we are to cure unemployment?

Mr. CHANDLER. May I comment?

Senator MILLER. I would like to get an expression from each of the members of the panel.

Mr. CHANDLER. Mr. Senator, I think you have put your finger on one of the most difficult problems facing the American Congress. We have been talking mostly this morning about the deficiency of demand and I agree with Mr. Duesenberry that we cannot solve this problem so long as we have that deficiency. But I am convinced also we cannot reconcile our employment, output and stability of the purchasing power of the dollar objectives, leaving for the moment the balance of payments out of the picture, unless something is done to make supply responses to changes in demand more favorable. I would emphasize one point already made by Mr. Duesenberry, the matter of trying to give people the kind of training, location, and so forth that would make them available for jobs, for the kinds of jobs that will in fact exist when demand is sufficient.

And the other problem which I think we are going to face as unemployment falls is simply the question of the wage-price relationship, and the market processes for determining wages. And I think that even if we postpone the day of more satisfactory employment 5 years, we are still going to face the problem of finding some way of making the response of labor supply and supply of output respond actively until you reach something close to a full employment level. Otherwise we are going to be fighting for years and years on the question of price stability versus employment levels.

And I think that although the most immediate problem, perhaps, and the pressing problem is that of getting a more adequate demand. It is not too early to start improving these other things that have to do with the supply side of the equation.

Senator MILLER. Might I say I couldn't more thoroughly agree with you, but what shocks me is Mr. Duesenberry states in his remarks that the real problem is to achieve price stability—and in our colloquy earlier we agreed that it could be "dollar stability"—and a satisfactory level of unemployment and capacity utilization at the same time, and now he tells me we can't.

Mr. DUSENBERRY. I am telling you we have not made any progress on the solution of that problem. Mr. Wirtz testified here, I think a few days ago, on retraining programs, and I read a newspaper quotation in which he said 15,000 people had been retrained through the program.

My feeling is that 15,000 is just really a drop in the bucket in the retraining problem.

Now, it is true that not everybody who is unemployed needs to be retrained. I don't mean to say that. But we need some really great effort in this area if we are going to solve the problem as I stated, and not merely achieve one of the goals without achieving the other.

I think that, I am sure that the committee has already looked into what is done, for instance in some of the Scandinavian countries on labor market organization, with a view to getting this better matching.

Senator MILLER. Do you, Mr. Meltzer, think we can solve this unemployment problem to the extent, that is, meet the target at least, of 4 percent, and at the same time maintain the purchasing power of our people's money?

Mr. MELTZER. Let me answer the question in the following way: I think that if we were to have expansion in 1963 that, of course, one result of that expansion would be some rise in prices as people started to buy more things. There would be a rise in some prices as the public demanded more commodities so that there would be some give and take between price stability and the level of unemployment. I cannot give a categorical answer to the question by saying "Yes, we can surely achieve both at the same time."

I think that that is our continuing problem as it has been for some long period of time. This committee has heard a great deal of testimony on that question. The question of where we choose between them, of course, is a question which you gentlemen I think have more to say about, more to do with, than I do. At the present time I would simply add that I think that the rise that you and Mr. Duesenberry pointed to of 1.5 percent in the Consumer Price Index is not what I would regard as an inflationary rise in the Consumer Price Index.

Senator MILLER. May I say—my time is just about over—I think all of us recognize that we might be able to have a decrease in the purchasing power of our money in a program that is designed to relieve unemployment which will in the overall give a real increase in GNP for our economy.

In other words, if we can reach a point where the reduced purchasing power of our money is offset and preferably more than offset by a real increase in GNP, then this is what we should strive for. But I would like to find out where we draw the line.

The other day we had some witnesses who said—these happened to be administration witnesses—who said that an $8 billion tax cut was exactly the dollar figure to draw this line at.

Now, I must say that I wasn't persuaded by their reasons because I have reason to suspect that somebody else had told them that this was the place to draw the line, but it may be that $4 billion should be the tax cut. It may be $24 billion.

I asked one of them why not $16 billion; why not $24 billion in tax cut?

I wish you gentlemen, if you can do it—I don't mean now because I realize this may take some study—if you could give us some guidelines which we could follow in arriving at that point of diminishing returns, the point of no return, the point where we will not have a real increase in GNP when we have this reduction in the purchasing power of our people's money.

Have you given any thought to it, and if you have, please comment on it?

Mr. DUESENBERRY. One comment: I think the 4-percent figure which has become a "sacred cow" in the last few years was arrived at really by considerations of the position in the labor market where an increase in demand would give you relatively little output mileage and a lot of increase in price mileage.

If I can put it this way, if you started out from a very high percentage of unemployment and increased demand, you would find that there were surpluses in every labor market in terms of skills, in terms of education, in terms of location, so that the increased demand would find the labor readily available to meet it, you would get a lot of output and very little wage pressure.

As you went from 10-percent unemployment to 6-percent unemployment, you would find that a further increase in demand would give you a little more labor shortage and a little more price pressure, so you wouldn't get quite so much out of it.

My impression is that a lot of people who have thought about it have felt that somewhere around 4-percent unemployment you get in a position that any further increase in demand will give you a relatively large amount of price increase and a relatively small amount of real gain. So that is how that target got arrived at. That is only very approximate.

It changes with changing labor market conditions, but I think the idea is that we want to calculate the tax cut on the basis of saying, of allowing for some caution so as not to overshoot all at once by trying to do it all at one crack in a calculated tax cut so that we can get toward that target without running any serious risk of going well beyond it.

There is some judgment here because if you do too little, you undershoot. If you do too much, you overshoot. I can't give you the exact figure, but I think this is the kind of approach one ought to take as to the size of the tax cut, how much do you need to get toward that target, because I think that target has a rationale in just the terms you would put it of the tradeoff that you get on prices and the impact you get on real output.

Senator MILLER. May I ask one more question, Mr. Chairman?

Would you gentlemen agree that the balance between tax cuts for consumers and tax cuts for investors in the President's tax message is desirable in the framework of what you have just referred to?

Mr. Duesenberry?

Mr. CHANDLER. Speaking in a general way, I would say "Yes," and the reason I put it this way is that I think we need a fairly quick increase in demand. I think you will get that more quickly by leaving more income in the hands of consumers. I would probably answer slightly differently if I thought investment would respond faster in time. But I think it is certainly defensible.

Mr. DUESENBERRY. I wouldn't have any great quarrel with this mix. I think I agree with Professor Chandler, that the timing problem requires a good deal of emphasis on the consumer side. It is also true that we need to do something to get capacity utilization up and the recent position has been that corporate cash positions have been quite strong. So it appears that it is poor capacity utilization, low profitability, which has been holding down the growth of industry.

From that standpoint it seems to me giving a tax reduction will have some effect on profitability but still only a modest one, all business would be able to take. The exact balance I think is very difficult to figure. But I don't think that this is far out of line.

Mr. MELTZER. I will comment very briefly and preface my remarks by saying again I am assuming the quantity of money will be increased along with the tax cuts. I think the balance probably errs somewhat in favor of an assumption that the consumer sector would respond quickly and in a positive way to a tax cut.

I think there is something in that. Although I think that possibly the stimulus to business of a cut in the corporate tax rate may be stronger than the Council has estimated, and I personally—and I hesitate to make this statement because I cannot back it up fully—but I think that perhaps a stronger business tax cut might be more effective.

Senator MILLER. There has been a lot of talk about the need for consumer demand. I believe Mr. Chandler referred to that.

Now, when I pick up a newspaper, as I did yesterday, and find this statement:

BANK CREDIT RISES AT RECORD RATE

Commercial bank credit rose at a record rate in 1962, the Federal Reserve Bank of Chicago said Friday. In its annual report the bank said loans to member banks increased nearly 12 percent, even though expansion in overall business was less than expected. The report said security holdings by banks in the five-State area climbed 8 percent from 1961. Checking account balances were almost unchanged while time and savings deposits rose 20 percent during 1962. The bank said this apparently reflected higher interest rates which went into effect the beginning of last year.

My reaction to something like that is that possibly this emphasis on consumer demand has been misplaced, that perhaps the emphasis should be on investment on industrial expansion rather than in consumer demand, because apparently there is plenty of money lying around waiting to be spent in these time and savings accounts.

Mr. CHANDLER. That increase in time and savings deposits at commercial banks needs a great deal of interpretation. There is always a temptation to say that this rise in savings deposits represents an increased propensity to save by households and so forth.

This is quite wrong. I think it represents much more simply a shift in the way people hold their assets of whatever sort. When the banks increased rates, they put them into a range which makes them directly competitive with even long-term Government securities and considerably more attractive than some alternatives.

I think it is reasonable to believe that the shift into the time deposits represented more of a shift of asset preferences, if you will, than it did any change in saving.

Furthermore, when one looks at the relationship between personal saving and personal disposable income in 1962, there is no such bulge in savings at all. As I remember, they spent as large a percentage of their disposable income as they had in any of the preceding years, or approximately the same.

Mr. DUESENBERRY. Mr. Mitchell's testimony the other day, I think, deals with this time deposit question very clearly along the lines of Professor Chandler's remark.

Representative REUSS (now presiding). We appreciate your patience, gentlemen, and the only question I have to ask is the one that is left hanging fire from my last round. I will repeat it, very briefly.

I start from the stated view of the monetary authorities that they have got to defend the dollar by raising interest rates and tightening money—or else short-term American capital will move abroad. They are going to keep right on saying this and throttling the domestic economy even if we bring our basic payments into balance. Even if our export earnings and other receipts, on the one hand, and our imports, long-term capital investments, foreign aid, and defense expenditures abroad, balance out, the dollar can be, in a convertible world, in constant jeopardy, if they are right in saying that differential interest rates can suck billions of dollars of American short-term capital overseas.

My question was, is there any earthly need to allow ourselves to be put into the absurd position where we have to stagger along with recessions and unemployment at home? Having frittered away several years with various currency swaps and other rather chickenfeed types of endeavor, is there any reason why we should not tomorrow ask our free world trading partners to enter into some sort of payments agreement with us whereby movements of short-term capital caused by speculation or interest rate differentials are by and large covered by the country to which they move, so that they don't cause a disruption of domestic policies?

I would like your several views on that along the lines of our report.

Mr. CHANDLER. I think a scheme of this sort, and probably others that more ingenious people can think of, is very highly desirable. I am in no position to judge the relative desirability and effectiveness of that sort of bilateral negotiations as compared with something that might be multilateral, sort of an adaptation of the EPU.

I am rather inclined to believe that certainly for a long period of time the multilateral scheme offers more chance of success.

Of course, one of the great problems you will run into there is the same sort of thing that became an issue in EPU, namely the breadth of the credit swings. In other words, how much in the way of American dollars our colleagues abroad would be willing to hold.

I would hope this could be as broad as possible. Of course, the corollary of that is we would have to agree to hold, should the occasion demand, very large amounts of their currencies, which might cause a few worries to us. But assuming that wide swings could be negotiated, it seems to me it would be a useful addition and would help take some of the pressure off.

I suspect, however, that many other measures are needed, too. The one thing that would warm my heart more than anything else would be a really effective device for expanding exports which would have the lovely merit of helping us out of both our domestic and balance-of-payments problems. I don't know to what extent this is feasible, but certainly the potentialities make it worth exploring.

Representative REUSS. May I interpose to say I completely agree with you and thus I phrased my question on this payments business to assume that we had done these things to expand our exports, but even if you do that, even if you expand your export surplus so that it covers our payments, the "defend the dollar" people are still going to want to raise interest rates because they can point out that there are a hundred billion dollars worth of liquid capital in this country which would go abroad at the drop of a hat.

I don't believe them, but I am anxious to take away this excuse for prolonging the recession.

Mr. CHANDLER. It almost goes without saying that an EPU type of arrangement would have much more chance of success if the balance of payments were much closer to our basic balance.

Representative REUSS. I am very glad to have your opinion.

Mr. Duesenberry?

Mr. DUESENBERRY. Well, I am not in a position to discuss international financial arrangements in any detail. I think that the real point is, though, if we could solve the problem of the basic balance, then we should be able to find some devices which would, and I don't know, I wouldn't like to comment on any specific one, but we should find some devices so that we would not have to worry about our short-term lending after we have solved our basic problem, which device is a matter that would take very long consideration.

Representative REUSS. Mr. Meltzer?

Mr. MELTZER. Very briefly, I agree with Professor Duesenberry.

Representative REUSS. To recapitulate, then, while, of course, we should move to solve our basic balance by extending the export surplus and by a variety of other ways which have been mentioned here this morning, even though this session wasn't primarily on this question, you all three agree that we should very promptly move to shore up these capital movements, the danger of which would exist even if we did attain basic balance in our payments. And that the sooner we do this, the better, and that while we delay, we, in effect, retard recovery at home. Is this not the sense of the meeting?

Mr. CHANDLER. I agree, although I do not pose as an expert on the feasibility of these multilateral as compared with the bilateral arrangements.

Mr. DUESENBERRY. I would agree.

Representative REUSS. Thank you very much.

Senator Proxmire?

Senator PROXMIRE. Yes. I have a couple of brief questions. I apologize for keeping you.

Dr. Meltzer, you are emphasizing the clear relationship of the multiplier to monetary change. I am delighted to see this because I think no other witness has emphasized this so strongly. We have been stressing the multiplier and the chairman of the committee, I think, has stated, wisely, that this is necessary to understand and that the public understand it, if we are going to have an effective economic policy, particularly an effective tax cut.

You argue that the effectiveness of the tax cut depends upon monetary policy, that there will be a clear mathematical relationship if you tighten the money supply or fail to expand it to keep pace with the GNP in some relationship. Your position is that if monetary authorities do not expand the money supply to keep pace with GNP the multiplier will be reduced, and I take it from previous questioning that this is shared by Dr. Duesenberry and Dr. Chandler.

Mr. MELTZER. That is correct. I believe that that was my statement. I believe the others concurred in the general conclusion, although they differ about precise effects. They agree with the general conclusion that the multiplier will grow larger in the presence of monetary expansion.

Senator PROXMIRE. We have had testimony yesterday from Dr. Lintner who was very confident and very emphatic as to precisely what the multiplier would be.

Dr. Burns, of Columbia, was not at all certain about it, but he did not relate it to any monetary factor. He related it to psychological factors and indicated dependence upon how consumers and business felt about the deficit and other factors.

But you gentlemen would feel that there is a much closer relationship between the effect of the tax cut and the interplay of monetary forces, rather than the vague business or consumer psychology, is that correct?

Mr. DUESENBERRY. I wouldn't rule those factors out and I suppose one way to put Professor Burns' position is that you might argue that even if you got a consumption multiplier, it would be offset if business got terribly scared. I must say that it is my impression that business doesn't get scared by things which tend to expand their sales.

Senator PROXMIRE. Well, they may get scared by assuming there is going to be an inflationary influence, and that is an expansionary kind of fright. The fright might result in their buying inventories now rather than waiting until the prices go up, buying plant now rather than waiting until the prices of building go up.

Mr. DUESENBERRY. I can't see why they would go the other way.

Senator PROXMIRE. Now, just one other point. Senator Miller's question was extremely interesting. I notice that looking at the price level of the economic indicators on page 26, consumer prices on page 26, I notice that in 1954 when the gross national product, real gross national product dropped by $8 billion, there was an increase in prices but it was a very small increase, three-tenths of 1 percent. The following year, 1955, GNP increased $33 billion and there was a drop in the price level. It was a drop of about three-tenths of 1 percent. So we went through 2 years in which the GNP in net increased about $22 billion real and there was no change in the price level. We had price stability.

As I review what happened to interest rates, I see the interest rates fluctuated but ended up at the end of the 2-year period close to the same, and I am wondering if maybe this can give us some clue as to how we can achieve growth without increases, substantial increases in prices.

Mr. DUESENBERRY. Sir, that 1954 experience involves a lot of things. Let me remind you that in the CPI you have, first of all, food prices which have fluctuations which are quite unrelated to what is going on elsewhere, and it also happens in those years that the post-Korean period, there was a substantial drop in retail margins due to the increase, development of automobile supplies, and the development of discounts. I think if you go through this carefully, looking at it item by item, see that if you take the very short period movements, look at one movement versus the next year, that these very short-term movements are influenced by all sorts of factors which are not related directly to the general situation.

So that one has to be very careful in drawing conclusions on any basis except from the run of experience in a number of periods and to match up the combination of circumstances in a particular year——

Senator PROXMIRE. Well, in a period of 5 years, there was remarkable price stability there, 92.5 in 1952, the price index of 94.7 in 1956, 1952 to 1956, a rise in prices of an average less than one-half of 1 percent a year, and it was a period of reasonably good growth altogether, and I just wonder how we can do that.

Now, there was some price control during the Korean period but that went out long before 1955 and 1956, and I presume, then, that your conclusion is that there are so many other conflicting and complicating factors that we can't draw any good guides as to wiser monetary-fiscal policy on the basis of that 5-year experience.

Mr. DUESENBERRY. I went through this very carefully once, a paper in the American Assembly volume on prices and productivity. I tried to understand that period, because this was a period when we had to have a lot of confidence in price stability, and I think that the situation really did produce some illusions because labor costs per unit were rising steadily through that period.

I think what happened was that commodity prices went up partly under speculative influences in the very early part of the Korean war. Some firms got ahead on their markups, meeting price control; then you had the retail.

Senator PROXMIRE. Then when you corrected for the commodity fluctuations, you had a steady increase in the cost of services and so forth, so that you can't draw any guides.

Thank you very much.

Representative REUSS. Thank you, gentlemen.

We are grateful to you, and the Joint Economic Committee, having completed its hearings, now stands adjourned.

(The following information was submitted by Secretary Dillon in response to a question by Representative Curtis (see p. 332).)

Congressman CURTIS. Question 4(a). Mr. Dillon, can you estimate the amount of tax reduction in dollars which would be received by each of the following income groups: Under $1,000; $1,000 to $1,999; $2,000 to $2,999; $3,000 to $3,999; $4,000 to $4,999; $5,000 to $5,999; $6,000 to $7,499; $7,500 to $9,999; $10,000 and over?

Answer. A breakdown in the requested detail is being prepared and will be forwarded to you shortly.

A less detailed breakdown of what the proposed changes in personal income tax rates will mean in terms of additional disposable income for different income groups is given in the attached table, taken from the statement of the Secretary of the Treasury before the House Ways and Means Committee (February 6, 1963).

It should be noted that, because of limitations of data, a breakdown as fine as the one requested involves considerable estimation work, and this inevitably affects its reliability adversely. Consequently, the forthcoming breakdown cannot be treated with the same confidence as the one supplied here.

Full year effect of the tax program (excluding capital gains) on individuals distributed by adjusted gross income classes

[In millions of dollars]

Adjusted gross income class:	Amount of tax reduction
Under $1,000	35
$1,000 to $2,000	220
$2,000 to $3,000	325
$3,000 to $4,000	490
$4,000 to $5,000	690
Under $5,000	1,760
$5,000 to $6,000	725
$6,000 to $7,500	1,325
$7,500 to $10,000	1,750
$10,000 to $20,000	1,940
$20,000 to $50,000	820
$50,000 and over	390
$5,000 and over	6,950
Total	8,710

Source: Office of the Secretary of the Treasury, Feb. 27, 1963, Office of Tax Analysis.

(Whereupon, at 12:45 p.m., the committee adjourned.)

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