THE ADVERTISING COUNCIL

WASHINGTON CONFERENCE

Panel Discussion on the Economy

May 6, 1964

Moderator:

Honorable Frederick G. Dutton
Assistant Secretary of State

Panelists:

Honorable C. Douglas Dillon
The Secretary of the Treasury

Honorable Luther H. Hodges
The Secretary of Commerce

Honorable William McChesney Martin
Chairman, Federal Reserve Board

Honorable Walter W. Heller
Chairman, Council of Economic Advisors

Representing the Conference:

Mr. T. R. Berner, Chairman & President
Curtiss-Wright Corporation

Mr. Joseph A. Grazier, President
American Radiator &
Standard Sanitary Corporation
Mr. Gabriel Hauge, President
Manufacturers Hanover Trust Company

Mr. William A. Hewitt, President
Deere & Company

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MR. MARTIN: When I had the privilege of visiting with this group a year ago, the situation was definitely different than it is today. We were having a quiet run on our dollar, not perhaps a too serious one, but its cumulative effect was giving all of us concern. We recognized that we had long had a tax situation which had been delayed in being corrected after the war. And while there were disagreements as to whether it was tax revision, tax reform or tax reduction which was needed, there was very little disagreement that something had to be done about our tax system if we were to get the maximum benefit from our economy.

To me, the most dramatic achievement of 1963 was the change in the competitive position of American business. I am generalising when I say that, but I think the profit margins did begin to improve by the end of the year. And whether they were what people to like them to be or not, there is no question that

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our competitive position in the world improved. And it demonstrated once again that American business, when it gets a head of steam on and sees the problem, can do what is necessary to compete.

President Kennedy in his balance of payments message in July of last year covered this problem adequately. Whether enough was there or not was not the point. The fact was that he had covered all the avenues that would need to be followed if we were to bring about equilibrium in our balance of payments. And he indicated that in the event we were not successful in this program, which included, as you know, an increase in the Federal Reserve discount rate from 3 to 3-1/2 percent, and a recognition that we could not be isolationists on interest rates any more than we can be isolationists in politics today. The flow of money around the world is such that we have to be aware of interest rate differentials, particularly with respect to short term movements, if we ever hope to maintain our position as a leading trading power.

It also seemed to me that his message indicated a recognition of the fact that reducing unemployment and promoting growth in bringing about equilibrium in our balance of payments, but regardless of the emphasis that was placed on one or the other at the time was one and the same problem. And it seems to me that the results since that time have indicated that we can move in those directions simultaneously and with a certain amount of

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success.

Now, as we approach the present situation we are not under the gun of a possible deflation as we were a year ago. I am doing something that I try to keep away from here when I am indicating the future, because in the Federal Reserve we try not to be forecasters, but try to analyse things as they are. But, nevertheless, I don't believe in my judgment that deflation is the problem at the moment. I think that we all recognize that we have more unemployment than we would like to have, and there are differing views as to how we should tackle this unemployment problem. And we should certainly bend every effort that we have to improve the unemployment picture. But at the same time we must recognize that we are now in an expanding economy. And the majority, I think, of consensus today is that we are not immediately faced with a possibility of a decline in business. Therefore, the threat of inflation rears its ugly head once again. And we have had recurring threats of inflation and recurring inflation in the entire postwar world. This means, obviously, that the period that we are now moving into requires prudence and caution. I think that the President has rightly stressed the responsibility of business men and of labor to be prudent and cautious in the way they handle the prosperity that we are presently enjoying. But when I use this word "prosperity," I am not saying that it's what it ought to be or that it's necessarily all that it is going to be, but I am saying that we are in a

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situation now where we can accept a certain amount of prosperity. And we should never be afraid of prosperity.

There are a certain number of people who constantly say, "Well, things are so good they just can't go on this way." I don't believe that we should ever take that view. I think that prosperity is nothing to be afraid of. But how you manage prosperity is in the long run the question of how you sustain it. And this is where the role of the central bank comes in, and this is really the gist of my comments today.

It seems to me that what we have and what is required in the central banking system is an understanding that, first, the central banks should see that there is enough money for the legitimate requirements of business. That's a primary responsibility. But having done that, it is our responsibility to regulate the total supply of money in such a way, including its cost and its availability, that the marginal requirements of business, the low requirements of business and the low priority requirements of government, do not waste themselves in speculation and rising prices in a time of expanding business. So that conversely you can use, to the extent that it can be used in a period of declining business monetary policy to stimulate some speculation and some new ideas, and to perhaps contribute to adjusting and keeping the decline from getting out of hand.

In other words, to put it simply, to level the peaks and to fill in the valleys. This is the basic role of a central

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bank. It requires judgment, it requires courage, it requires making from time to time some judgments with respect to the future. It's more flexible than other instruments of policy because it can be adjusted more quickly. You can move in either direction without, in my judgment, doing too much damage, and it certainly is not the controlling factor alone in the economy.

Let me just close by saying that I rate the forces in the economy, as many of you have heard me rate them before, as budgetary being number one, and in this connection, I think that the President's emphasis on reducing unnecessary expenditures in government has been helpful to all of us in the period that we are presently in.

In the second place, we are using fiscal policy because the tax program is now under way. To what extent it will stimulate business, we don't know. But we know that cumulatively it is likely to encourage business further.

In the area of debt management, the Federal Reserve has worked very closely with the Treasury and the Treasury has been most cooperative in seeing to it that we have issues that make it possible for us to finance the deficit outside the banking system.

Of course the Treasury has a problem in this because we have a 4-1/4 percent interest ceiling. And if we reached a point where we could not deal with that, there is a real problem with the Treasury and the Federal Reserve in that.

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So far, however, we have had no problem in financing the deficit outside the banking system. And there has been complete cooperation and harmony between the Treasury and the Federal Reserve.

You are all familiar with the wage price problem and here we have to watch developments and await developments.

Monetary policy is the fourth of these policies. Monetary policy must be maintained alert, but it must also keep in front of people the fact that when money is as available as it has been there is a tendency for a deterioration in the quality of credit to persist and continue. In the building of hotels and motels and multi-family dwelling units and in other real estate ventures, and in particular, there has been a tendency to extend terms and to engage in activities which may ultimately cause us trouble. I don't think that point has been reached yet, but I think we would be unwise not to be calling attention to it.

And let me just close by saying that I think it's good for all of us, in a period such as the present, when we have an opportunity to think about it, to be beginning to think about what we do when we have another recession, because we will have another recession at some time. And I hope no one will think I am forecasting a recession now. But it is in periods like this that we have got to think about it. It will be more difficult to get a tax cut the next time if we are trying to stimulate the economy, because we are no longer to the same extent as we were before under the gun of the war time tax problem. It

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will be more difficult for us to use easy money policy because we have used it, very effectively, and aggressively during this recent period. And it will be, therefore, incumbent upon us to see to it that we do what we can by prudence and discipline to stretch out the current period of prosperity and to use what expenditures we can to improve the employment picture at every opportunity, so that we can continue to have the growth and the development and the move toward equilibrium in our balance of payments which is required.

Thank you.

(Applause.)

MR. DUTTON: We will now open up the four officials to questions from the panel.

I would like to just very briefly introduce them, although I am sure most of you know them all.

First, Mr. Gabriel Hauge, President of the Manufacturers Hanover Trust Company.

Mr. Joseph Grazier, Chairman of the American Radiator and Standard Sanitary Corporation.

Mr. T. R. Berner, Chairman and President of the Curtiss-Wright Corporation.

And Mr. William Hewitt, President of Deere and Company.

Just fire away.

MR. HAUGE: Well, I don't know whether I am to start, because I am up here at this end, but I will open off, Mr.

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Chairman, with a question that has been prompted by the remarks of two or three of the speakers.

And I might do it in terms of an article I read in the New York Journal of Commerce the other day, written by Professor Henry Wallack of Yale University. He recalled that at the time the tax cut was proposed an important part of the analytical basis for the tax cut was that the burden of sustaining or developing the economy could be put on fiscal policy, and the burden of fighting for stability on a price and balance of payments fund could be more logically reserved to monetary policy.

Now we have had the tax cut, and we are out into the beginning part of the effective period of this tax cut. And from the comments that have been made here today, it is fair to conclude that we can expect to have some more favorable effects from this tax cut.

The question posed by Professor Wallack, and I think would be of interest to many members of the Conference, and this goes back in a way to a statement in the President's economic report of last January that it would be self-defeating to cancel the stimulation of a tax cut by tightening credit, is what is the thinking today of the relation of monetary and fiscal policy at this stage of the cycle, and with the prospect for apparently a good deal more pressure on the economy as time goes on?

SECRETARY DILLON: Well, I would be glad to say at

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least a beginning word on that.

I think that probably applies to a number of us here. It covers a broad area.

I do think that the argument that fiscal policy had to bear a greater proportion of the load in stimulating our economy has been just what's happened because fairly on, right in the beginning, and even in the spring of 1961, we never allowed -- or in the winter of 1960, we never allowed monetary policy the freedom that it had in the preceding recessions during the 50's, when the price of short term money went down to roughly half of one percent. This time, because of balance payments reasons and no other reason, it never went below for a very short period maybe 2-1/8 percent, which is quite a lot different. And then it kept, as we saw the needs moving upwards, the short term rate, right along. And, finally, with the discount rate increase last summer and stabilization as a result of that rate shortly thereafter of our short term rates at about 3-1/2 percent, and fitting into that relaxations, two of them of regulation Q by the Federal Reserve System, which allowed the payment of higher rates on time deposits and savings deposits, I don't think that there is anything much further that monetary policy could very usefully do in the balance payments field. And so then we did turn parallel to all this during this period, to tax reduction as the prime motor to allow this improvement, economic improvement to

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carry on. And I think that situation is still maintained .

As Mr. Martin points out, we have come to sort of a new situation where it is far more difficult with convertible currencies to use monetary policy in the event of a recession the way it used to be used because we have got to maintain short term interest rates relatively parallel throughout the world, throughout the parts of the world where money flows. That can be done by action on both sides and is done that way.

Some may say, "Why don't we handle the whole long term portfolio problem, also, by monetary policy?" And the argument in that is that that just isn't possible. To do it would require at least a full one percent increase in the present levels of interest rates for mortgages, for all sorts of other -- for municipal bonds, corporate bonds, borrowing generally. We do some $40 billion or $40 billion to $50 billion of that sort of business in a year here. That is the flows of savings in and the flows of savings out. And to somehow to be able to force that rate up one percent to cut down a $2 billion outflow, a very small piece of that that's going abroad, is sort of an extreme example of the tail trying to wag the dog. And we just don't think it could be done, even if you set out to try and do it.

Also, if you look back historically over any long period of time, the longer term rates that are presently currently in Europe are far higher than they were in many periods of the

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past. Taking the whole Nineteenth Century, for instance. And our rates are much nearer what would appear to be, at least past history, proper rates of an economy that is relatively advanced. In under-developed countries, of course, they have much higher rates.

So I don't think that anything that's happening now is contrary to what -- the question you are posing certainly I don't think anyone in the government, and certainly not the President, would feel that we should not use monetary policy. The dollar got in trouble, he has said so very clearly, and is fully prepared to back up the Federal Reserve, whose primary responsibility is to do that. So I think that there really isn't a great problem there.

MR. DUTTON: Mr. Martin, do you have any comments?

MR. MARTIN: Well, I would just comment that we have been very aware of the problem. A year ago, to go back again, we were talking about not financing whatever deficit that developed through the banking system. And we have been successful in maintaining that position.

Now, just to show you how you can be wrong on these things, if you had asked me at that time what would be the effect on interest rates when the tax reduction--

VOICE FROM THE FLOOR: Louder.

MR. MARTIN: (Continuing) If you had asked me what would have been the effect on interest rates when the tax

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reduction went through, I would have said it would have caused an increase in interest rates. It actually has not, because retained earnings and depreciation of corporations has been adequate up to the present time to meet their requirements. And on the projections that we use at the Board, those that I personally use at the Board, the requirements of the community for money have been far below anything that I anticipated. Therefore, we have pursued a neutral policy in the Federal Reserve. We are waiting for the market to determine what the forces are. And I believe that there is no immediate prospect of an increase in interest rates based on supply and demand factors.

Now, we have been dealing here with a lot of expectational forces that are always in markets. There are a lot of people in the market who immediately jump to the same conclusion that I was jumping to, that when the tax reduction program went through the demand for credit would surge here. Only they went one step further and said, "And the Federal Reserve will lead the move toward higher interest rates." Well, the Federal Reserve hasn't lead the move toward higher interest rates, and I don't think the Federal Reserve should lead the move toward higher interest rates. I think we try to lean against the wind but we don't try to make the wind. And two or three times the money market has been fooled by these expectational forces here. What they will be in the future, I am not forecasting, but I can assure

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you, as I tried to in my general remarks, that the Federal Reserve is very aware and alert to this problem, and that it is our intention to do what we can here to prevent a speculative boom developing, or an inflationary surge which could come at any time, which would mean that the sustaining of this prosperous period would be shortened. And if it were shortened, unless all of us are alert and active on this, it will mean that we will have a larger recession than we would otherwise have from the inevitable corrections that always come in an economy.

MR. DUTTON: Walter, do you have a comment on this?

MR. HELLER: Well, just one quick comment, which I think Gabe Hauge is well aware of, and that is that as compared with about seven years ago, before our persistent balance of payments deficit became a balance of payments problem, and before we developed the persistent slack in the economy, many of us were advocating just the opposite policy; namely, tighter budget policies, surpluses at full employment and relatively easier monetary policy to put more funds into investment. And I think that there has been a very substantial change. Economists are capable of adapting to the situation and I think there is a general acceptance of the proposition that relatively speaking there should now be a heavier reliance on fiscal policy for expansion. And that this, obviously, in the course of time gives greater freedom to monetary policy to do the job on the international front.

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And I think that the explanations given by both Secretary Dillon and Chairman Martin indicate that the tool is there, but that at the present time we are in the happy position, both on expansion and on the balance of payments front of not having to tighten on the monetary front.

QUESTION: Continuing the same thought, all of us, I am sure, applaud the courage and foresight of the Administration and its action on taxes. But I wonder if we aren't over-estimating, or if we haven't over-estimated from the top down the rapidity with which the tax cut or the benefits of it can be translated into those things which create jobs, and unemployment remains a very serious problem. And since it does, can't this result in rather serious political frustrations, and perhaps some pump priming activities which may accentuate and aggravate this monetary situation?

MR. DUTTON: Walter?

MR. HELLER: Well, as I tried to say in my comments, we have, I think, pretty consistently, both in the Treasury and in the Council, in fact, throughout the Administration, tried to say that the impact of the tax cut was not going to be an overnight impact, that we weren't going to just jump from persistent levels of 5-1/2 percent unemployment, let's say, to 4 percent unemployment, or persistent levels of 85 percent utilization capacity to a preferred average operating rate of 92 percent.

It's interesting, by the way, that in the British

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tax cut about a year ago, which was almost exactly comparable to ours in terms of the balance of payments -- excuse me, in terms of the translation of the gross national product, there was a rather flat period of lull and not much response in retail sales, and so forth, for a couple of months after the tax cut came in and then a very much enhanced and increased response in the later months. Of course, the British economy is much more exposed. They are in a tougher and tighter position to take the kind of expansion that we are able to take with our lesser foreign exposure and with our greater flow of both labor and industrial capacity available to meet the impact of the tax cut.

I think it fair to say that the employment record of the past few months, whether it's the buoyancy of the tax cut or not, has been outstanding. We have created over 900,000 new jobs -- that's not even counting the April results -- which I think will add to that -- over 900,000 new jobs since December. And about 1,400,000 -- this is non-farm jobs, -- about 1,400,000 since a year ago. And our prediction, after all, is fairly modest; not that we will be jumping down to 4 percent by the end of the year, but that we will be getting down to about 5 percent unemployment and then going below that as we move on. The full impact of the tax cut won't have worked its way through the economy for about two years.

QUESTION: The recent joint economic report proved the elimination or reduction of the gold cover requirements of

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the Federal Reserve credit. What substitute restrictions or limitations on the Federal Reserve in extending credit to the U. S. banking system in issuing money are contemplated?

SECRETARY DILLON: Well, I think that again hits a lot of us.

The Joint Economic Committee did make this recommendation, and many bankers, students of the problem, are in agreement with them fundamentally. The reason for this is that the United States is presently the only country that has such a connection between gold and domestic currency and credit. Gold everywhere else is used solely as the medium to settle international payments and that's what it really is under the present gold exchange standard. That's what it is under our laws, because under our laws you cannot any more, ever since 1934, turn in currency or obtain gold or own gold yourself. So logic would indicate that we should have, as we do have, our whole gold supply available to protect the dollar in international dealings. We do have it because the present law gives Federal Reserve the flexibility to waive this requirement when necessary. And the Chairman of the Federal Reserve, Mr. Martin, has repeatedly said that he would exercise that right if such a situation arose.

Now, the second question is the question of timing. This is a highly emotional issue in this country. There are a lot of people who feel that because we have always had this connection, we should continue it, although we have changed it

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from time to time. It used to be 40 percent a few years ago, now it's 25, that that should continue. And certainly we have felt that it would be unwise to ask the Congress to make that change and precipitate a major battle there, a major emotional battle in the country, which would bring in the question of the stability of our currency because those who attack it would say that the currency would no longer be any good at the time when our balance of payments was still in relatively large deficit. So if anything was to be done, it should be done at a later date when we have got our balance of payments in order so people wouldn't think we were doing it so we could continue to run very big deficits.

That is the way we have looked at it in the Treasury. Now, this can be technically modified in many ways. It doesn't haveto be done away with completely. We have gone down from 40 to 25 at once, and it applies to both currency and to deposits of banks with the Federal Reserve System. It could be left to apply maybe only to currency which would free up about half the gold that's tied up behind that. So there are a number of things that could be done. I think, basically, our feeling is that it is not much of a restraint on the Federal Reserve and never has been. The Federal Reserve could issue literally billions and billions, tens of billions of dollars of extra credit, bank credit even with the leeway they now have. The Federal Reserve hasn't shown that it needs that sort of a restriction on them,

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and I would think that when the time came that the Federal Reserve needed that sort of a restriction that we would be in pretty bad shape ourselves. I think we ought to rely on the Federal Reserve as an institution rather than on this sort of artificial means of trying to tell the Federal Reserve or control their actions.

MR. DUTTON: Mr. Martin.

MR. MARTIN: No embargo on gold has been our consistent policy, and it's only as an international media of exchange, as the Secretary has pointed out, that it is primarily important today. There are only two important currencies in the world that have a statutory gold reserve covered today, that is the Belgian franc and the Swiss franc. Our ratio now stands at 30.3 per cent, 25 percent is the requirement. I would certainly hope that we would get our balance of payments situation under control before we go down below that 25 percent.

MR. HEWITT: I would like to address a question to Secretary Hodges.

Mr. Secretary, in the last sentence of your presentation you referred to a subject that's of considerable current interest. I have in mind the question of trade between the United States and Russia and the Russian satellite countries in eastern Europe.

The sales of goods by western countries to the Soviet Bloc last year totalled $4.2 billions and these sales by western

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countries to the Soviets are increasing at the rate of about 10 percent a year. The United State's share of this export to Russia totalled about 2 percent or $166 million.

Now, it is relatively difficult for United States companies to trade with Russia, Hungary, Czechoslovakia, Bulgaria and East Germany. It's relatively easier to trade with Romania and Yugoslavia.

I am wondering, Mr. Secretary, if you could tell us whether you anticipate any relaxation in the government controls of exports by United States companies to the Soviet Bloc? And if you do anticipate that, I wonder if you could help clarify the criteria which should control, rather, which should determine what strategic materials are and what non-strategic goods are. This is sometimes a little confusing. I believe that approval is necessary by a number of different government agencies, any one of which, any department can cancel a bona fide opportunity to sell to the Soviet Bloc. These include, I believe, the State Department, Agriculture Department, Defense Department, the Commerce Department and also, I believe, the CIA.

SECRETARY HODGES: Well, the last part of your statement is not entirely correct, Mr. Hewitt. Unfortunately, we have the responsibility in Commerce, so you can put the total responsibility on us. Because under the designation of the President the Commerce Department Secretary has the responsibility of passing or not passing applications for license.

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As a practical matter, however, we naturally would consult with those agencies you are talking about. And if one of them had a bona fide argument or case, we would sit down and discuss it. And, of course, it would go up to the very highest level. But you do not have to go to all of these places, nor does each one of them have a veto. I just wanted to make that clear. Of course, you have raised a serious, current question, in the matter of how we do in trade with the Soviet and the Bloc. I am using that now, if you don't mind, with two premises; that we are separating Red China, North Korea and Cuba from your question. We are only talking about dealings with the Soviets, particularly in Europe, and we are only talking about items that are non-strategic.

Now, to try to answer your question about strategic. Bernard Baruch one time said, "Nothing is nonQstrategic." But, actually, we go basically by the COCOM list, the list that the allies and ourselves have agreed on are strategic items and should not be shipped to the Soviets et cetera, as it would add to their military potential.

The truth of the matter is that we in this country -- I am making this very short -- we in this country are very sentimental about a thing like this. We are not in a way as strong in our controls and our negative point of view as the Congress and much of the public would like us to be. We are far more liberal today, in May 1964, than we were in May 1962.

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MR. DUTTON: I am sorry, I am going to have to cut it off here now for the President to come in.

We thank you, gentlemen, very much for coming today.

(Applause.)

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