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Statement of

William McChesney Martin, Jr.,
Chairman, Board of Governors of the Federal Reserve System,

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Throughout the world there is an imperative need to increase productive capital. As population continues to grow rapidly and the supply of easily accessible natural resources diminishes, we must look to more efficient technology in production and distribution if living standards are to be maintained—let alone raised—for the vast numbers of people now living in poverty.

The scientific base for improving our technology is available, and growing rapidly as we reap the benefits of two decades of large expenditures for technological research and development. What is lacking, in many countries, is adequate incentive to convert this scientific knowledge into working practice—into machinery which can increase the yield of usable product from our natural resources, into machinery which can release human labor for more dignified and useful tasks. And many countries also lack the incentives or capacity to save—to free the financial and physical resources needed for building the capital base necessary for increased production in the future.

We in the United States are indeed fortunate to have, in such large measure, the conditions necessary to exploit scientific advance in the service of economic progress. We have a large savings flow, an efficient financial mechanism for making savings available to finance investment, the technical knowledge required to develop complex production processes, a competitive business community eager to apply technological innovation in the pursuit of profits, and large and affluent markets receptive to the new and better products of industry. In recent years, moreover, our tax structure
has been revised to promote the long-term economic growth of the United States. The investment tax credit for equipment, introduced in 1962, must be regarded as an important landmark in this respect.

This tax change has rewarded us even in the short-term. As industry responded to new incentives, business expenditures for new plant and equipment rose rapidly. In the three year period from 1960 to 1963, the average rise in business outlays for fixed capital was only about 3 per cent. But in the past three years—1964 through 1966—such outlays increased, on average, over 15 per cent a year.

The more efficient plant that resulted from rising capital spending was an important factor in maintaining cost and price stability during the economic expansion after 1961. The high rate of investment helped to employ our growing labor force, and to raise real wages and incomes. And labor was employed more effectively; productivity per manhour rose considerably faster than earlier. Unit labor costs in manufacturing showed an almost unprecedented stability, and this was reflected in a long period of nearly constant prices of industrial commodities.

These results paid important dividends for our international balance of payments. The competitive position of the United States in export markets was substantially improved, a development that was vital in offsetting increased outflows of U.S. financial capital. And the investment credit was also helpful in increasing the attractiveness of investment in the United States compared to that overseas.
While many other measures contributed directly or indirectly to the exceptionally long and stable expansion, there is no doubt that the investment tax credit was an important element. But in economics, as in all other aspects of life, it is possible to have too much of a good thing, particularly when it becomes a case of too much, too fast. The combination of sharply accelerating military needs after mid-1965, strong and expanding civilian markets for durable goods, and sharp further increases in spending for fixed capital spurred by the tax incentives, focused unmanageable demands on the metals and machinery producing industries. Business capital outlays last year amounted to almost 11 per cent of GNP compared with 9 per cent in 1961, the year before the investment tax credit was instituted.

Backlogs of orders for machinery mounted, even though output in the machinery producing industries had been running at or above reasonable capacity limits for some time. The workweek in these industries rose to the highest levels in over 20 years, owing to shortages of skilled workers, and imports of equipment increased while exports of capital goods were cut back. And shortages of supply of many metals necessitated releases from the Nation's stockpiles to alleviate production bottlenecks.

Increases in the prices of machinery and equipment began to accelerate because of rising order backlogs and rising costs. Although the price rise last year was not as rapid as in the 1955-57 investment boom, nevertheless the increases were substantial for
almost all classes of machinery. Over the twelve months preceding the investment credit suspension, electrical machinery prices rose 2-1/2 per cent, farm machinery and construction machinery prices advanced 3 per cent, general purpose machinery 5 per cent, and metal working machinery 5-1/2 per cent.

With the economy over-stimulated by rapidly expanding business investment and defense spending, it was natural to search for any device that could help reduce demand pressures in the metal and machinery industries. Monetary policy was doing all it could to restrain aggregate demand, though its effects could not easily be focused on the business investment area.

There were differences in view on the wisdom of meeting the situation by suspension of the investment tax credit. Some observers felt that the effectiveness of the tax credit as a long run investment incentive might be blunted if it were switched on and off periodically. Others felt that owing to the long lead time for large integrated investment projects, the suspension would have little immediate effect in reducing demand pressures, and instead might tend to slow down the expansion in productive facilities only after a substantial lag, perhaps at a time when the pinch on resource availability was coming to an end. Still others pointed out that a substantial share of business equipment--such as trucks, office equipment, and the like--has a fairly short lead time between order and delivery. It was argued that the marginal effects of suspending
the tax credit would be large enough and come soon enough to be worth departing temporarily from what was, for the long-term, a desirable structural feature of our tax laws.

In the event, the suspension of the investment incentives, following increased restraint on the availability of investment finance, did prove effective in damping down the investment boom. As the special survey conducted by the Department of Commerce and the Securities and Exchange Commission indicated, businessmen reported that the tax law changes induced them to reduce their capital spending plans for 1967 by $2.3 billion below what otherwise would have been spent. And some of the reductions apparently took place rather promptly. In the fourth quarter of 1966, business capital spending was three-quarters of a billion dollars below the amounts businessmen had earlier reported they intended to spend. While the amounts of actual and planned spending reductions involved are small, relative to the $60 billion annual rate at which capital outlays are running, the reductions have taken some of the edge off current pressures on the machinery producing industries. And the possibility of further reductions in capital spending was suggested by the most recent survey of business capital spending plans, which reported that businessmen are planning to increase investment outlays by only 4 per cent this year, compared with a 17 per cent rise from 1965 to 1966.
Even before the latest survey of spending intentions, evidence of reduced pressure in the metals and machinery industries was accumulating. New orders for machinery leveled off in the fall and recently have begun to decline. And the accumulation since last summer of excessive inventories in both investment and consumer goods industries suggested some weakening in over-all economic prospects, which would inevitably feed back onto business demands for additional new equipment. In recent months, moreover, price pressures have eased in many of the commodity and product areas where demand had been most intense.

The time now seems appropriate, therefore, to restore the incentives for maintaining capital formulation at a rate we will need over the longer run to meet the requirements of a growing population desirous of rising living standards. Physical resources have come into better balance with demands, suggesting that a somewhat faster pace of investment than presently contemplated by businessmen can be accommodated without regenerating the price pressures evident a year ago. And in financial markets, the abatement of inflationary pressures has permitted the Federal Reserve to resume vigorous expansion of bank reserves; this, along with a high and rising rate of personal saving, should provide sufficient funds to accommodate business financing requirements and an adequate volume of home financing.
Restoration of the investment incentives would be particularly important for smaller enterprises, the segment of our business community which contributes so much to technological innovation. The Department of Commerce survey to which I referred earlier indicated that suspension of the investment incentives hit hardest on small business--firms with assets of less than $5 million. In manufacturing and commercial lines, these small companies accounted for the bulk of the reductions reported in capital spending programs.

Reinstatement of the accelerated depreciation provisions should also aid in the recovery of construction activity. I have every expectation that home building will increase as the year progresses, stimulated by an ample supply of credit. Apartment building could lag, however, if builders tend to delay their plans and orders--which in the case of apartment projects often require a long lead time--until the accelerated depreciation option were restored. Investment plans of commercial establishments, where new construction is a large part of the investment total, are also likely to be affected by uncertainties about the rapidity of tax write-off to be permitted.

More generally, reinstating the investment credit now would avoid the possibility of an unnecessary and undesirable hesitation in the rate of economic advance as the year progressed. If the law were to be left as it is, with reinstatement of the incentives deferred until next January, we might have to face the possibility of
an "air pocket" in new orders for equipment later this year, as businessmen delayed orders pending final decisions on the fate of the legislation. Economic expansion could falter as both Government and business policy makers found it difficult to assess the strength of economic prospects. Now that the need for investment restraint has lessened, we should not defer the decision to restore to our tax structure features we regard as desirable for the long run.

Let me note in conclusion that I see no inconsistency in advocating termination of the investment tax credit suspension now, and an increase in income taxes later this year. Restoration of the incentives to invest in new plant and equipment is needed to maintain and improve the efficiency of our productive mechanism; it is an important element in achieving and sustaining our long-term objectives of rapid economic growth. And it is appropriate to restore these incentives now, since some of the bottlenecks in the machinery producing industries have been removed and some of the pressures on scarce labor and material resources in that industry have moderated.

But in the short run, we must bear in mind that we are still fighting a war, that rising Federal spending for this military effort is contributing to a large deficit in the Federal Government's accounts, and that a resurgence in economic activity is the most likely prospect as 1967 progresses. It seems to me that we should all be expected to pay our share of military costs. Moreover, on budgetary grounds, we must recognize that continued large deficits
in the Government's budget during prosperous times can diminish confidence, both here and abroad, in the soundness of our money. On economic grounds, it seems to me that prudence calls for moderate fiscal action, as envisaged in the President's tax surcharge proposal, as insurance against the possibility that we might again confront difficulties of the character that developed in 1965 and 1966. This course seems to me to offer the best prospect for achieving the sustained economic growth that all of us want.