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John Sparkman (Senator), Alabama, Vice Chairman

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Henry O. Talle, Iowa
Thomas B. Curtis, Missouri
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J. W. Fulbright, Arkansas
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Arthur V. Watkins, Utah
Barry Goldwater, Arizona

Chairman Martin

Union Calendar No. 557

85th Congress, 2d Session - - - - - House Report No. 1409

1958
JOINT ECONOMIC REPORT

REPORT

OF THE

JOINT ECONOMIC COMMITTEE

CONGRESS OF THE UNITED STATES

ON THE

JANUARY 1958 ECONOMIC REPORT OF THE PRESIDENT

WITH

SUPPLEMENTAL AND DISSENTING VIEWS

AND

THE ECONOMIC OUTLOOK FOR 1958 PREPARED BY THE COMMITTEE STAFF

FEBRUARY 27, 1958.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

UNITED STATES
GOVERNMENT PRINTING OFFICE
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JOINT ECONOMIC COMMITTEE

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

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JOHN SPARKMAN, Senator from Alabama, *Vice Chairman*

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JOHN W. LEHMAN, *Acting Executive Director*

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Union Calendar No. 557

85TH CONGRESS } HOUSE OF REPRESENTATIVES { REPORT
2d Session } { No. 1409

1958 JOINT ECONOMIC REPORT

FEBRUARY 27, 1958—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

Mr. PATMAN, from the Joint Economic Committee, submitted the following

REPORT OF THE JOINT ECONOMIC COMMITTEE ON THE JANUARY 1958 ECONOMIC REPORT OF THE PRESIDENT

The Joint Economic Committee has studied and given consideration to the Economic Report of the President. It has heard testimony from administration officials, the Chairman of the Board of Governors of the Federal Reserve System, and numerous non-Government experts of widely varying views.

The conflict between the free world and the Communist-bloc nations imposes a responsibility upon the United States to maintain a strong, prosperous, and stable economy. Our economic superiority may be as important as military supremacy, if indeed it is not more important, in assuring peace and the conditions for improved living standards for the entire world. Against this background, the current decline in the Nation's economy assumes an importance beyond that of purely domestic concern. This contraction, which originated in part from falling United States exports, has repercussions on economic activity elsewhere in the free world because of the resulting decline in our imports. The interrelationship between this Nation's economy and world economic conditions is well demonstrated by experience of the past year.

The present economic downturn in this country has been characterized in detail in the President's Economic Report, in the testimony by Government and non-Government witnesses during the committee's hearings on the report, and in current statistics dealing with various sectors of the economy. While some of us may differ as to the exact causes underlying the decline and the economic trends for the coming months, we are agreed that public policies should contribute to halting the decline, to setting in motion forces for renewed and vigorous economic growth, and to producing the revenues needed to discharge our national responsibilities. Such policies must be of primary concern to the Federal Government this year.

As policy guides to the several committees of the Congress dealing with legislation, the Joint Economic Committee, pursuant to its duties under the Employment Act, has set forth below six main considerations for economic policy today:

1. Monetary action should be used without hesitation and in such degree as the situation requires if, as a flexible instrument of public policy, it is to make its contribution to recovery. From the testimony presented at the hearings, we find no reason why the

monetary authorities should, under today's conditions, hold back on supplying additional reserves to the monetary system. It is well recognized that such monetary action may not succeed in reversing the present economic downtrend but the absence of such further action might perpetuate monetary stringency and lack of liquidity for consumers, business, and Government.

2. Arresting the present decline and promoting economic recovery calls for acceleration of a number of Federal Government expenditure programs.[1] Outlays for development of the Nation's water resources, including navigation and flood control, water and soil conservation and reclamation command a high priority. These programs have great merit in the present circumstances, both for the immediate employment opportunities they create and because of their contributions to long-run economic development. Similarly, expanded grants to accelerate the Federal-aid highway program, stepped-up urban renewal programs, programs for needed public buildings such as post offices, the revision of present public and private housing programs to meet the accumulated backlog and demands of our expanding population, and a higher level of participation by the Federal Government for additions to the Nation's school and health plant would stimulate economic activity and contribute to long-run growth.[2]

The Federal, State, and local governments, therefore, should promptly activate projects in advanced stages of planning and accelerate those now in progress, especially those which will have a prompt and large effect on economic activity.

The Federal Government should also expand its public assistance grants to the States and should provide the financial assistance required to liberalize and extend unemployment compensation in order to provide quickly a cushion against the decline in income.

3. If monetary action, expenditure measures, and other actions, public or private, fall short in stemming recession and promoting recovery, tax reduction will be in order, but such action is not now recommended. The committee is confident that the tax-writing committees of the Congress will keep a close and continuing watch on economic and budgetary developments and will be prepared to move quickly in enacting general tax reduction if needed.

As we have repeatedly urged, tax revision as distinguished from tax reduction is always timely. These revisions should aim at greater equity, less interference with considerations of sound business practice, and a more favorable climate for new and small businesses. In recommending tax revision last year, the committee pointed out the limitations imposed by the need for maintaining revenues to combat inflation. In view of the changed

[1] Representative KILBURN. I feel that I must dissent from any view that treats Government spending as even a partial remedy for the present slowup in economic activity. I am against any additional Federal Government expenditure or works programs, which will have the effect of increasing the national debt. A further increase in the national debt will only serve in the long run to lower the value of the dollar still further and hence do the economy more harm than good. The millions of people who are on a fixed income in this country are being priced right out of the market. That is one reason for our so-called current recession. Our first objective, this year as always, should therefore be the preservation of a sound dollar.

During the thirties we were fortunate in having a low national debt. We then went into a mammoth public works program during the thirties and even at the end of that time we still had 9 million to 12 million unemployed. Spending wasn't the answer then and it isn't the answer now. At a time when our debt is already high and we are being urged to raise the debt ceiling so that it can go even higher, we simply cannot afford to expend the money without reducing the value of the dollar.

[2] Representative PATMAN. While I strongly support the construction of needed post offices and the expansion of other public works at this time, I believe the post offices should be financed by direct appropriations subject to the regular budgeting and congressional appropriations procedures. Expenditures for such buildings needed to perform a clearly public function should not be outside the budget and the debt limit ceilings as is substantially the case under the lease-purchase program.

economic circumstances, the consideration represents a much less significant constraint at this time.

4. The United States must be prepared for a long-term rise in defense demands. These demands must be determined upon their merits in terms of military and diplomatic strategy, rather than by their effects upon the economy or by the availability of governmental revenues to support them. Whether or not these rising demands will require increasing outlays will depend in part on specific, positive efforts to achieve more efficient use of resources committed to defense preparations. In any case, the Nation's economic capacity can bear whatever burden national security requirements may impose. The weight of this burden will depend on whether defense demands increase more rapidly than our productive capacity. The prospect of increasing defense requirements, therefore, emphasizes the importance of achieving and maintaining a high rate of economic growth.

5. The lower, but still high, level of plant and equipment outlays in prospect for this year need not materially affect the Nation's economic growth, if other types of growth-generating activity take their place. The fundamental source of growth over the long run is creative intelligence which produces new wants and the resources and techniques for their satisfaction at lower costs. The committee notes with satisfaction that expenditures for research and development are increasing. Economic policy oriented to long-term growth must be developed to assure an adequate flow of resources into education and research activities, as well as into those activities aimed at satisfying the consumption demands of a growing population and the investment demands of a growing business community.

6. The current economic contraction and the uncertainty about its magnitude and duration emphasize the importance of a strong integrated Federal program for economic statistics adequate for today's complex needs. Substantial increases in expenditures for this purpose will be the best possible budget economy, contributing to early detection and quick corrective action before economic difficulties progress far enough to cause a large Federal deficit, to say nothing of the private losses due to unemployment and idle capital. Present expenditures for economic statistics and the cost of needed improvements are both so small compared to other items in the budget that Congress this year should grant the increased appropriations recommended in the President's budget. The need was vigorously set forth in the President's Economic Report and supported by witnesses at our hearings. We commend the Division of Statistical Standards of the Bureau of the Budget and the Council of Economic Advisers for their leadership in developing and supporting the improved Federal system of integrated economic statistics needed by the executive branch, by the Congress, especially this committee, and by private labor, business, agriculture and research organizations.

The President's report contains several score of specific recommendations which the legislative committees will want to examine against the backdrop of the broad principles stated above.

As individual members of the Joint Economic Committee, we have varying views as to how these guides may best be applied in drafting legislation this session. Some of these views are set forth in individual footnotes and statements.

REPORT ON COMMITTEE ACTIVITIES AND PLANS

The Joint Economic Committee is directed by the law creating it (Public Law 304, 79th Cong.) to report to the Congress on the main recommendations of the President's Economic Report and to make a "continuing study" of the economy. During the period January–March of 1957 the committee held hearings and prepared its report on the 1957 Economic Report of the President. In its report on the 1957 Economic Report of the President, the committee indicated 5 areas of study and directed the continuation of 4 of its subcommittees established in 1956. One new subcommittee, the Subcommittee on Agricultural Policy, was established. The work of the committee and its subcommittees during the past year is summarized below.

President's 1957 Economic Report

Hearings on the January 1957 Economic Report of the President provided an opportunity (1) for the executive branch to indicate the economic assumptions and reasoning underlying the President's economic program and to justify major economic recommendations; (2) for a limited number of outside experts to set forth their views on the President's economic analysis and program; (3) for the economic interest and research groups to submit their views. The committee's report on the President's report was transmitted to the Congress on February 28, 1 day before the statutory deadline. The report included supplemental and minority views of committee members, and materials on the economic outlook for 1957 prepared by the committee staff (H. Rept. No. 175, 85th Cong., 1st sess.).

Subcommittee on Economic Stabilization

The Subcommittee on Economic Stabilization was composed of Representative Wright Patman, chairman; Senator Joseph C. O'Mahoney, Senator Barry Goldwater, Representative Augustine B. Kelley, and Representative Clarence E. Kilburn.

The Subcommittee on Economic Stabilization continued its study of automation in hearings on Automation and Recent Trends, November 14 and 15. Representatives of business and labor joined with technical experts in discussing the significance to the economy of current developments in automation.

No reports were prepared on these individual hearings since it was the feeling of the subcommittee that the proceedings would be given consideration by the Joint Economic Committee in connection with its March 1 report.

Subcommittee on Economic Statistics

The Subcommittee on Economic Statistics was composed of Representative Richard Bolling, chairman; Senator John Sparkman, and Representative Henry O. Talle.

In accordance with instructions of the full committee (H. Rept. No. 175, 85th Cong., 1st sess., p. 9) the subcommittee, through correspondence and personal consultation with members of the appropriations committees in the House and the Senate, attempted to assist in obtaining favorable action on the 1958 budget for economic statistics. On October 2 the chairman of the subcommittee released a mimeographed statement which summarized the status of the final appropriations for the Federal Government statistical programs. (See pp. 287–291, Joint Economic Committee Hearings on the 1958 Economic Report of the President.)

The subcommittee held hearings on the National Economic Accounts of the United States, October 29 and 30. Outstanding experts and representatives of both producers and users of national statistics discussed the findings which the National Accounts Review Committee of the National Bureau of Economic Research presented concerning the status and recommendations for improvements in the Federal Government's work in the field of national income and product accounts.

In accordance with the instructions of the full committee, the subcommittee arranged for a 1957 revision of the Historical and Descriptive Supplement to Economic Indicators, which was prepared and released in September.

In response to a request by Representative Curtis for a brief study of foreign economic statistics, the subcommittee obtained the cooperation of the Office of Statistical Standards, Bureau of the Budget, which prepared a two-part memorandum containing a summary of statistical activity of international agencies and a review of national income and expenditure accounts in leading countries. The memorandum was released February 21, 1958, as a committee print.

Subcommittee on Foreign Economic Policy

The Subcommittee on Foreign Economic Policy was composed of Representative Richard Bolling, chairman; Senator J. W. Fulbright, Senator Ralph E. Flanders, Representative Augustine B. Kelley and Representative Henry O. Talle.

As directed by the full committee, the subcommittee continued its examination of the relationship between economic trends in the Soviet Union and in the United States. A study, Soviet Economic Growth: A Comparison With the United States, prepared for the subcommittee by the Legislative Reference Service of the Library of Congress, was released as a committee print in September.

Subcommittee on Fiscal Policy

The Subcommittee on Fiscal Policy was composed of Senator Paul H. Douglas, Senator Joseph C. O'Mahoney, Senator Barry Goldwater, and Representative Thomas B. Curtis. Until his resignation from the committee, Representative Wilbur D. Mills served as chairman of the subcommittee.

The subcommittee undertook two inquiries in 1957. Hearings were held June 3–7, 13–14, on the Fiscal Policy Implications of the Economic Outlook and Budget Developments. The purpose of these hearings was to examine the facts concerning economic and budget developments as they appeared at mid-1957 upon which fiscal policy, consistent with the economic growth objectives of the Employment Act, should be based. The subcommittee had the benefit of discussions with 33 non-Government experts and with the Director of the Bureau of the Budget, the Secretary of the Treasury, and the Chairman of the Board of Governors of the Federal Reserve System.

The subcommittee's report was filed with the full committee on June 24, 1957, and was transmitted to the Congress on June 26, 1957 (H. Rept. No. 647, 85th Cong., 1st sess.).

Pursuant to the suggestion of the Joint Economic Committee in its February 28, 1957, report to the Congress (H. Rept. No. 175, 85th Cong., 1st sess.), the Subcommittee on Fiscal Policy developed a study of Federal Expenditure Policies for Economic Growth and Stability. In the course of its study the subcommittee invited and received the assistance of 102 experts from business, labor, research groups, universities, and Government. These participants prepared papers on a wide range of issues concerning Federal expenditures. The papers were printed and distributed to subcommittee members, participants, and the general public in early November. Hearings were held November 18–27, during which the participants and the subcommittee developed more fully the problems and issues raised in the papers. The subcommittee presented its report to the Joint Economic Committee in January (Federal Expenditure Policies for Economic Growth and Stability, report of the Subcommittee on Fiscal Policy to the Joint Economic Committee, Congress of the United States, committee print, January 23, 1958, 85th Cong., 2d sess.).

Subcommittee on Agricultural Policy

The Subcommittee on Agricultural Policy was composed of Senator John Sparkman, chairman; Senator Paul H. Douglas, Senator Arthur V. Watkins, Representative Wright Patman, Representative Wilbur D. Mills, Representative Henry O. Talle, and Representative Thomas B. Curtis.

The subcommittee, as directed by the full committee, conducted a study of Policy for Commercial Agriculture: Its Relation to Economic Growth and Stability. Over 60 experts from universities, Government, and farm organizations submitted papers on the invitation of the subcommittee. These papers were released in the form of a printed compendium prior to hearings which were held December 16–20, during which the authors of the papers and the subcommittee developed more fully the problems and issues raised in the papers. The subcommittee presented its report to the full committee on February 5, 1958 (Policy for Commercial Agriculture: Its Relation to Economic Growth and Stability, report of the Subcommittee on Agricultural Policy to the Joint Economic Committee, Congress of the United States, committee print, February 10, 1958, 85th Cong., 2d sess.).

Changes in committee membership

Representative Augustine B. Kelley, who had been a member of the committee since January 1955, died in November 1957. The committee has expressed its sorrow by formal resolution.

Representative Wilbur D. Mills resigned from the committee upon assuming the chairmanship of the House Ways and Means Committee.

Senator Barry Goldwater felt it necessary to submit his resignation in February 1958 because of conflict with the work of other committees.

Representatives Hale Boggs and Henry S. Reuss were appointed to the House vacancies.

Committee and staff participation in meetings with outside groups

Several members of the committee attended the 46th Annual Conference of the Interparliamentary Union at London, England, during September. The acting executive director, from the committee staff, attended the 30th session of the International Statistical Institute held in Stockholm, Sweden, August 8–15. He presented a paper on The Statistical Testing of National Economic Projections for Public Policymaking in the United States. This paper is being printed in the annual proceedings of the International Statistical Institute.

In addition to conducting formal studies and arranging hearings for the committee, the staff participated in discussions of economic problems and research techniques with outside groups. The following list of meetings illustrates the nature of these activities in which the staff took part during 1957: economic workshops and conferences at Goucher College, Pennsylvania, Princeton, and West Virginia Universities; investment banking seminar conducted by the University of Pennsylvania; annual sessions of the National Tax Association, Mortgage Bankers Association of America, the National Bureau of Economic Research, Federal Statistics Users' Conference, American Economic Association, American Statistical Association, the Econometric Institute, Inc., and the National Planning Association; conferences with groups of foreign economists brought here under the sponsorship of the State Department and the International Cooperation Administration; the annual seminar of the Prices and Cost of Living Division of the Bureau of Labor Statistics; seminars of the Industrial College of the Armed Forces; meetings of local chapters of the American Statistical Association; meetings of The Brookings Institution, and the Chamber of Commerce Committee on Business Statistics; and other meetings of business groups, civic organizations, and university classes.

Committee study of the relationship of prices to economic stability and growth

The committee issued a factbook compiled by the staff on Productivity, Prices, and Incomes, as a committee print on June 26, 1957. This study, which left interpretation and conclusions to the user of the materials, was compiled in response to a committee request outlined in its 1955 report (S. Rept. No. 1606, 84th Cong., 2d sess., p. 13). A program for further investigation in the area of prices was developed by the staff during the summer in response to a request from the committee. At a meeting of the full committee on October 7, the program was reviewed, several modifications and additions were made, and approval granted to proceed with the study.

As the first phase of its study, the committee directed the staff to proceed with the preparation of a compendium—or collection of research papers—presenting the analyses and findings of impartial experts and the most authoritative information available.

Plans for this compendium were approved at a committee meeting on January 13, 1958. The topics and list of contributors to the compendium were announced in a press release of January 17, 1958. The committee has also approved a schedule of hearings for May 12–29, 1958. At these hearings, after oral presentations by the expert contributors to the compendium, representatives of industry, labor, trade associations, consumers, and others will be asked to address themselves to the issues raised in the compendium. Details as to dates and lists of witnesses will be announced shortly.

Other committee studies

The persistence of upward price pressures in the United States since the end of World War II has raised important questions about the adequacy of fiscal and monetary policy in assuring stability without impairing economic growth. Other countries of the free world have also been plagued with inflationary pressures, frequently in association with rapid rates of growth in real output. These problems of economic instability have been approached with widely varying combinations of fiscal, monetary, and other public policies with varying degrees of success.

The committee recognizes that differences in circumstances from one nation to another may materially affect the usefulness of public stabilization policies. It will endeavor during the year, therefore, to develop a more detailed and clearer picture of the factors underlying postwar general price movements, the usefulness of and limitations upon public stabilization policies under different circumstances, with particular emphasis upon the functioning of central banks and their relationship to other public institutions and devices used for economic stabilization purposes. The committee's study of prices and price-making discussed above will be one major part of this inquiry. In addition, members of the committee, accompanied by the staff, will confer with Government and non-Government experts on these and related questions in major cities in Europe. The committee's findings will be made available in detailed reports.

Committee publications.—During 1957 the Joint Economic Committee and its subcommittees issued 12 publications after hearing 237 invited witnesses and panel experts in 32 days. Nearly 50,000 single copies of committee publications were distributed to fill individual requests. Most of these publications are also available through the Superintendent of Documents. During the past year, individual sales and quantity orders of committee publications, current and past, have exceeded \$16,000. This does not include the 6,662 paid subscriptions for the monthly publication Economic Indicators.

A checklist of committee publications will be found at the back of this report.

SUPPLEMENTAL VIEWS OF REPRESENTATIVE CURTIS AND SENATOR FLANDERS

In light of the extensive public and political discussion of the present economic decline it was especially important that this Committee on Economics attempt to define the present economic downturn in economic terms in this report. I regret that this was not done.

No two periods of economic decline are identical, yet much can be learned by comparison. Certainly the specific factors that go to make up a particular decline should be set forth. I suggest a few that seem to underlie the present phenomena: (1) The sudden sharp cutback of inventory in the fourth quarter of 1957, (2) the cutback in certain types of defense expenditure such as was occasioned by the shift of emphasis from airplanes to guided missiles, (3) the decline in expansion and replacement of capital plant expenditures, (4) the continued low level of automobile production, (5) the decline in exports.

And just as important to point up are the features of strength; e. g., (1) the maintenance of the high level of consumer purchasing, (2) the increased expenditures in research and development, (3) the resurgence of defense expenditures, (4) the increase in expenditures for the highway program, (5) the upturn of housing starts, (6) the relative high rate of capital plant replacement in spite of the decline from the high level of 1957, (7) the easing of tight money.

In view of the use of noneconomic terms and the abuse of economic terms in the public discussions describing the present phenomena, which can be called a recession if the overtone of "mildness" was understood by the public, it might be well to make a general comparison with the economic phenomena which occurred in 1949 and 1954. Both of these were recessions. Many competent economists agree that the present recession is probably more severe than that of 1954 and less severe than that of 1949. This knowledge should give us a little more perspective and keep us from rushing into programs which will not help us, but indeed can hurt us. Essentially it should make us realize that the economy itself will adjust and that, at most, governmental action should be geared to assisting rather than hampering this adjustment.

In concurring in recommendation No. 1 on monetary policy, I want to refer to the warnings we were given by some of the expert witnesses that inflationary forces are still close to the surface and an injudicious use of monetary action may swing things too far.

I concur in recommendation No. 2 but I am disturbed by the implications which may be drawn from it by a careless reading. The report dated January 22, 1958, of the Subcommittee on Fiscal Policy based upon the hearings on the subject, Federal Expenditure Policies for Economic Growth and Stability, should be read in order to obtain a better understanding of the limitations that public-works programs have in assisting growth and stability and easing a recession. Only public works already in the advanced planning stage can be of immediate assistance in the present recession. Furthermore, as already stated, Federal expenditures according to plan were to accelerate in 1958 and this acceleration is coming about.

The suggestion that the Federal Government should extend the public assistance grants and the unemployment compensation program involves questions of Federal-State relationship, matters of policy, and many technical difficulties which are the proper province of the legislative committees which have jurisdiction over these matters. If a quick cushion against the decline in income is needed, it will hardly be found in this complicated area. On this basis I disagree with the inclusion of this suggestion in the report.

THOMAS B. CURTIS.
RALPH E. FLANDERS.

DISSENTING VIEWS OF SENATOR DOUGLAS

I find it necessary to register a vigorous dissent from the report which my colleagues have approved. This dissent is registered not so much against the particular points in the majority report but against the priorities the report establishes as a means of overcoming the present serious recession.

UNEMPLOYMENT

The latest figures—which are now 6 weeks old—show that in January some 4.5 million, or 6.7 percent of the civilian labor force were fully unemployed. Many millions more worked only part time. Two men working half time are equal to one man fully unemployed. The equivalent full-time unemployment of these part-time workers is equal to 1.2 million, or 1.8 percent. Thus, the total full-time equivalent unemployment for January was 5.7 million, or 8.5 percent of the entire civilian labor force.

Even these figures underestimate the seriousness of the situation, for included in the 67 million civilian labor force are over 10 million people who are self-employed or who work in family businesses and who consequently could never qualify as "unemployed."

A recession or depression reduces the incomes of these 10 million but, since they "own" their own jobs, it does not throw them out of work as long as they have their farms and businesses. They therefore are not liable to unemployment and their numbers should be subtracted from the total working force. This means that in computing the percent of unemployment we should use as our denominator, not 67 million, but 57 million. This is the number either actually employed at wages or salaries by others, or who are seeking such employment. When this is done, it is seen that the true unemployment for January was 10 percent, i. e., 5.7 million out of 57 million. This is serious. When unemployment reaches such a magnitude, the time to act has arrived.

SERIOUS NATURE OF THE RECESSION

The present recession is potentially much more dangerous than those of 1948–49 and 1953–54. Those were essentially "inventory" recessions. This recession has all the appearances of also being a classical capital goods or investment recession. We do not have too much investment for long-term growth but we do have more investment and production than there is demand for the products of industry at present prices. Further, in the present recession, almost all the basic economic indicators reflect the decline. In addition, there certainly is no major objective evidence—as opposed to overly optimistic statement—to indicate any speedy turnaround in the direction in which economic forces are now going.

DANGER OF CUMULATIVE BREAKDOWN

Consequently, the real danger at the moment is that of a cumulative breakdown in the economy. I am not predicting that this will happen but when unemployment exceeds 8 percent and when production and investment indicators have fallen as they have, then such a breakdown is always possible. Further, economic breakdowns do not proceed in some natural and orderly way. This is true even though the followers of equilibrium theory tend to believe that a decline in one economic sector can always be neatly counterbalanced by an equivalent increase in some other sectors. The fact is that when unemployment, production, and investment figures are at the levels such as they now are, economic forces are more apt to be impetuous than orderly. At some point like that at which we now stand, the forces of breakdown can snowball and avalanche. Production, employment, purchasing power, and investment all decline and each decrease leads to further decreases. Therefore, remedial action of a size which might have been very effective in the early stages of a recession can be almost completely useless in the later stages of a decline.

It is the danger of a cumulative breakdown in our economy, brought on by impetuous forces which are almost impossible to turn around once they have gained real momentum, about which we should be worried. Because this recession has now reached very serious proportions and because of the dangers of a cumulative breakdown, the time to act has arrived. The danger is not that we will do too much, but rather that we will do too little and do it too late.

Those who refuse to look at facts and who think they can drive away realities by boastful talk and by reviling all critics are the ones who may lead us into disaster. For they delude both the public and themselves into believing that all is well and nothing needs to be done. They are like the Persian king who executed all messengers who brought him unfavorable news only to find that the "good news" he later received, and which caused him to invade a neighboring country, was false and led him into disaster. The realist and not the blind optimist is, therefore, the best guardian of the republic.

TAX CUTS MOST EFFECTIVE

The quickest and most effective way to act is by means of a tax cut for lower and middle income groups, i. e., those groups which tend to spend almost all of their income. Such a tax cut would be fed into the economy almost immediately; it would stimulate demand for goods and services; afford the best hope for stopping the current economic recession and help to start an economic upturn. The increase in the demand for consumers' goods should also stimulate the demand for, and investment in, capital goods.

Specifically, I would propose that we either raise the personal exemption from $600 to $700, or tax the first $1,000 of taxable income at 15 percent rather than 20 percent. Either of these proposals could go into effect immediately and could be made retroactive to January 1, 1958. Further, such a cut should expire on January 1, 1959, so that if the recession is stopped, the loss of revenue—which is proper in a recession—could be recouped during a prosperous period.

Such a tax cut would pump some $3 billion per year into the economy. This would take effect currently and immediately.

In addition, I propose that the excise taxes on consumer durables, such as radios, television sets, refrigerators, air conditioners, gas and oil appliances, luggage, handbags, wallets, etc., be repealed; that the excise taxes on the transportation of property and persons and on communications be cut in half; and, if the automobile industry will agree to pass along such a cut in lowered prices, a 50 percent reduction in the manufacturer's excise tax on passenger automobiles. Such cuts could go into effect at once. Unlike the cut in personal income taxes, they could not be made retroactive and there are too many administrative obstacles to reinstating them after they are dropped. However, we should not worry excessively about repealing them, for these taxes were initiated largely for revenue purposes during World War II. They are extremely regressive and fall unfairly and disproportionately on lower and middle income groups. The total revenue losses in the excise repeals and cuts which I have recommended are in the neighborhood of only $1.4 billion.

Both the personal income and excise cuts could become effective almost immediately. They would show up in the weekly paychecks of individuals within a week or two following congressional passage, and they would bring a reduction in the prices of consumer durables for which the demand has declined.

PUBLIC WORKS

While I am certainly not opposed to the expansion of needed public works in periods of economic recessions, I do not have the same faith as my colleagues in their ability to help matters quickly, nor would I give them the priority over tax cuts which my colleagues do.

There are three principal reasons for this. First, public works are too slow. Except for possible psychological effects, major new projects would be very slow in actually being started. Plans must be made, land bought, contracts bid for, etc. Therefore, even at best it would be many months before most of these projects could actually influence the course of the recession. By that time, the question of whether the recession will deepen into a depression, or whether it will be turned around, will more than likely have been decided.

Second, even those projects which can begin early will not necessarily be in the localities where the major portion of the unemployment exists. Navigation and flood-control projects on our major and minor rivers, and reclamation projects in the scantily populated areas of the West are not calculated to provide jobs for unemployed workers in the automobile, steel, and the fabrication industries in our great industrial centers. I can say without stretching the truth in the least that public works are popular in part because many see in them an opportunity finally to get a new post office or a new dam for a given congressional district. By the nature of the legislative process and the composition of the Congress, and in particular the Senate, this public works money goes in major proportion to those areas of the country which are scantily populated but overrepresented. These areas have many Senators but relatively few people.

Third, even if taken off the shelf quickly, and even if built in the right localities, public works generally do not directly employ those who have lost industrial jobs.

I favor, in this period, an expansion of needed public works. I would put schools and hospitals along with slum clearance and housing for low and middle income groups at the top of the list of priorities.

Funds to build lakes to provide industrial water, particularly in those areas of chronic unemployment such as depressed coal-mining regions, so that new industry could be attracted to them, would be particularly meritorious. These projects do not now qualify as navigation or as river and harbor projects. They qualify only secondarily as flood-control projects and are considered to be too large for the small watershed program. Yet they are extremely meritorious and they could provide badly needed help to the chronically depressed areas.

Other public-works projects to be built should be economically justified; primarily those where the benefit-cost ratios are at least 1.5 to 1. Nonetheless, public works cannot be relied upon to give the economy the immediate stimulus it needs to change the direction in which economic forces are moving, but they should be provided at an appropriate time so that men will not be forced to be permanently unemployed if we experience a cumulative breakdown in the economy.

SUMMARY

In summation, what we need is an immediate tax cut for lower and middle income groups in order to increase demand and purchasing power. At the same time, we should increase unemployment benefits for those out of work, for a personal tax cut will not be received by them directly;for, if they have no income, they pay no taxes. However, they would benefit immediately from the excise cuts on the goods they buy. Therefore, an increase in unemployment benefits to approximately half of the average wage as opposed to the one-third which is now the case, and an extension of time for receiving unemployment benefits by an additional 13 weeks, are both needed. Further, we should start processing needed public-works projects so that if a tax cut fails, these men will have jobs to go to.

In addition, of course, the Federal Reserve should ease monetary and credit restrictions. The Federal Reserve Board failed to read the economic signs correctly as late as last August when they increased the rediscount rate by one-half of 1 percent, and it still appears to be most fearful of inflation, which does not now exist. It is true that the wholesale price index is at its highest point and the industrial price component of this index also remains within three-tenths of 1 percent of its highest level. But monetary policy cannot have any decisive effect over these prices for they are largely the administered prices of monopolies and oligopolies. How else can one account for the fact that steel prices remain basically as high as they were many months ago while production has dropped to 53 percent of capacity and that automobile prices have risen while production has dropped by at least 25 percent?

What is needed is a vigorous prosecution of the antitrust laws and the promotion of competition in these huge cartelized industries. Using monetary policy in a period of a recession to fight inflation in the administered prices of the giant monopolies is to outdo Don Quixote in tilting at windmills.

Further, easing monetary policy should take the form of open market operations rather than a reduction in the reserve ratios of member banks. The latter method denies to the Government its "commission" on an increase in credit and money, and is a clear windfall to the banks.

However, increasing the availability of loans and credit cannot be effective unless individuals and businesses are willing to borrow. What appears to be the right course for the economy as a whole during a recession, namely, an increased expenditure of funds, appears to hard-pressed individuals and businesses to be the wrong course for them. Consequently, we cannot and should not rely too heavily on easier credit and relaxed monetary policy to bring an upturn.

For all of these reasons, a tax cut is the quickest and best way to proceed. If we do that now, it may be unnecessary to spend billions on public works later, but if we rely on public works as the major antidote to the recession, we may well find that a few months from now we may need a tax cut of gigantic proportions to stop a decline. The deficit then, from (1) expanded public works, (2) a larger tax cut, (3) greatly reduced revenues because of declining production and employment, and (4) outlays for missiles and national defense would be very costly in both money and human terms. A $4 billion tax cut now, on the other hand, seems to me to offer both the quickest and best opportunity for reversing the present serious recession.

Paul H. Douglas.

THE ECONOMIC OUTLOOK FOR 1958

PREPARED FOR THE

JOINT ECONOMIC COMMITTEE

BY THE

COMMITTEE STAFF

LETTER OF TRANSMITTAL

FEBRUARY 14, 1958.

Hon. WRIGHT PATMAN,
United States House of Representatives,
Washington, D. C.

DEAR REPRESENTATIVE PATMAN: Transmitted herewith are committee staff materials on the economic outlook for 1958. These materials, as in previous years, attempt to quantify the "foreseeable trends" of economic activity for 1958 which the committee staff believes are consistent with the outlook assumptions of the President's Economic Report and budget, as well as those consistent with testimony during the recent committee hearings.

While it is necessary to use detailed and precise figures in preparing economic projections which are internally consistent, it must be emphasized that the purpose of such projections is to show the general order of magnitude and direction of possible major economic developments on the basis of stated assumptions.

Sincerely yours,

JOHN W. LEHMAN,
Acting Executive Director.

THE ECONOMIC OUTLOOK FOR 1958

(NOTE.—References in text and tables are to numbered sections of the Technical Materials beginning on p. 28.)

A gross national product of $445 billion for 1958 appears consistent with the President's Economic Report and his Budget Message.[1] The foreseeable trends underlying these documents envisage an extension for a time into 1958 of a decline in our economy and contemplate thereafter a reversal during 1958.[2] As explained in the committee hearings, this pattern of recovery within the year, if realized, could be regarded as consistent with the objectives of the Employment Act in the sense that the rise from current low levels toward "maximum employment, production, and purchasing power" would be as fast as usually has been achieved.[3]

The report and the budget assume little change in the price level prevailing at the beginning of the year.[4]

No specific pattern of timing and speed of recovery of the economy during 1958 has been stated in connection with the President's Budget or Economic Report [2] though they do contemplate recovery being underway in the third quarter at the latest. The later in the year the turning point is assumed to occur, the faster output would have to rise in the remaining months of the year in order that the assumed average for the year could be realized. Since the rate of increase becomes unrealistically rapid if the turning point is assumed to be later in the year, the outlook underlying the Economic Report and Budget is illustrated by assuming that the low point is reached in the first quarter of 1958 and that each successive quarter of the year would show a rise. As will be seen from chart I, this assumption would give a rate of increase after the first quarter similar to the recovery of 1954.

If the assumptions for 1958 underlying the President's Economic Report and Budget are realized, it would represent a growth in real output of about 1 percent from 1957 compared to a growth in output of 1 percent between 1956 and 1957 and of 3.1 percent between 1955 and 1956. The recovery pattern illustrated on chart I would require a growth in real output during the last 3 quarters of the year at an annual rate of about 7 percent, or about the same rate of recovery as occurred between 1954 and 1955.

To bring about such an early reversal the Economic Report assumes an upturn in plant and equipment expenditures before the end of the year, a quick end to current inventory liquidation, further improvement in residential housing, continued strong consumer buying, further increases in State and local government spending, and increased Federal defense expenditures. It also assumes significant additional stimulus to economic activity from the high rate of defense orders placed in the first half of 1958 to make up for the low rate of orders placed in the last half of 1957.[5]

On the policy side, the Economic Report assumes continued easing of credit and recommends continuance of present tax rates through fiscal year 1959, though with some modifications, particularly for aiding small business.[6]

Whether the demands by consumers, business, and government will, in total, be adequate to bring about realization of the assumptions underlying the President's Economic Report and Budget as set forth above is examined in the following sections of these materials in the light of the record of the committee hearings and other information assembled by the staff.

Estimated Demand for National Production During 1958 Derived From the Committee Hearings

Alternative estimates of demand during 1958 can be derived by analysis and synthesis of testimony in the record of the committee hearings on the Economic Report of the President and other information from official and private sources.

These alternative demand estimates provide a second set of economic assumptions for public policy this year which differ from those underlying the President's Economic Report and Budget. Both sets of demand estimates are assumptions which can be used as a basis for policy decisions. They are not forecasts of what will happen to the economy. Indeed, any forecast of the pattern of economic changes during 1958 would require a forecast of the character, magnitude, and timing of changes in public policies which this committee may recommend and which the Congress and the administration may put into effect.

These materials do not incorporate any such forecast of changes in public economic policies precisely because the analysis and quantitative estimates are assembled to assist the committee in making its decisions about needed policy changes, by providing a comparison of the assumptions underlying the President's Economic Report and Budget with a synthesis of testimony during the hearings as to what non-Government witnesses expect might happen if present policies are not altered significantly.

Assuming no significant change in expenditure policies from those envisaged in the President's Budget Message, total Federal, State, and local demand for goods and services is expected to reach $89.5 billion for calendar 1958, an increase of $3 billion over 1957—an increase due almost entirely to State and local government spending. The rise in State and local expenditures would reflect, mainly, higher payrolls and expanding construction programs. Federal expenditures for goods and services are scheduled to average $50.5 billion in 1958, about the same as in 1957. They would increase almost $2 billion between the first and fourth quarters of this year, in contrast to the declining trend that prevailed in the last half of 1957.[7]

Total business demand may not exceed $58.5 billion compared to $67.6 billion in 1957. Business spending on plant and equipment (producers' durable equipment, and construction other than nonfarm residential) appears likely to show a declining trend throughout 1958. For the year as a whole, such spending might average about $4 billion less than the average of 1957. Between the fourth quarter of 1957 and the fourth quarter of 1958, the decline might be $6 billion or more.

Continuing declines in new orders, in contract awards, and in capital appropriations confirm this tendency revealed by recent surveys of business plans for 1958. The next Government survey of such plans, to be available in March, will shed additional light on these prospects.[8]

Residential construction may average about the same or somewhat higher than the average of 1957 on the basis of present trends in contract awards and housing starts which are expected to average about a million or a little more this year.[9]

Heavy business liquidation of inventories has been underway for several months. Further liquidation can be expected until the trend of sales turns upward. On the basis of past behavior, an average of $2.5 billion of inventory liquidation for the year as a whole would not seem unreasonable even if liquidation ends by the fourth quarter.[10]

If present income tax rates are continued and the rate of personal savings falls somewhat below that of 1957, consumer demand might total about $281.0 billion in 1958 almost the same as the $280.4 billion in 1957. These expenditures were running at an annual rate of $282.4 billion in the fourth quarter of 1957.[11]

The Economic Report, as well as other analyses, points toward a lower net foreign investment this year than in 1957. The rate fell from an annual rate of about $4.1 billion in the first quarter of 1957 to about $2.0 billion in the fourth quarter. This trend is expected to continue. Therefore, net foreign investment is assumed to average about $1.5 billion for 1958 as a whole.[12]

The total of these demands by consumers, business, and Government amounts to $429 billion for 1958 as a whole.[13]

The Nation's Economic Budget for 1958

The assumptions underlying the President's Economic Report and his Budget Message permit construction of a nation's economic budget for 1958 which is shown as "A" in table 1, page 26. Except for the Government expenditures, personal income, and corporate profits before taxes, the various estimates are not necessarily identical, but are nevertheless consistent with those of the executive branch which, as a matter of policy, does not publish detailed numerical estimates of the assumptions underlying economic policies.

The alternative estimates of Government, business, and consumer demand derived from the committee hearings and other information, permit construction of a nation's economic budget totaling about $429 billion for 1958, shown as "B" in table 1, page 26.

Chart I, page 25, shows a comparison of gross national product in recent years and the two assumptions for 1958 with the trend of potential gross national product in past years not marked by war or severe recession.

It will be noted that the deflated gross national product is shown quarterly on chart I. This chart is based on crude figures developed by the committee staff in consultation with the Department of Commerce for illustrative purposes only. Official figures for deflated gross national product and for the deflators are not available on a quarterly basis from the Office of Business Economics, Department of Commerce, which now prepares such figures on an annual basis.

Quarterly figures will be developed if the increase in funds for the Office of Business Economics for fiscal 1959 requested in the President's budget is approved by the Congress.

What are the implications of these figures which, it will be recalled from the previous discussion on page 22, express present plans and expectations without adjustment for possible changes in public policies, rather than predictions of what actually will happen during the coming year?

First, in early 1958 economic activity is still declining and now is substantially below the trend of potential output consistent with past years not marked by wars or severe recession. Such a potential gross national product for 1958, consistent with long-run trends in labor force, hours of work, and output per man-hour, would approximate about $459.5 billion for calendar 1958 measured in terms of the prices slightly above those prevailing in the fourth quarter of 1957.

If total demand turns out to be as large as assumed in the President's Economic Report and Budget, gross national product for 1958 would total $445 billion, or $14.5 billion below this long-run trend. The pattern of recovery within the year, however, could be regarded as consistent with the Employment Act objectives in the sense that the rise toward "maximum" employment, production, and purchasing power from present levels would be as fast as usually has been achieved.[3]

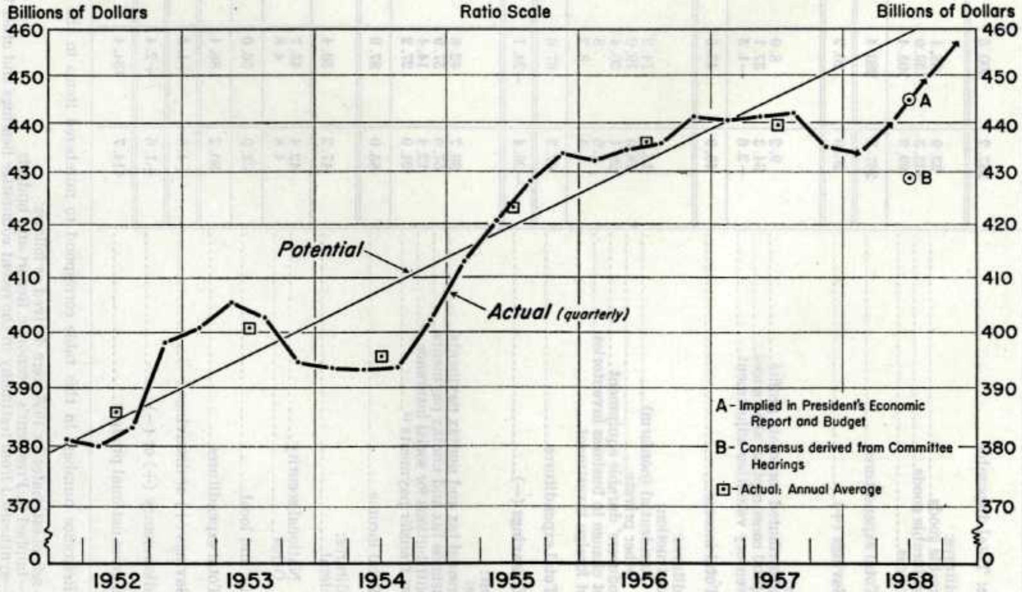
Second, the consensus of the testimony by non-Government witnesses at the hearings and other information about trends in aggregate demand and its components for 1958 suggest that unless present private and public policies are changed, the current decline in economic activity is likely to continue through at least midyear.

Basing their conclusions mainly upon current expectations that private spending for plant and equipment will continue to decline throughout this year and perhaps into 1959, some suggest that it would be hazardous to base public policies on the assumption of a substantial recovery even in the second half. This weakness in the investment sector has generally been attributed to a rate of increase in aggregate demand too slow to provide markets for the output from rapidly rising capacity in the last 3 years.

Third, how much unemployment might accompany the two alternative estimates of aggregate demand? If the more optimistic outcome envisaged by the President's Economic Report and budget were to be realized, the unemployed might range between 5 and 6 percent of the civilian labor force, or between 3½ and 4½ million after adjustment for the usual seasonal variations. If the more pessimistic outlook expressed during the hearings occurs, unemployment, seasonally adjusted, might average between 6 and 7 percent of the civilian labor force, or 4½ to 5½ million. In considering these estimates it is necessary to keep in mind that changes in hours of work, in output per man-hour, and in the rate of increase in the labor force might cause unemployment to vary appreciably from these figures.

CHART I. POTENTIAL GROSS NATIONAL PRODUCT COMPARED TO ACTUAL 1952-1957, AND ASSUMED FOR 1958

(In constant beginning-of-1958 prices — seasonally adjusted)



Source: Department of Commerce, Council of Economic Advisers, and Staff, Joint Economic Committee.

TABLE 1.—*Summary of the Nation's economic budget, calendar years: Actual, 1956; preliminary, 1957; and estimated, 1958*

[Billions of dollars]

Item	1956	Preliminary 1957	1958 estimated [4] "A" [1]	1958 estimated [4] "B" [13]
Personal:				
Income: Total disposable	287.2	300.6	[14] 307.0	[14] 298.0
Expenditures:				
Durable goods	33.9	35.1	35.0	33.0
Nondurable goods	133.3	139.9	145.0	139.0
Services	99.9	105.4	110.0	109.0
Total expenditures	267.2	280.4	290.0	281.0
Savings (+)	20.0	20.2	[11] 17.0	[11] 17.0
Business:				
Income:				
Undistributed corporate profits	9.2	8.0	[14] 8.4	[14] 8.0
Capital consumption allowances	34.3	37.1	[15] 40.0	[15] 40.0
Inventory valuation adjustment	−2.6	−1.5	−1.0	+1.5
Total income	40.9	43.5	47.4	49.5
Expenditures:				
Construction:				
Residential (nonfarm)	15.3	14.2	[9] 16.0	[9] 14.3
Other private	18.0	19.0	[8] 19.4	[8] 18.2
Producers' durable equipment	28.1	30.4	[8] 28.4	[8] 27.0
Net change in business inventories	4.6	.8	[10] .2	[10] −2.5
Net foreign investment	1.4	3.2	[12] 1.5	[12] 1.5
Total expenditures	67.3	67.6	65.5	58.5
Dissavings (−)	−26.4	−24.1	−18.1	−9.0
Government:				
Income:				
Personal tax and nontax payments	39.7	42.8	45.0	43.0
Business tax and nontax payments	57.0	57.9	60.6	54.0
Contributions for social insurance	12.4	14.4	14.6	14.5
Less transfer payments [16]	24.0	27.2	29.6	[22] 31.7
Total income	85.0	87.9	[7] 90.6	[17] 79.8
Expenditures:				
Federal	47.2	50.4	50.5	50.5
National security	42.4	45.7	45.7	45.7
Other	4.8	4.8	4.8	4.8
State and local	33.0	36.0	39.0	39.0
Total expenditures	80.2	86.4	[7] 89.5	[7] 89.5
Savings (+) or dissavings (−)	+4.8	+1.5	[7] +1.1	[17] −9.7
Statistical discrepancy (+) or (−)	+1.6	+2.4	0	+1.7
Total gross national product	414.7	434.4	445.0	429.0

NOTE.—Reference numbers in this table correspond to numbered items in the Technical Materials, p. 28.
The two sets of estimates for 1958 were derived as follows:
"A"—implied in President's Economic Report and budget;
"B"—synthesized from testimony in the recent committee hearings and other information.
Detail may not add to totals because of rounding.

Sources: 1956–57: Office of Business Economics, Department of Commerce; 1958: Staff, Joint Economic Committee.

TABLE 2.—*Relation of gross national product, net national product, national income, and personal income, calendar years: actual 1956; preliminary, 1957; and estimated, 1958*

[Billions of dollars]

Item	1956	Preliminary 1957	1958 estimated [4] "A" [1]	1958 estimated [4] "B" [13]
Gross national product	414.7	434.4	445.0	429.0
Less: Capital consumption allowances	34.3	37.1	[15] 40.0	[15] 40.0
Equals: Net national product	380.4	397.3	405.0	389.0
Less:				
Indirect business tax and nontax liability	35.0	36.9	[7] 39.2	[17] 36.0
Business transfer payments	1.3	1.3	1.3	1.3
Statistical discrepancy	1.6	2.4	0	1.7
Plus: Subsidies less current surplus of Government enterprises	1.1	1.3	[7] 1.7	[7] 1.7
Equals: National income	343.6	358.0	366.2	351.7
Less:				
Corporate profits and inventory valuation adjustment	40.4	39.5	[18] 41.0	[19] 37.5
Contributions for social insurance	12.4	14.4	[7] 14.6	[17] 14.5
Excess of wage accruals over disbursements	0	0	0	0
Plus:				
Government transfer payments	17.2	19.9	[7] 21.3	[20] 23.5
Net interest paid by Government	5.7	6.0	[7] 6.6	6.5
Dividends	11.9	12.1	12.2	10.0
Business transfer payments	1.3	1.3	1.3	1.3
Equals: Personal income	326.9	343.4	[21] 352.0	341.0
Less: Personal tax and nontax payments	39.7	42.8	[7] 45.0	[17] 43.0
Federal	35.1	37.8	[7] 39.7	[17] 38.0
State and local	4.6	5.0	[7] 5.3	[17] 5.0
Equals: Disposable personal income	287.2	300.6	307.0	298.0
Less: Personal consumption expenditures	267.2	280.4	290.0	281.0
Equals: Personal saving	20.0	20.2	[10] 17.0	[10] 17.0
Addendum:				
Corporate profits and inventory valuation adjustment	40.4	39.5	[18] 41.0	[19] 37.5
Inventory valuation adjustment	−2.6	−1.5	−1.0	+1.5
Corporate profits before tax	43.0	41.0	[18] 42.0	[19] 36.0
Corporate profits tax liability	22.0	21.0	21.4	18.0
Corporate profits after tax	21.0	20.0	[22] 20.6	[22] 18.0
Dividends	11.9	12.1	[23] 12.2	[24] 10.0
Undistributed corporate profits	9.2	8.0	8.4	8.0

NOTE.—Reference numbers in this table correspond to numbered items in the Technical Materials, p. 28.

The two sets of estimates for 1958 were derived as follows:

"A"—implied in President's Economic Report and budget;

"B"—synthesized from testimony in the recent committee hearings and other information.

Detail may not add to totals because of rounding.

Sources: 1956–57: Office of Business Economics, Department of Commerce; 1958: Staff, Joint Economic Committee.

TABLE 3.—*Actual and "potential"* [25] *gross national product in constant 1947 prices, calendar years 1956–58*

Item	1956 Actual	1956 Potential [25]	1957 Preliminary	1957 Potential [25]	1958 Potential [25]
Total labor force (in millions) [29]	70.4	[26] 69.7	70.8	[26] 70.6	[26] 71.5
Armed Forces	2.9	[27] 3.0	2.8	[27] 3.0	[27] 3.0
Civilian	67.5	66.7	68.0	67.6	68.5
Unemployment	2.6	2.7	2.7	2.7	2.7
Percent of labor force	3.8	[28] 4.0	4.0	[28] 4.0	[28] 4.0
Employment	65.0	64.1	65.3	64.9	65.8
Private	58.4	57.6	58.5	58.3	59.0
Agriculture	6.6	6.2	6.2	6.1	6.1
Nonagriculture	51.8	51.4	52.2	52.2	53.0
Government—civilian [30]	6.6	[27] 6.5	6.8	[27] 6.6	[27] 6.7
Private:					
Average annual hours: [31]					
Agriculture	2,359.0	2,406.0	2,289.6	2,387.0	2,368.0
Nonagriculture	2,018.0	1,991.0	1,997.9	1,976.0	1,960.0
Output per man-hour (in 1947 dollars): [32]					
Agriculture	$1.667	$1.545	$1.753	$1.592	$1.641
Nonagriculture	$2.699	$2.755	$2.739	$2.827	$2.903
Gross national product (in billions of 1947 dollars) Total	$332.0	$328.9	$335.2	$339.3	$350.0
Private	308.0	304.7	310.9	314.7	325.0
Agriculture [33]	25.9	23.2	25.0	23.4	23.6
Nonagriculture	282.1	281.5	285.9	291.3	301.4
Government [34]	24.0	24.2	24.3	24.6	25.0

NOTE.—Reference numbers in this table correspond to numbered items in the Technical Materials, p. 28. Detail will not necessarily add to totals because of rounding.

Sources: Population, labor force, and average annual hours: Bureau of the Census, Department of Commerce. Gross national product: 1956 actual, and 1957 preliminary, Office of Business Economics, Department of Commerce. Potentials: Staff, Joint Economic Committee.

TECHNICAL MATERIALS

These technical materials correspond to the numbered references to the preceding text and tables. In addition to references to sources of information, these materials contain definitions of terms, explanations of points of analysis, statements of basic assumptions, and supporting materials drawn from committee hearings on the January 1958 Economic Report of the President, from that report itself, from the President's January 1958 Budget Message, from other official statements or reports, and other sources.

(1) The estimate of a gross national product of $445 billion for 1958, together with the detailed income and expenditure estimates associated with it, reflect assumptions contained in executive branch statements, and the Joint Economic Committee staff's interpretation of levels and trends consistent with the President's Economic Report and Budget. These estimates are shown under the "A" column in tables 1 and 2. The various detailed assumptions and reasons for particular points of the staff's interpretation are given in other notes below. Together these detailed assumptions provide the basis for

deriving the estimate of a $445 billion gross national product for 1958. The general character of the administration's outlook analysis is given in the January 1958 Economic Report of the President (hereinafter cited "Economic Report"), p. III, as follows:

> As we look ahead in 1958, there are grounds for expecting that the decline in business activity need not be prolonged and that economic growth can be resumed without extended interruption. The policies of Government will be directed toward helping to assure this result.

In his budget for fiscal 1959 submitted to the Congress January 13, 1958, the President stated:

> There are strong grounds to support my confidence that the expansion of our economy will soon be resumed, bringing higher levels of receipts with present tax rates. The acceleration of defense efforts already under way, the increasing pace of activity in a number of programs involving State and local as well as Federal expenditures, the rapid pace of technological advance and its application by American industry, the expanding needs and desires of our growing population, and Government policies designed to facilitate the resumption of growth are among the major factors that justify this confidence. (Budget of the United States Government for the Fiscal Year Ending June 30, 1959, pp. M9–M10; hereinafter cited "1959 Budget.")

(2) The foreseeable trends underlying the President's Economic Report and budget were outlined by Dr. Raymond J. Saulnier, chairman of the President's Council of Economic Advisers, as follows:

> That takes into consideration an extension, for a time into 1958, of a decline in our economy, which we have seen developing for some months in 1957. However, it contemplates a reversal of that trend in 1958. For the revenue estimates which are set forth in the budget to be realized, and, similarly, for these foreseeable trends to which I have alluded and which underlie the President's Economic Report to be realized, a reversal of that trend is required. (Hearings on the January 1958 Economic Report of the President before the Joint Economic Committee, 85th Cong., 2d sess., p. 6; hereinafter cited "Hearings.")

Concerning the course of the economy during the year, Dr. Saulnier testified that:

> * * * There is no single course that our economy must take, but it is quite clear that, if the revenue estimates are to be realized, recovery could not come much later than, say, the middle of the year. They do not contemplate a recovery in the first quarter, in which we are currently nearly a third through, and they do not necessarily require, though they do not rule out, a recovery early in the second quarter. On the other hand, they do contemplate a recovery movement being underway in the third quarter, and, most assuredly, in the fourth. (Hearings, pp. 6–7.)

During hearings before the Subcommittee on General Government Matters of the Committee on Appropriations of the House of Representatives, Dr. Saulnier stated on January 16, 1958:

> I would say, Mr. Chairman, that economic growth ought to be resumed during 1958. It is, I think, unlikely that we could expect that to happen in the first quarter of the year. I would certainly expect it to be underway before the fourth quarter of the year. And so it becomes a question whether to expect it in the second or third quarter. My guess is that it will occur around the middle of the year. * * * I want to say, Mr. Chairman, that I am very reluctant to attempt to date economic recovery. No one can do this altogether accurately. I can only give you my best judgment, which is that this will occur during the year. I would certainly expect it to come before the midpoint of the year is long past, and, as a Council, we will do everything we can to bring it about before the middle of the year. (General Government Matters Appropriation for 1959, Hearings Before the Subcommittee of the Committee on Appropriations, House of Representatives, 85th Cong., 2d sess., pp. 144–145.)

On this same point, the President in his press statement released at the White House on February 12, 1958, said:

> From the best advice I can get, and on my own study of the facts regularly placed before me, I believe that we have had most of our bad news on the unemployment front. I am convinced that we are not facing a prolonged downswing in activity. Every indication is that March will commence to see the start of a pickup in job opportunities. That should mark the beginning of the end of the downturn in our economy, provided we apply ourselves with confidence to the job ahead. As Americans we have a responsibility to work toward the early resumption of sound growth in our economy.

(3) The Economic Report of the President does not contain any explicit statement that the foreseeable trends underlying the report will, if realized, constitute achievement of the objectives of the Employment Act during 1958. The report does say:

> The legislative program for the coming year, which is presented here, is designed to help discharge the responsibilities of the Federal Government under the Employment Act of 1946 (Economic Report, p. 55).

In his testimony before the Joint Economic Committee, Dr. Saulnier said:

> I believe, Mr. Chairman, that the foreseeable trends of employment, production, and purchasing power which underlie the President's Economic Report and which similarly underlie the budget message, are adequate, if realized—and, I repeat, "if realized"—to carry out the objectives of the Employment Act of 1946 (Hearings, p. 6).

(4) In constructing the quantitative analyses contained in these materials, it is necessary to incorporate some measure of changes in the general price level and to make some assumption about possible changes in prices during 1958. Since the Office of Business Economics of the U. S. Department of Commerce regularly publishes on an annual basis both gross national product deflated to constant 1947 dollars and the indexes of implicit prices of gross national product, the staff uses the OBE gross national product deflator as a convenient index of general price movements. For the year 1957, this index is estimated to have averaged 129.6 (1947=100). Prices rose throughout the year so that the index was undoubtedly above this average by the end of the year although this index is not available on a quarterly basis. (See p. 23 of text above.) The staff assumes for purposes of these quantitative analyses that the index will average about 131.3 (1947=100) for 1958 or somewhat above what it may have reached by the fourth quarter of 1957. This assumption is believed to be consistent with the President's Economic Report and Budget.

In testimony at the committee hearings on February 7, 1958, Secretary of the Treasury Robert B. Anderson, stated:

> We do not assume any change in prices from the present (Hearings, p. 416).

(5) Statements by the executive branch about specific factors which are expected to bring about the upturn in economic activity during 1958 are given in other notes below. These have been summarized in the hearings.

See colloquy between Mr. Raymond J. Saulnier, chairman, Council of Economic Advisers, and Representative George W. Andrews, chairman of the Subcommittee on General Government Matters, in hearings before that subcommittee:

> Mr. ANDREWS. What do you think will cause the reversal?
>
> Mr. SAULNIER. A number of factors.
>
> First of all, our economy has been affected by a leveling out and then a decline in the expenditures of business concerns on new plant and equipment. It may well be that we have seen the most of that decline. It will probably continue through the early part of the year, but should not extend long into the year.
>
> Second, we have already gone through quite a sharp reduction in exports. They were very high early in the year, because of transient conditions abroad.
>
> Mr. ANDREWS. Is that calendar year 1957?
>
> Mr. SAULNIER. That is right. The closing of the Suez Canal brought about a very sharp increase in exports, followed by a decline as that condition was corrected, and we have probably seen the major part of that decline. So that that factor, which was a force making for some worsening in economic conditions, may have exhausted itself.
>
> Third, we are already witnessing a picking up in the rate at which defense procurement orders are being placed. This is being done in order to meet urgent national needs, not because such expenditures are needed for economic reasons; that is, strictly for defense purposes.

Mr. ANDREWS. But will, of necessity——

Mr. SAULNIER. Have an economic impact; that is correct, sir. And, in our thinking and planning about economic policy, we must take this into effect.

Next, we have already underway some increase in expenditures on residential construction. That has been going on now for some 4 months or so, and an improvement in credit conditions should help to increase that rate of expenditure.

Similarly, expenditures of State and local governments are increasing. This is a long-term trend, but that rate of increase may well be accelerated further by a reduction in the cost of money and by the greater availability of money.

All of these are factors which, as we look ahead in 1958, suggest the resumption of economic growth without, as it has been put in the President's Economic Report, "extended interruption." (General Government Matters Appropriations for 1959, Hearings before the Subcommittee of the Committee on Appropriations, House of Representatives, 85th Congress., 2d sess., pp. 144–145.)

In the hearings, the Secretary of the Treasury, Robert B. Anderson, stated:

In the short-term area, a number of favorable factors can be discerned. First of all, part of the readjustment has occurred. Reduction of inventory in some lines and certain adjustments in output and prices have already taken place. * * *

The level of personal income has held up well. There has been prompt and responsive readjustment in certain stock and bond yield and interest rate relationships, and the stock market has shown some elements of strength during the past month.

Residential housing construction has turned upward slightly, and mortgage money is becoming more readily available. A sustaining influence can be expected from the stepped-up pace of certain Federal programs such as highway building, and from a number of State and local projects having to do with community facilities. Increased defense spending and contract placement will also have a stimulating effect on the economy.

Perhaps one of the most important considerations, however—either long-term or short-term—is the fact that the confidence of the American people in the basic strength of our economy has remained strong. There is evidence that this confidence is increasing (Hearings, p. 460).

(6) See Economic Report, pp. 57 and 63.

(7) Estimates of Government receipts and expenditures are based on the budget and on information on State and local finances furnished during the hearings in testimony by Dr. Louis J. Paradiso, Assistant Director and Chief Statistician of the Office of Business Economics, Department of Commerce. The calendar year estimates are either given directly in Dr. Paradiso's testimony or were calculated from the fiscal year estimates by interpolations. For example, total expenditures for goods and services for 1958 of $89.5 billion consist of $50.5

billion of Federal spending shown in the second of Dr. Paradiso's tables and of $39 billion of State and local spending obtained by adding $3 billion to the calendar 1957 estimate.

On a fiscal year basis, Dr. Paradiso summarized official budget estimates as follows:

Federal Government receipts and expenditures: Administrative budget, cash budget, and national income and product account, 1957–59

[Billions of dollars]

	Fiscal years		
	1957, actual	1958, estimated	1959, estimated
Administrative budget:			
Receipts	71.0	72.4	74.4
Expenditures	69.4	72.8	73.9
Surplus or deficit (−)	1.6	−.4	.5
Cash budget:			
Receipts	82.1	85.1	87.3
Expenditures	80.0	84.9	86.7
Surplus	2.1	.2	.6
National income and product account:			
Receipts	81.4	84.0	86.5
Expenditures	76.2	81.0	84.0
Surplus	5.2	3.0	2.5

Source: Administrative and cash budgets from the budget of the U. S. Government for the fiscal year ending June 30, 1959; national income and product account data from the U. S. Department of Commerce, Office of Business Economics, statistics for 1958 and 1959 based on estimates in the budget (Hearings, p. 79).

On a national income and product account basis, Dr. Paradiso provided the following additional data about Federal Government expenditures:

Federal Government expenditures, 1957–59 (on national income and product basis)

[Billions of dollars]

	4th quarter, 1957 (annual rate)	Actual fiscal year 1957	Projections		
			Fiscal year 1958	Calendar year 1958	Fiscal year 1959
Total expenditures	80.5	76.2	81.0	83.0	84.0
Purchases of goods and services	50.0	49.5	50.0	50.5	52.0
Other expenditures	30.5	26.7	31.0	32.5	32.0

Source: Estimates for 1958 and 1959 are based on the budget of the U. S. Government for the fiscal year ending June 30, 1959. Data for 1957 are estimated by the Department of Commerce. (Hearings, p. 78.)

Concerning State and local receipts and expenditures, Dr. Paradiso said:

> For the period under review, State and local government receipts and expenditures are somewhat more tenuous than the Federal estimates since there are no budgetary summaries of overall spending or revenue estimates for these bodies compared with the budget presentation for the Federal Government.

However, based on information developed by the Bureau of the Census, and studying and analyzing past trends, it appears that purchases of goods and services by these governments will continue to increase at about the same rate as in the recent past. Expenditures of State and local governments on a national income and product basis were $37 billion in fiscal year 1957. They are expected to be $40 billion in fiscal year 1958, and $43 billion in fiscal year 1959.

Purchases of goods and services by these governments, which totaled $34½ billion in fiscal 1957, are expected to rise $3 billion in each of the following 2 fiscal years.

Increased outlays for construction and employee compensation will account for almost all of these advances. State and local government revenues are projected upward in line with increased expenditures, so that the deficit on income and product accounts for these governments will be about the same as in fiscal 1957; namely, about one-half billion dollars.

The higher revenues are mainly due to increased receipts from property and sales taxes, moderate increases in personal income taxes, and higher grants-in-aid from the Federal Government.

* * * Total receipts of State and local governments on the national income and product account were $35.5 billion in fiscal 1957 and are estimated at $39 billion in fiscal 1958 and $41.5 billion in fiscal 1959.

Now, in summary, it seems clear the prospect for purchases of goods and services by Federal, State, and local governments combined for the next year and a half is one of a rising trend. For the fiscal year 1957 these purchases amounted to $84½ billion. They are expected to increase $3 billion, to $87½ billion in fiscal 1958, and an additional $5 billion, to $92½ billion, in fiscal 1959 (Hearings, pp. 79, 80).

In addition to the direct effect of increased Government expenditures, several witnesses referred to the possible stimulating effects on the economy of the sharp increase in placement of defense contracts scheduled for the first half of 1958. The Economic Report said:

In view of the necessary acceleration of certain defense programs, and the steps already taken to give effect to this change, national security expenditures may be expected to increase during the year ahead. Insofar as business activity is affected by the award of procurement contracts, which are being placed at an increased rate, it may rise earlier and more strongly than the prospective increase in national security expenditures (Economic Report, p. 50).

W. J. McNeil, Assistant Secretary of Defense (Comptroller), placed in the record of the hearings the following estimates of these defense contracts:

Estimated Obligations for Contracts Placed With Private Industry

Following is a table which indicates that the volume of procurement of goods and contract services for the period January to June should total \$13.4 billion—as compared with \$7.9 billion for the first 6 months of this fiscal year (July–December). During the early months of fiscal year 1958 only those contracts which required placement or extension were consummated. In November and December—after completion by the military departments of a complete review of the buying programs—the rate of placement of contracts sharply increased. This increased rate is continuing and obligations for these purposes for the last 6 months of this fiscal year of \$13.4 billion appear reasonable and feasible.

Department of Defense—Military functions: Estimated obligations for contracts placed with private industry

[Billions of dollars]

	Major procurement	Other contracts: Total	Other contracts: Construction	Other contracts: Research and development consumption-type material and contract services	Total
January–June 1957	6.7	3.2	1.2	2.0	9.9
July–December 1957	5.7	2.2	.3	1.9	7.9
July	.3	.40	.04	.36	.7
August	.6	.30	.02	.28	.9
September	1.2	.33	.05	.28	1.5
October	.7	.39	.05	.34	1.1
November	1.3	.33	.03	.30	1.6
December (projected)	1.6	.45	.11	.34	2.1
Total, calendar year 1957	12.4	5.4	1.5	3.9	17.8
January–June 1958 (projected)	9.7	3.7	1.6	2.1	13.4
July–December 1958 (projected)	7.5	2.7	.6	2.1	10.2
Total, calendar year 1958	17.2	6.4	2.2	4.2	23.6

Jan. 24, 1958

(Hearings, p. 367.)

In response to a question from Senator Douglas concerning the effects of this step-up in defense contracts on capital investment, Mr. McNeil replied:

In large part they will be produced with the capital facilities that presently exist. In my statement I made this remark: that similar expenditures for production equipment and facilities which took 9.7 of each major procurement dollar in 1953 will take only 2.7 in fiscal 1959. However that 2.7 figure out of each procurement dollar in 1959 was not too different than the figure of the current year or last year.

> But we do not—we do not require substantial or huge capital expansion to produce the items on our 1959 shopping list. (Hearings, p. 377).

In his statement, Dr. Gerhard Colm stated:

> The expectation for an early economic upturn could, in my opinion, be based only on the fact that there will be a substantial though short-run increase in the placement of defense contracts during the next few months. This rise in defense orders is due not to any general increase in the defense procurement program but to a reversal of the sharp curtailment in the placement of orders during the preceding 6 months. * * * Although this concentrated placement of orders during the next few months should have some effect on the level of economic activities, it cannot be expected to bring the economy back on the track of sustained economic expansion. (Hearings, pp. 120, 121.)

(8) Estimates of prospective spending during 1958 by business on plant and equipment are based on the Economic Report and on testimony during the hearings. The estimate consistent with the Economic Report—the "A" estimate—assumes that the decline in plant and equipment purchases by business will slow up in the second quarter and that an upturn in these expenditures will be underway by the fourth quarter. See Dr. Saulnier's testimony quoted in footnote 5 above. The Economic Report states:

> Although an extension into 1958 of the decline in business expenditures on plant and equipment is suggested by data on new orders and contracts, and by information on businessmen's investment intentions, the magnitude of the decline and its duration are uncertain. Decisions regarding these expenditures are influenced by a variety of conditions that affect particular industries and firms and are subject to rapid change. The outcome will be especially affected by sales experience and expectations. A decline in investment spending seldom lasts only a few months; however, in some industries reductions began as early as 1956, and in many others they have been in progress during much of 1957. Also, certain conditions that tend to limit the decline may be noted. Pressures to reduce costs and to improve products continue and in some respects have been intensified. Research and development activities, which are cumulative in their results, continue at a high level and are certain to yield many practical suggestions for undertakings the financial feasibility of which will be enhanced by the greater availability and lower cost of capital and credit (Economic Report, p. 49).

The second, or "B," estimate of plant and equipment purchases by business in 1958 was based on testimony of nongovernment witnesses in the hearings and on the Commerce-SEC survey of business plans for such expenditures through the first quarter. These materials indicate a decline of 7 to 10 percent for the year as a whole from 1957 levels and of about 10 to 15 percent by the fourth quarter, with the decline continuing into 1959.

Douglas Greenwald, chief statistician, department of economics, McGraw-Hill Publishing Co., Inc., stated:

There is no doubt as to the direction capital investment is taking in 1958. It is going down; but it is down from an extraordinarily high level. The McGraw-Hill preliminary survey of business' plans to invest in new plants and equipment was completed late in October. It indicated that total business investment in new facilities will be down about 7 percent from 1957. Business expects to spend $36.1 billion on new plants and equipment in 1958 compared with $38.6 billion in 1957 and $36.6 billion in 1956. (These figures are based on the McGraw-Hill definition of business capital expenditures, which differs somewhat from that of the United States Department of Commerce and the Securities and Exchange Commission.)

* * * * *

We do not carry out quarterly surveys of business' plans. But it seems probable from both our preliminary survey results and our current new orders indexes that investment will be declining throughout the calendar year, and at least into the first half of 1959. On the basis of our survey data, I estimate that the fourth quarter 1958 rate of capital expenditures will be about 10 to 15 percent below the fourth quarter of 1957.

Our survey also provides a clue to the expected trend in 1959. It showed that 28 percent of the reporting companies plan to cut investment in 1959 below the 1958 level. One-fifth of the companies expect to increase spending. And the remainder, more than half, expect to spend the same amount in 1959 as in 1958.

As I stressed earlier, I believe capital expenditures will decline into 1959, but the magnitude of the decline from the all-time peak to the low point should not exceed 15 to 20 percent. One reason for expecting a relatively high level of capital investment in 1958 and 1959 is the increased spending on research and development.

For more conclusive evidence of what will happen to capital expenditures in 1958, we must await the results of the next quarterly survey of the United States Department of Commerce and the Securities and Exchange Commission, which will cover the full year 1958, and the regular annual McGraw-Hill survey, which will cover the years 1958 through 1961. Both of these surveys will be released early in the spring.

But from all the statistical evidence now at hand, it seems probable that industry's expenditures on new plants and equipment for the year 1958 will be down no more than 10 percent and may well be off only 7 percent, as indicated by the preliminary McGraw-Hill survey. We cannot count on any significant lift to the overall economy from the capital goods area for at least 18 months. But we can expect that the current decline will moderate and that investment will remain relatively high by historical standards (Hearings, pp. 85–88).

Martin R. Gainsbrugh, chief economist of the National Industrial Conference Board, testified:

> My opening comments are confined to what I consider the hard core of this recession, namely the downward trend in private capital investment. The National Industrial Conference Board, some quarters back began a survey of capital appropriations in large manufacturing industries. And I believe this provides insight in our current and prospective trends.
>
> * * * * *
>
> Starting with the fourth quarter of 1954 and continuing through the first half of 1956, unspent appropriation backlogs climbed steadily upwards. It was only in the second and third quarters of 1957 that capital goods spending substantially exceeded the rate of appropriation approvals. During these 6 months over one-fourth of the unspent backlogs accumulated in the previous 10 quarters were used up.
>
> We found in the third quarter of 1957 that capital appropriations of the thousand largest manufacturing corporations had been cut 30 percent from the figure for the third quarter of 1956.
>
> I now bring you a preliminary result of our findings for the fourth quarter. Mind you, these are for the giants of American industry. On the basis of returns for about 80 or 90 companies this downward trend in appropriations is still continuing, if not accelerating. Capital appropriations may have been cut back about 40 percent in the fourth quarter as compared with 30 percent in the third quarter. * * *
>
> As frequently happens in an investment boom everyone gets into the act and then some. We now face the temporary problem of unused capacity in many lines of American industry, including many of our growth industries. And the working off of this unused capacity will take some time, time measured in terms of a year or more, not in terms of a few months. I am not a member of the 6-month club. (Hearings, pp. 133, 134.)

Prof. Jewell J. Rasmussen, of the University of Utah, stressed the implications of the current decline in investment, as follows:

> * * * Two of my colleagues who have done considerable work in forecasting and cycle analysis indicate that the decline for 1958 in this category will be between 20 and 30 percent. * * *
>
> The possibility of a recession of the more serious type appears to be much greater now than in 1949 or 1953–54. For the first time since 1945, there is perhaps a real danger that a serious recession could develop. There is ample justification to regard the present recession with particular suspicion.
>
> A principal causal factor in this potential threat is overcapacity. It is quite true that there are significant countercyclical factors to be taken into account—for example, national defense, the highway program, and State local

public works have been mentioned—but I think it would be a mistake to assume that these forces will automatically check a downturn in a few months' time. (Hearings, pp. 137, 138.)

(9) Estimates of construction expenditures, especially private residential (nonfarm), are based on executive branch statements and on testimony in the hearings. For views of the executive branch, see; (*a*) Construction Outlook for 1958, prepared jointly by the Departments of Commerce and Labor, press release of November 15, 1957; (*b*) President's Economic Report, pp. 49–50; and (*c*) testimony of Ewan Clague (Hearings, pp. 37, 38, and 69–75). Other views expressed in the hearings were:

> MILES L. COLEAN. If FHA should do no more than this, house building, instead of providing a real stimulus to the economy, would at best be neutral. I do not believe that the considerations I have mentioned have been given sufficient weight in the hopeful view that many have taken of the housing outlook. They are the basis for my own forecast of only a slight increase in the total number of new private dwelling units to be started this year, in spite of my conviction that the market could absorb a good deal more, if our mortgage-insurance mechanism were effectively energized. (Hearings, p. 84.)
>
> GERHARD COLM. In view of this anticipated contraction in federally supported housing programs and in view of the increased feeling of uncertainty among potential home buyers, it is less certain that the expected increase in residential construction will materialize. Thus, Federal activities under the President's program do not represent a substantial expansionary influence if the fiscal year 1959 is compared with the current or last fiscal year. (Hearings, p. 120.)

(10) Two estimates of net change in business inventories were made. The first of these is consistent with the President's Economic Report and budget—the "A" estimate. This estimate assumes continued liquidation in the first quarter of 1958, no change in the second quarter, and renewed accumulation in the remaining two quarters. See Economic Report where it is stated:

> * * * And the rate of inventory reduction may not be substantially greater than it has been so far, if the balance between Government expenditures and business capital outlays is favorable and if personal incomes and consumption expenditures are well maintained, as seems likely. (p. 50.)

Before the subcommittee of the House Committee on Appropriations, Dr. Saulnier said:

> * * * Our businessmen have been using up their inventories, and this has caused decreases in production more than would have been required by the decrease in actual final sales.
>
> Now, it is quite possible, Mr. Chairman, that we might, early in 1958, begin again to accumulate inventories. Even if we cease liquidating inventories, that will be a helpful factor in the economy. (General Government Matters Appropriations for 1959, Hearings Before the Subcommittee of the

Committee on Appropriations, House of Representatives, 85th Cong., 2d sess., p. 146.)

The second, or "B", estimate was based on testimony of non-Government witnesses during the hearings. Continued liquidation in the first quarter and probably in the second, was expected. Furthermore, inventory liquidation was expected to end when the decline in purchases of goods by consumers and Government was reversed. In the "B" estimate this would not come before midyear. Inventory movements usually lag about 6 months behind sales or final purchases so it was assumed in these "B" estimates that inventory liquidation would end in the fourth quarter. On the basis of past relationships of inventories to sales, a liquidation of this duration was assumed to amount to $2.5 billion.

During the committee hearings the following statements about possible inventory changes were made:

> MYRON S. SILBERT. If consumer demand holds as we have estimated, curtailment of production will ultimately bring inventories back into line. It is hard to estimate how long this period of correction may be. In the past, the curtailment has not only eliminated the excess, but continued beyond that until inventories got too low.
>
> * * * * *
>
> In the second and third quarters of 1957, inventory was being accumulated at a rate of $2 billion per year. That is in all of business—manufacturing, wholesaling, and retailing. In the fourth quarter, inventory was probably being decreased at a rate larger than the previous increase, probably at the $3 billion annual rate estimated by the Council of Economic Advisers. This shift from increase to decrease contributed to the cut in production and employment during the fourth quarter. The reduction is continuing in the first quarter of 1958.
>
> If business merely brought inventories to a normal position and not below, this negative factor could be brought to a halt without being unnecessarily prolonged. (Hearings, p. 97.)
>
> JAMES S. DUESENBERRY. If inventory decumulation is to continue at a rate as high as $3 billion per year some further cuts in production must take place. But personal disposable income declines much less than production because profits and taxes fall while transfer payments rise as production declines.
>
> Moreover, consumers will not reduce consumption as fast as their income falls. When dealing with changes which are after all very small percentages of income, any forecast is hazardous. But if increased Government orders balance off reductions in plant and equipment expenditure, the inventory decline should not carry income down by more than say another 5 billions. In those circumstances the rate of inventory reduction should decline by about the middle of the year or—if the outlook for defense expenditures appears favorable—even sooner. (Hearings, p. 125.)

MARTIN R. GAINSBRUGH. What we are witnessing today, therefore, is the opening stage of a capital-goods cycle rather than an inventory recession of the type we have experienced ever since the end of World War II. This time the inventory cycle was induced by the impending decline in capital goods rather than being the cause of the decline. (Hearings, p. 135.)

(11) In the "A" budget for 1958 personal savings are assumed to be 5.5 percent of disposable personal income compared to 6.7 percent for the year 1957. Neither the Economic Report nor Dr. Saulnier's testimony is explicit about the rate of savings in 1958. However, the above assumed fall in the savings rate seems consistent with other assumptions underlying the President's Economic Report and budget.

In the "B" budget for 1958 personal savings are assumed to be about 5.7 percent of disposable personal income.

Professor Duesenberry, recognized authority on the relationship of consumer savings to incomes, stated in the hearings:

> I think there is not as much difference as there appears to be. When income is falling I think you will find that consumers do reduce their consumption by less than the decline in income. I think it is also true that they won't finance consumption by reducing savings to as great an extent in this situation as they did in, say, 1953–54, when their general financial position was better.
>
> In other words, you always have some tendency for savings to decline on declining income. And they decline not only absolutely but as a proportion of income. But I think that tendency will not be as strong this time as it has been sometimes in the past. (Hearings, p. 159.)

(12) A continued decline in net foreign investment seems to be expected by almost all analysts. The Economic Report, for example, says:

> Foreign demand, on the other hand, is likely to exert a moderately contractive influence on economic activity for the time being. The reasons for this are discussed in chapter 3. They include the passing of the special circumstances which accounted for part of the sharp increase in United States exports in 1956 and early 1957, some slowing down in economic expansion abroad, and pressure on the foreign exchange positions of certain nations abroad. While a reduction in some categories of United States import demand is also evident, exports seem likely to decline relative to imports. This development, in conjunction with other international economic transactions, would involve a further, though probably modest, reduction in net foreign investment and hence in the stimulus provided to production and employment from this quarter. (Economic Report, p. 50.)

(13) The "B" estimates for 1958 in the text and in tables 1 and 2 were derived by the staff almost entirely from testimony during the hearings supplemented by other sources where necessary to fill out a complete and consistent set of estimates. They constitute an

internally consistent quantitative summary of the outlook materials in the hearings—especially of the views of the non-Government experts. They are not forecasts by the committee staff of expected trends in 1958. Indeed, such a staff forecast is impossible at present since it would require a forecast of policy decisions yet to be made by the committee itself, by Congress, and by the executive branch.

(14) For derivation, see table 2, p. 27.

(15) Capital consumption allowances were estimated by extending the trend of recent years.

(16) Includes Government transfer payments, net interest paid by Government and subsidies minus current surplus of Government enterprises.

(17) Government receipts in the "B" projections for 1958 are modifications of those in the "A" estimates derived from the President's Budget as shown in note 7 above. Adjustments were made for lower receipts resulting from the lower levels of incomes and corporate profits implicit in the "B" projections.

(18) The corporate profits assumption for 1957 and 1958 underlying the President's Economic Report and Budget were stated by Treasury Secretary Anderson as follows:

> Corporate profits were assumed to be $42 billion in each of the 2 years. (Hearings, p. 416.)

(19) For the "B" projections corporate profits before taxes were assumed to be $36 billion compared to $42 billion assumed by the Treasury (see note 18). The lower level reflects a rough estimate of the effect of lower levels of total sales in these "B" estimates.

(20) In the "B" estimates, Government transfer payments were increased to be consistent with the larger payments to the unemployed implied by the lower output.

(21) Assumption underlying the President's Economic Report and Budget as stated in the hearings by Secretary of the Treasury Anderson:

> Personal income was assumed to be $343 billion in the calendar year 1957 and $352 billion in the calendar year 1958. (Hearings, p. 416.)

(22) Assumes continuation of present tax rates (1959 Budget, p. M10):

> * * * If the Congress follows my recommendations, I believe that we shall be able to do what is required for our defense efforts and meet the basic needs of our domestic programs without an increase in tax rates. To maintain present rates, I recommend that tax rates on corporation income and certain excises, which under existing law are scheduled for reduction next July 1, be extended for another year.

(23) Dividends were assumed to be about 59.2 percent of profits after tax compared to 60.5 percent in 1957.

(24) Dividends were assumed to be about 55.6 percent of profits after tax compared to 59.2 percent in the "A" estimates and to 60.5 percent in 1957. The lower percentage reflects assumed effect of lower earnings on corporate dividend policy.

(25) The potentials are consistent with projections of long-run trends published in Potential Economic Growth of the United States

During the Next Decade (Materials Prepared for the Joint Economic Committee by the Committee Staff), joint committee print, 83d Cong., 2d sess. The word "potential," therefore, refers to average long-run trends of past years exclusive of those marked by war or severe recession. The estimates given in table 3 are consistent with the original estimates made in 1954, but incorporate adjustments for revisions in data and are stated in 1947 prices rather than 1953 prices.

(26) It is assumed that the potential labor force will increase about 900,000 from the 1957 potential to the 1958 potential. The potential labor force data are trend estimates which, through 1955, assume the 1920–50 trends in age-sex labor force participation rates with an adjustment in the rate for adult women based on accelerated increases observed in the postwar years 1947–50. After 1955, the trend assumes continuation of 1947–55 trends in age-sex labor force participation rates.

(27) The estimates of potential Government employment, civilian and military, are based on long-term trends which smooth out year-to-year fluctuations. For the Armed Forces, the potential assumes 3 million each year; less than the strength prevailing when the study was made originally in 1954 but more than the 1956 size of about 2.9 million. For civilian government employment the trend increases about 100,000 per year to take care of the long-term growth, principally at the State and local level, in such occupations as schoolteaching, police, fire, etc., where employment is related to population growth.

(28) Unemployment is assumed to average about 4 percent of the civilian labor force each year. These assumed unemployed persons would be largely new entrants into the labor force; the frictionally unemployed (i. e., those in process of changing jobs) and those shifting to new industries or occupations because of technological advances. The use of this assumption does not imply that the committee staff necessarily believes that this level of unemployment is "the level" consistent with the goals of the Employment Act. Such a determination is beyond the scope of staff responsibilities. However, such data as are available suggest that unemployment in years not marked by war or severe recession has averaged close to 4 percent of the civilian labor force.

(29) Labor data in table 3 correspond to the old definitions in use by the Bureau of the Census up to January 1957 and which were used in the original 1954 staff study of potential output.

(30) Estimates of civilian government employment were taken from the estimates of the National Income Division, Office of Business Economics, Department of Commerce, in order to be consistent with their estimates of Government gross product. The figures include all Federal, State, and local civilian employees except employees in government commercial-type enterprises.

(31) It is assumed that average annual hours of work will decline slightly less than 1 percent per year over the decade ending in 1965. See Potential Economic Growth of the United States During the Next Decade, pp. 6–7.

(32) Output per man-hour is assumed to increase about 3 percent per year in agriculture and about 2.5 percent in private nonagricultural industries. These are rates of change which correspond to the long-

term trend assumed for the current decade. They are above the average rates over the past century but are moderately below the rates of the past decade. Actual changes in any particular year-to-year comparison may be somewhat greater or smaller, depending upon a variety of factors reflecting the way in which our flexible economy adapts itself to changing demands. In the case of agriculture, particularly, the change for any individual year may differ from the assumed 3 percent because of temporary departures of growing conditions from average or Government restrictions on crop acreage. Studies by the Bureau of Labor Statistics on trends in output per man-hour in manufacturing appear to be roughly consistent with the estimates of output per man-hour in private nonagricultural industries developed in committee-staff studies. See report of the Bureau of Labor Statistics in Hearings on Automation and Technological Change before the Subcommittee on Economic Stabilization of the Joint Economic Committee, 84th Congress, 1st session, pages 301–334. Also, see appendix E to the 1958 Economic Report, pages 107–110, and testimony of Ewan Clague (Hearings, pp. 37, 64–68).

(33) "Potential" agricultural gross national product differs from, and is generally lower than, the actual in each of these years because of (*a*) year-to-year fluctuations in yields due to weather and other growing conditions; and (*b*) the "potential" reflects long-term trends roughly consistent with a balance between agricultural output and demand, while in recent years actual agricultural output has exceeded demand.

(34) Government gross product represents compensation of general Government employees—civilian and military. The potential is based on the assumed trends in Government employment specified in footnote 27 above.

PUBLICATIONS OF THE JOINT ECONOMIC COMMITTEE[1]

January 1947–March 1958

**Declaring a National Policy on Employment, Production, and Purchasing Power* (Report of the Joint Committee on the Economic Report), Senate Report No. 11: January 1947.

Food Prices, Production, and Consumption (Report of the Joint Committee on the Economic Report), Senate Document 113: April 1957.

*Hearings on Current Price Developments and the Problem of Economic Stabilization (June 24, 25, 26, July 2, 8, 9, 10, 14, 15, 16, and 17, 1947): July 1947.

**Interim Report on the President's Program To Deal with the Problems of Inflation* (Report of the Joint Committee on the Economic Report), Senate Report 809: December 1947.

*Hearings on Anti-inflation Program as Recommended in the President's Message of November 17, 1947 (November 21, 24, 25, 26, 28, December 2, 3, 4, 5, and 10, 1947): December 1947.

**Allocation and Inventory Control of Grain for the Production of Ethyl Alcohol* (Report of the Joint Committee on the Economic Report), Senate Report 888: February 1948.

*Hearings on Allocation of Grain for Production of Ethyl Alcohol (February 5 and 6, 1948): February 1948.

**High Prices of Consumer Goods* (Report of the Joint Committee on the Economic Report), Senate Report 1565: June 1948.

Hearings on Increases in Steel Prices (March 2, 1948).

**Joint Economic Report* (Report of the Joint Committee on the Economic Report on the January 1948 Economic Report of the President), Senate Report 1358: May 1948.

*Hearings on Credit Policies (April 13 and 16, May 12, 13, 27, 1948): July 1948.

**Statistical Gaps, Current Gaps in Our Statistical Knowledge* (materials assembled by the staff of the Joint Committee on the Economic Report), committee print: July 1948.

Consumers' Price Index (materials assembled by the staff of the Joint Committee on the Economic Report), committee print: December 1948.

*Hearings on Profits (December 6, 7, 8, 9, 10, 15, 16, 17, 20, 21, 1948): December 1948.

Profits (Report of a Subcommittee of the Joint Committee on the Economic Report on Profits Hearings), committee print: February 1949.

Hearings, January 1949 Economic Report of the President (February 8, 9, 10, 11, 14, 15, 16, 17, 18, 1949): March 1949.

[1] Single copies of the publications listed may be obtained from the Joint Economic Committee except as otherwise noted. Additional copies of committee publications may be purchased from the Superintendent of Documents, Washington 25, D. C., at the price given. The prices shown are for single copies. There is a discount for quantity orders. Out-of-print publications are denoted by an asterisk. Publications available *only* from Superintendent of Documents are denoted by a dagger (†).

Joint Economic Report (Report of the Joint Committee on the Economic Report on the January 1949 Economic Report of the President), Senate Report 88: March 1949.

Joint Economic Report (minority views of the Joint Committee on the Economic Report on the January 1949 Economic Report of the President), part II of Report 88: April 1949.

Employment and Unemployment (initial report of the Subcommittee on Unemployment), committee print: July 1949.

**Economy of the South* (the impact of Federal policies on the economy of the South), committee print: July 1949.

Factors Affecting the Volume and Stability of Private Investment (materials on the investment problem assembled by the staff of the Subcommittee on Investment) Senate Document 232 (sale price, 60 cents): September 1950; reprinted from committee print of October 1949.

*Hearings, Subcommittee on Monetary Credit, and Fiscal Policies, Federal Expenditure and Revenue Policies, September 23, 1949 (containing National Planning Association reports prepared by Conference of University Economists): October 1949.

**Selected Government Programs Which Aid the Unemployed and Low-Income Families* (materials assembled by the staffs of the Subcommittee on Unemployment and the Subcommittee on Low-Income Families), committee print: November 1949.

Low-Income Families and Economic Stability (materials on the problem of low-income families assembled by the staff of the Subcommittee on Low-Income Families), Senate Document 231 (sale price, 35 cents): September 1950; reprinted from committee print of November 1949.

Compendium of Materials on Monetary, Credit, and Fiscal Policies (a collection of statements submitted to the Subcommittee on Monetary, Credit, and Fiscal Policies by Government officials, bankers, economists, and others), Senate Document 132 (sale price, $1): January 1950; reprinted from committee print of November 1949.

Hearings, Subcommittee on Investment, Volume and Stability of Private Investment, Part 1 (September 27, 28, 29, 1949): November 1949.

Basic Data Relating to Steel Prices (materials assembled by the staff of the Joint Committee on the Economic Report for use in steel hearings), committee print: January 1950.

Highways and the Nation's Economy (materials assembled by the staff of the Joint Committee on the Economic Report), Senate Document 145 (sale price, 20 cents): January 1950.

*Hearings, Subcommittee on Monetary, Credit, and Fiscal Policies, Monetary, Credit, and Fiscal Policies (September 23, November 16, 17, 18, 22, 23, and December 1, 2, 3, 5, 7, 1949): January 1950.

**Monetary, Credit, and Fiscal Policies* (Report of the Subcommittee on Monetary, Credit, and Fiscal Policies), Senate Document 129 (sale price, 15 cents): January 1950.

**Employment and Unemployment* (Report of the Subcommittee on Unemployment), Senate Document 140 (sale price, 30 cents): February 1950.

*Hearings, Subcommittee on Investment, Volume and Stability of Private Investment, Part 2 (December 6, 7, 8, 9, 12, 13, 14, 15, 17, 1949): February 1950.

Hearings, Subcommittee on Low-Income Families, Low-Income Families (December 12, 13, 14, 15, 16, 17, 19, 20, 21, 22): March 1950.

*Hearings, January 1950 Economic Report of the President (January 17, 18, 19, 20): February 1950.

Hearings, December 1949 Steel Price Increases (January 24, 25, 26, 27): March 1950.

**Low-Income Families and Economic Stability* (final report of the Subcommittee on Low-Income Families), Senate Document 146 (sale price, 15 cents): March 1950.

Volume and Stability of Private Investment (final report of the Subcommittee on Investment), Senate Document 149 (sale price, 15 cents): March 1950.

December 1949 Steel Price Increases (Report of the Joint Committee on the Economic Report), Senate Report 1373 (sale price 20 cents): March 1950.

Handbook of Regional Statistics (material assembled by the staff of the Joint Committee on the Economic Report), committee print (sale price $1): April 1950.

Joint Economic Report (Report of the Joint Committee on the Economic Report on the January 1950 Economic Report of the President), Senate Report 1843 (sale price 35 cents): June 1950.

General Credit Control, Debt Management, and Economic Mobilization (materials prepared by the staff of the Joint Committee on the Economic Report), committee print (sale price 25 cents): January 1951.

Underemployment of Rural Families (materials prepared by the staff of the Joint Committee on the Economic Report), committee print (sale price 20 cents): February 1951.

**The Economic and Political Hazards of an Inflationary Defense Economy* (materials prepared by the staff of the Joint Committee on the Economic Report), committee print (sale price 30 cents): February 1951.

Hearings, January 1951 Economic Report of the President (January 22, 24, 25, 26, 29, 31, February 2): March 1951.

Joint Economic Report (Report of the Joint Committee on the Economic Report on the January 1951 Economic Report of the President), Senate Report 210 (sale price 30 cents): April 2, 1951.

Making Ends Meet on Less Than $2,000 a Year, Case Studies of 100 Low-income Families (communication to the Joint Committee on the Economic Report from the Conference Group of Nine National Voluntary Organizations Convened by the National Social Welfare Assembly), committee print (sale price 35 cents): July 1951.

Prevalence of Price Cutting of Merchandise Marketed Under Price-Maintenance Agreements, May 28 through June 25, 1951 (study prepared for the Joint Committee on the Economic Report and the Select Committee on Small Business), committee print: July 1951.

The Need for Industrial Dispersal (materials prepared for the Joint Committee on the Economic Report by the committee staff), Senate Document 55 (sale price 30 cents): August 1951.

**National Defense and the Economic Outlook* (materials prepared for the Joint Committee on the Economic Report by the committee staff), committee print: August 1951.

Inflation Still a Danger (report of the Joint Committee on the Economic Report together with materials on national defense and the economic outlook included in committee print mentioned above), Senate Report 644 (sale price 15 cents): August 1951.

**Questions on General Credit Control and Debt Management* (prepared by staff of the Subcommittee on General Credit Control and Debt Management of the Joint Committee on the Economic Report), committee print (sale price 15 cents): October 1951.

Monetary Policy and the Management of the Public Debt. Their Role in Achieving Price Stability and High-Level Employment (replies to questions and other material for the use of the Subcommittee on General Credit Control and Debt Management) (sale price: Part I, $1.75; Part II, $2.50): February 1952.

Hearings, January 1952 Economic Report of the President (January 23, 24, 25, 26, 28, 30, 31, February 1) (sale price $1.25): February 1952.

Constitutional Limitation on Federal Income, Estate, and Gift Tax Rates (materials assembled for the Joint Committee on the Economic Report and the Select Committee on Small Business of the House of Representatives), committee print (sale price 15 cents): February 1952.

Joint Economic Report (Report of the Joint Committee on the Economic Report on the January 1952 Economic Report of the President together with National Defense and the Economic Outlook for the Fiscal Year 1953, materials prepared for the Joint Committee on the Economic Report by the Committee staff), Senate Report No. 1295 (sale price, 35 cents): March 1952.

The Taxation of Corporate Surplus Accumulations, The Application and Effect, Real and Feared, of Section 102 of the Internal Revenue Code dealing with Unreasonable Accumulation of Corporate Profits (study prepared for the Joint Committee on the Economic Report by Dr. J. K. Hall), committee print (sale price 55 cents): May 1952.

*Hearings, Subcommittee on General Credit Control and Debt Management, Monetary Policy and the Management of the Public Debt (March 10, 11, 12, 13, 14, 17, 18, 19, 20, 21, 24, 25, 26, 27, 28, and 31, 1952) (sale price $2.25): May 1952.

Monetary Policy and the Management of the Public Debt (Report of the Subcommittee on General Credit Control and Debt Management) Senate Document No. 163 (sale price 25 cents): July 1952.

Federal Tax Changes and Estimated Revenue Losses under Present Law (Materials prepared for the Joint Committee on the Economic Report by the Committee Staff), committee print: November 1952.

Sustaining Economic Forces Ahead (Materials prepared for the Joint Committee on the Economic Report by the Committee Staff), committee print (sale price 20 cents): December 1952.

†*Pensions in the United States* (A Study prepared for the Joint Committee on the Economic Report by the National Planning Association), committee print (sale price 30 cents): December 1952.

Index of Joint Economic Publications: January 1947 through December 1952. Committee print (sale price 55 cents): January 1953.

**Historical and Descriptive Supplement to Economic Indicators* (sale price 30 cents): December 1953.

Hearings, January 1954 Economic Report of the President (February 1, 2, 3, 4, 5, 8, 9, 10, 11, 15, 16, 17, 18) (sale price: $3.00): March 1954.

**Joint Economic Report* (Report of the Joint Committee on the Economic Report on the 1954 Economic Report of the President), House Report No. 1256 (sale price 30 cents): February 1954.

Hearings, Subcommittee on Economic Statistics, Economic Statistics (July 12 and 13, 1954) (sale price $1.50): August 1954.

Economic Statistics (Progress Report prepared by the Subcommittee on Economic Statistics). House Report No. 2628: August 1954.

Congressional Action on Major Economic Recommendations of the President, 1954 (Materials prepared by the Joint Committee on the Economic Report by the Committee Staff), committee print: September 1954.

†*Potential Economic Growth of the United States During the Next Decade* (Materials prepared for the Joint Committee on the Economic Report by the Committee Staff), committee print (sale price 15 cents): October 1954.

*Hearings, Subcommittee on Economic Stabilization, United States Monetary Policy: Recent Thinking and Experience (December 6 and 7, 1954) (sale price $1.25): December 1954.

†*Trends in Economic Growth, A Comparison of the Western Powers and the Soviet Bloc* (Materials prepared for the Joint Committee on the Economic Report by the Legislative Reference Service of the Library of Congress), committee print (sale price $1): January 1955.

†Hearings, January 1955 Economic Report of the President (January 24, 26, 27, 28, 31, February 1, 2, 3, 8, 9, 10, and 16, 1955) (sale price $3.50): February 1955.

Joint Economic Report (Report of the Joint Committee on the Economic Report on the 1955 Economic Report of the President), Senate Report No. 60 (sale price 30 cents): March 1955.

Historical and Descriptive Supplement to Economic Indicators (sale price 40 cents): November 1955.

*Hearings, Subcommittee on Economic Stabilization, Automation and Technological Change (October 14, 15, 17, 18, 24, 25, 26, 27, and 28, 1955) (sale price $2.00): November 1955.

Automation and Technological Change (Report of the Subcommittee on Economic Stabilization) committee print, November 1955 (sale price 10 cents): became Senate Report No. 1308, January 1956.

Hearings, Subcommittee on Economic Statistics, Reports of Federal Reserve Consultant Committees on Economic Statistics (July 19 and 26, October 4 and 5, 1955) (sale price $2.25): November 1955.

Hearings, Subcommittee on Economic Statistics, Employment and Unemployment Statistics (November 7 and 8, 1955) (sale price 45 cents): November 1955.

1955 Report on Economic Statistics (Report of the Subcommittee on Economic Statistics) committee print, November 1955 (sale price 15 cents): became Senate Report No. 1309, January 1956.

**Federal Tax Policy for Economic Growth and Stability* (Papers submitted by panelists appearing before the Subcommittee on Tax Policy), committee print (sale price $2.50): November 1955.

†Hearings, Subcommittee on Tax Policy, Federal Tax Policy for Economic Growth and Stability (December 5, 6, 7, 8, 9, 12, 13, 14, 15, and 16, 1955) (sale price $2.00): January 1956.

Federal Tax Policy for Economic Growth and Stability (Report of the Subcommittee on Tax Policy) committee print, December 1955 (sale price 10 cents): became Senate Report No. 1310, January 1956.

†*The Federal Revenue System: Facts and Problems* (Materials assembled for the Subcommittee on Tax Policy by the Committee Staff), committee print (sale price 55 cents): January 1956.

†*Characteristics of the Low-Income Population and Related Programs* (Materials prepared by the staff of the Subcommittee on Low-Income Families), committee print (sale price 60 cents): October 1955.

Hearings, Subcommittee on Low-Income Families, Low-Income Families (November 18, 19, 21, 22, and 23, 1955) (sale price $2.00): December 1955.

A Program for the Low-Income Population at Substandard Levels of Living (Report of the Subcommittee on Low-Income Families), committee print, December 1955 (sale price 10 cents): became Senate Report No. 1311, January 1956.

Hearings, Subcommittee on Foreign Economic Policy, Foreign Economic Policy (November 9, 10, 14, 15, 16, 17, 1955) (sale price $1.75): December 1955.

Foreign Economic Policy (Report of the Subcommittee on Foreign Economic Policy), committee print, December 1955 (sale price 15 cents): became Senate Report No. 1312, January 1956.

Hearings, January 1956 Economic Report of the President (January 31, February 1, 2, 3, 6, 7, 8, 9, 14, 15, 17, and 28, 1956) (sale price $2.00): March 1956.

†*Joint Economic Report* (Report of the Joint Committee on the Economic Report on the 1956 Economic Report of the President): Senate Report No. 1606 (sale price 35 cents): March 1956.

Hearings, Subcommittee on Economic Stabilization, Conflicting Official Views on Monetary Policy: April 1956 (June 12, 1956) (sale price 20 cents): June 1956.

Hearings, Subcommittee on Foreign Economic Policy, Defense Essentiality and Foreign Economic Policy (June 4, 5, 6, and 7, 1956) (sale price $1.50): July 1956.

Defense Essentiality and Foreign Economic Policy, Case Study: Watch Industry and Precision Skills (Report of the Subcommittee on Foreign Economic Policy), Senate Report No. 2629, Parts I and II (sale price 15 cents with Part II): July 1956.

Hearings, Subcommittee on Economic Stabilization, Monetary Policy: 1955–56 (December 10 and 11, 1956) (sale price 45 cents): January 1957.

Hearings, Subcommittee on Foreign Economic Policy, World Economic Growth and Competition (December 10, 12, and 13, 1956) (sale price 45 cents): February 1957.

†Hearings, Subcommittee on Economic Stabilization, Instrumentation and Automation (December 12, 13, and 14, 1956) (sale price 75 cents): February 1957.

Employment Act of 1946, as Amended, and Related Laws, and Rules of the Joint Economic Committee (prepared by staff of the Joint Economic Committee) committee print: January 1957.

†Hearings, January 1957 Economic Report of the President (January 28, 29, 30, 31, February 1, 4, 5, 6) (sales price $2.25): February 1957.

**Joint Economic Report* (Report of the Joint Economic Committee on the 1957 Economic Report of the President): H. Rept. No. 175 (sale price 25 cents): February 1957.

Fiscal Policy Implications of the Economic Outlook and Budget Developments (Report of the Subcommittee on Fiscal Policy), House Report No. 647 (sale price 10 cents): June 1957.

Hearings, Subcommittee on Fiscal Policy, Fiscal Policy Implications of the Economic Outlook (June 3, 4, 5, 6, 7, 13, and 14, 1957) (sale price $1.00): June 1957.

†*Productivity, Prices, and Incomes* (Materials prepared for the Joint Economic Committee by the Committee Staff), committee print (sale price 70 cents): June 1957.

Soviet Economic Growth: A Comparison with the United States (A study prepared for the Subcommittee on Foreign Economic Policy of the Joint Economic Committee by the Legislative Reference Service of the Library of Congress), committee print (sale price 40 cents): September 1957.

1957 Historical and Descriptive Supplement to Economic Indicators (Prepared for the Joint Economic Committee by the Committee Staff and the Office of Statistical Standards, Bureau of the Budget), committee print (sale price 40 cents): September 1957.

†*Federal Expenditure Policy for Economic Growth and Stability* (Papers submitted by panelists appearing before the Subcommittee on Fiscal Policy), committee print (sale price $3.25): November 1957.

Hearings, Subcommittee on Fiscal Policy, Federal Expenditure Policy for Economic Growth and Stability (November 18–27, 1957) (sale price $2.00): January 1958.

Federal Expenditure Policies for Economic Growth and Stability (Report of the Subcommittee on Fiscal Policy), committee print (sale price 10 cents): January 1958.

†*Policy for Commercial Agriculture: Its Relation to Economic Growth and Stability* (Papers submitted by panelists appearing before the Subcommittee on Agricultural Policy), committee print (sale price $2.25): November 1957.

Hearings, Subcommittee on Agricultural Policy, Policy for Commercial Agriculture: Its Relation to Economic Growth and Stability (December 16–20, 1957) (sale price $1.00): January 1958.

Policy for Commercial Agriculture: Its Relation to Economic Growth and Stability (Report of the Subcommittee on Agricultural Policy), committee print (sale price 15 cents): February 1958.

†Hearings, Subcommittee on Economic Statistics, The National Economic Accounts of the United States (October 29 and 30, 1957) (sale price 75 cents): December 1957.

Hearings, Subcommittee on Economic Stabilization, Automation and Recent Trends (November 14 and 15, 1957) (sale price 30 cents): December 1957.

Automation and Technological Change (Reprint of S. Report 1308 of the Joint Committee on the Economic Report, January 1956) (sale price 10 cents): January 1958.

International Economic Statistics (A Memorandum prepared for the Subcommittee on Economic Statistics of the Joint Economic Committee by the Office of Statistical Standards of the Bureau of the Budget), committee print (sale price 25 cents): February 1958.

Hearings, January 1958 Economic Report of the President (January 27, 28, 29, 30, February 3, 4, 5, 6, 7, and 10) (sale price $1.50): February 1958.

Joint Economic Report (Report of the Joint Economic Committee on the 1958 Report of the President): H. Rept. No. 1409 (sale price 20 cents): February 1958.

Economic Indicators (a monthly publication of the Congress under Public Law 120, 81st Cong., 1st sess.) (sale price 20 cents a copy, $2.00 a year): Issued monthly.

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March 12, 1958

Airmail

R. Rees & Zoonen
Rotterdam
Netherlands

Gentlemen:

Thank you for sending me a copy of your "Economisch-Statistische Berichten," in which is reprinted the statement I presented on February 6 before the Joint Economic Committee on recent problems of Federal Reserve policy.

This is a public document and, accordingly, I am returning herewith the check made out to me for $13.17. I am gratified that you thought it worth while to reproduce this statement, and I appreciate your thoughtfulness in mailing a check, but you are welcome at any time to print such public documents without remuneration.

Very truly yours,

Wm. McC. Martin, Jr.

Enclosure

ET:nbk

February 13, 1958.

Dear Mr. Hill:

Thank you for giving me the statement of the Farmers & Merchants Bank.

It was nice of you to attend the hearing and I am glad you thought our testimony was appropriate.

With all good wishes,

Sincerely yours,

Wm. McC. Martin, Jr.

Mr. G. L. Hill,
Executive Vice President,
Farmers & Merchants Bank,
Aberdeen, South Dakota.

For release on delivery

Statement of

William McChesney Martin, Jr.,

Chairman, Board of Governors of the Federal Reserve System

before the

Joint Economic Committee

February 6, 1958

As always, Mr. Chairman, the Board of Governors welcomes these discussions with your Committee.

Only five years ago, we were exploring the role of credit and monetary policy in some detail and at some length with a subcommittee of this Committee charged with making an inquiry into "Monetary Policy and the Management of the Public Debt: Their Role in Achieving Price Stability and High Level Employment." You will recall that one of the issues was the potential contribution of flexible monetary policy in fostering balanced and orderly economic growth. In our presentation, we emphasized that flexible monetary policy could make a positive contribution to stable economic growth, indeed was indispensable to it, though it could not do the whole job. Although monetary policy was only one of the instruments available to Government policy to help carry out the objectives of the Employment Act of 1946, it needed to be used if we were to have tolerable success in meeting those objectives.

In administering our responsibilities since that inquiry we have endeavored at all times to adjust our policies affirmatively and promptly to the changing economic situation. We have consistently acted to encourage such credit and monetary expansion as would be needed by a growing economy without inflation. We have resisted inflationary pressures by credit and monetary restraints whenever such pressures have mounted. We have relaxed restraints and made bank credit more available and eased credit conditions generally whenever inflationary tendencies have abated.

Anti-inflationary policies and anti-deflationary policies are inseparably linked. To achieve maximum success in contributing to stability, Federal Reserve policies, and indeed all types of government, as well as private, actions, must resist excesses on the upside if they are not to complicate the adjustment process on the downside. On the other hand, excessive stimulus during recession can jeopardize long-run stability.

Throughout the period since flexible credit and monetary operations were resumed in early 1951, we have endeavored to shape our policies continuously in accordance with basic economic forces and conditions. The economic situation, to be sure, has been influenced in some degree by our policies, but it has not been created by them. Many other forces are also at work in a dynamic enterprise economy.

This background is relevant to an understanding of more recent developments. A year ago when I testified before your Committee, economic conditions were characterized by strong inflationary pressures. This was exemplified by the substantial rise that was occurring in gross national product measured in current dollars compared with the relatively modest increase that was being experienced in product measured in constant dollars. In spite of the preceding credit and monetary actions that had been taken, money was losing its value at a pace that was a matter of deep concern to all.

Inflationary excesses had clearly gotten ahead of us and the economy stood in danger of an inflation crisis. The adjustment problems that the economy is confronting today are the aftermath of those excesses.

In retrospect, none of us participating in economic decision-making adequately appraised the speed and the force of inflationary boom. Consumer credit rose substantially in 1955. Businesses vastly increased their expenditures for plant and equipment in 1956 and 1957. Bankers and other lenders greatly expanded their commitments to lend. Labor unions sought current wage increases--and commitments for future increases--that pressed against or exceeded gains in productivity. nevertheless However, inflationary trends seem to have halted before creating maladjustments of such severity as to lead to a protracted period of liquidation and structural realignment in the economy.

Inflationary trends continued through the summer months of last year. There was an alarming spread of the belief, not only in this country but also abroad, that creeping inflation under modern economic conditions was to be a chronic and unavoidable condition. Reflecting this view, common stocks, the most popular hedge against inflation, rose sharply in price in July to a level where for the first time in two decades their yields fell below the yields on high-grade bonds. Furthermore Also, credit demands generally continued to show great strength, and interest rates were rising. Large city banks on August 7 raised their lending rate to prime business borrowers from 4 to 4-1/2 per cent. In this situation, Federal Reserve Bank discount rates, which were below market rates by a widening margin, were raised from 3 to 3-1/2 per cent, thus increasing member bank costs of operating on the basis of borrowed reserves.

In late summer and early autumn, however, developing uncertainties here and abroad began to affect the short-term economic outlook. In European exchange markets, widespread expectations of changes in exchange rates fostered large speculative movements of funds between European centers. These expectations in part reflected further accentuation of inflationary developments in some key countries, despite actions to tighten credit that were taken in various countries during the summer. It was not until late September, after the Bank of England established a 7 per cent discount rate, that it became clear that key foreign currency values would be maintained and that inflation would be strongly resisted.

In this country, the unexpected curtailment in defense payments and changes in procurement policies that were inaugurated during the summer, to avoid breaking through the debt ceiling, had an unsettling effect on business. In September, retail trade, which had been at record levels in July and August, began to show signs of sluggishness and this continued. Partly as a result of all of these developments, common stock prices, which had already begun to react from their extremely low yield relationships to bonds reached in July, broke further and passed in late September through the lower edge of the trading range that had prevailed during the past two years. With changing attitudes toward the economic outlook, adjustments that had been occurring for some months in various lines of activity, including some capital goods lines, came to be reappraised by businessmen, investors, and the public generally. In contrast to earlier indications of strong credit demands, bank loans to business during early autumn decreased contrary to usual seasonal tendencies.

The pace of business was maintained for a time despite these uncertainties, with employment and industrial output continuing at relatively high levels in August and September. By late October, the composite of most recent economic information suggested that inflationary pressures might be abating, and open market operations were modified to lessen restraint on bank credit and monetary expansion. By mid-November, information becoming available, incomplete though it was, indicated that general downward adjustment was setting in. In response to this evident change in basic economic conditions, Federal Reserve Bank discount rates were reduced from 3-1/2 to 3 per cent.

Since that time, other successive System actions were taken in accordance with information increasingly indicative of the emergence of recessionary trends. Thus, monetary policy contributed to a marked easing in the credit and capital markets. This is illustrated most dramatically by the very sharp drop in market rates of interest, the sharpest drop for any comparable period of which I have knowledge. This adjustment in credit and capital markets is helping to facilitate and cushion other adjustments in the economy as well as to strengthen demands in important areas dependent on credit financing. It is thus helping to set the stage for recovery in activity and employment as soon as other developments contribute to revival.

History shows that our market economy has cyclical characteristics, and the consequences of this irregularity in terms of hardship and unemployment are a matter of deep concern to everyone. When downward readjustment becomes unavoidable, it is incumbent on business enterprises, financial institutions, and labor organizations, as well as Government generally, to adjust policies and programs to foster recovery. We have been concerned, for example, at the decline in output and employment while prices generally have been maintained and some prices even have risen further. How soon recession is checked and recovery is resumed will depend in some part at least on the speed with which economic corrections and adaptations are made in factors beyond the province of monetary policy, that is to say, in business pricing, other selling practices and efficiency, in wage bargaining, in various financing arrangements, and in the incentives to consumers to buy.

These general remarks are by way of introduction, for you have requested in advance that I address myself today to four major questions. The balance of this statement is concerned with answers to these questions, but I have rearranged the order in which I will take them up.

1. "What is the current policy of the monetary authorities?"

In recent months, the Federal Reserve System has operated to make bank and other credit more available and cheaper.

Over this period, open market and discount policies were used in a complementary fashion. Open market operations provided sufficient reserves to permit member banks not only to repay a substantial portion of their indebtedness to the Reserve Banks, but also to accumulate some addition to reserves available for bank credit expansion. Discount rates were lowered on two occasions, mid-November and mid-January, from 3-1/2 to 2-3/4 per cent. These reductions in discount rates assured member banks that, if loan operations should require temporary borrowing of Federal Reserve credit for reserve purposes, its cost would be cheaper.

As a result of these developments, bank credit, capital market credit, and mortgage credit, have become more readily available to borrowers who have delayed or postponed financing as well as to borrowers seeking to finance new projects. Furthermore, the cost of credit has been reduced as a result both of lower rates of interest and more favorable terms of borrowing. These conditions are favorable to monetary expansion.

At the end of 1957, total customer credit for purchasing and carrying securities was 10 per cent less than the amount outstanding at midyear and back to the level of early 1955. Thus, the need for preventing an excessive expansion of stock market credit through the higher level of margin requirements had abated. The Board of Governors in mid-January reduced margin requirments for purchasing or carrying listed securities from 70 to 50 per cent.

2. "What would you regard as the proper division of labor between tax policy and monetary policy as instruments of economic stabilization during the coming year?"

From the standpoint of economic stabilization, tax policy needs to be reviewed in relation to expenditure requirements. Therefore, it is appropriate to consider monetary actions in the perspective of general fiscal policy rather than just tax policy.

The combination of fiscal and monetary policies that are appropriate at any particular time depends upon the circumstances prevailing and upon the feasibility of action in one field or the other. These policies are most effective in achieving their purposes when utilized in a complementary fashion. Yet, to an extent, each can be used in varying degrees independently of the other.

Fiscal policy is less flexible than monetary policy. Nevertheless, the so-called built-in stabilizers in the Federal Budget do come into operation promptly. As personal income and corporate profits decline, tax collections relatively decline more sharply. At the same time, unemployment insurance payments increase. These features of the budget and fiscal system are already operating to cushion the reduction in private incomes and expenditures.

Whether further action is desirable in either or both of these fields depends on the unfolding economic and financial picture. As of the present, the division of labor between monetary and fiscal policy is about as follows. Through the automatic stabilizers, fiscal operations have provided some offset to the decline in incomes and expenditures. Monetary policy has actively increased the availability and lowered the cost of credit, thereby encouraging loan-financed expenditures, raising capital values, and enhancing liquidity throughout the economy.

3. "What, if any, elements exist in the current situation which suggest or might permit a resurgence of inflationary forces in the next 12 or 15 months?"

In retrospect, it is now clear that economic activity in the United States reached a peak in the third quarter of 1957 and that it has been receding since then. Thus far, the downward movement has been reminiscent in many ways of the declines that occurred in 1948-49 and in 1953-54. The early stages of all three postwar cyclical contractions have been marked by rather rapid declines in output and employment in industrial sectors. It may be remembered that the two preceding contractions were moderate and short-lived.

Resurgence of inflationary forces in the next 12 or 15 months is contingent on general revival of demands, output, and employment; on the vigor of such a revival; on institutional forces such as wage bargaining, cost plus purchasing practices, and easy credit terms that may foster price advances; on market pressures of demand in relation to supply in particularly strategic areas; and, finally, on the nature and timing of governmental actions to deal with the developing economic situation generally or with key sectors of it.

No one can speak with certainty about the future course of economic activity. There is, in fact, a range of views currently held regarding the duration and extent of this recession and of the timing and vigor of the ensuing recovery. In my own view, the underlying strengths of the economy are many. After not too long a period of readjustment and realignment of activities, healthy revival should set in, progressing to new records of economic performance and new high levels of national well being. But everything depends upon the speed with whcih needed readjustments and realignments of activities are made.

We are all, of course, well aware that reasoning by analogy may be misleading and that history does not repeat itself. In the two preceding postwar recessions, lows in activity were reached in less than a year from the cyclical peak and recovery to new high levels of output, demands, and employment was rapid and substantial. With the exception of the catastrophic depression of the early 1930's, the downward phase of every cycle since World War I has been over or virtually over in the course of a year.

As in our other postwar recessions, many basic forces are present in the situation favorable to recovery.

(1) For instance, as I have already mentioned, credit and capital market conditions have already responded to relaxed monetary policy and are much easier than they were a few months ago. Important financial adjustments also have already been started. By borrowing from the capital market, business firms have been able to repay bank debt, thus rebuilding the liquidity positions of both financing institutions and business enterprise.

(2) Consumer incentives to achieve still higher standards of living are strong, and research continues to provide new products of wide consumer appeal. As a group, businessmen and consumers continue to have confidence in the long-term growth prospects for our economy.

(3) Population increase has been maintained at a rapid pace--the rise of 1.8 per cent in 1957 compares with a postwar average of 1.7 per cent, and hence the market is expanding steadily.

(4) Consumer incomes have shown some cyclical decline recently, but the decline has been small and moderated by unemployment compensation benefits. Consumer demands are supported by a record volume of financial assets, the ownership of which is widely distributed. Growth in such assets was rapid in 1956 and 1957, while growth in consumer instalment and mortgage debt, though not small, was at a much slower rate than in 1955. The availability and terms of mortgage credit have recently become more favorable to borrowers.

(5) At the State and local government level, community demands for schools and teachers, for roads, public buildings, and other community facilities are continuing large and insistent.

(6) For the Federal Government, postwar budgets have been dominated by the need to cope with critical international stresses and tensions and to provide an adequate defense under conditions of major scientific advance and rapid technological change. National security and related problems continue to be urgent.

(7) Insofar as international economic developments are concerned, Western Europe still shows considerable strength. Industrial activity, while no longer expanding, has generally been maintained at or close to record levels. In general, balance of payments positions have improved although in several countries reserves of gold and foreign exchange are not as large as might be desired. Outside Europe, however, raw materials producing countries are facing difficulties because of declines in prices or volume of their exports.

A primary uncertainty with respect to the timing and pace of economic revival and renewed growth relates to the course of business outlays for new plant and equipment. Some observers view the business capital goods boom of the past three years as having provided a margin of industrial capacity over prospective demands greater than can be absorbed quickly. These observers tend to expect a more protracted period of adjustment than took place in the two preceding cycles.

This concern may turn out to have been well founded, but it may be noted that capacity never appears more excessive than in the midst of recession. Cyclical recovery, in due course, can certainly be expected to be accompanied by effective and profitable use of the economy's capacity to produce and by still further additions to capacity. The important factors working to expand business capital investment in the period ahead should not be minimized. The advance in the technology of production, in part the result of the huge investment in research of recent years, has been rapid and can be expected to continue. Incentives to reduce costs, to meet competition, and to sustain or improve profitability, are strong.

If revival in over-all economic activity becomes vigorous, there will be, of course, the accompanying possibility of resurgence of inflationary pressures. Postwar experience has demonstrated that, in a period of expanding demand, upward pressures on prices and costs can develop quickly. Once under way, inflationary movements tend to spread themselves throughout the economy, not only because of normal market reactions, but also because of a variety of institutional arrangements such as cost-of-living clauses in wage contracts and cost-plus arrangements in business or Government procurement contracts, in part designed to protect one group or another from the ill effects of inflation. Currently, it may be noted, consumer prices reached a new high in November and remained at that high in December, notwithstanding significant declines in activity and employment.

As I said earlier, those charged with responsibility for national economic policies must at all times reckon with the dangers both of inflation and of deflation. The central policy problem, in one sense, is to prevent either inflationary trends or deflationary trends from becoming dominant. Public policies for one objective or another can have effects that go far beyond those that are intended. Both fiscal and monetary policies must be carefully formulated to exert enough pressure but not too much. That is a difficult task.

4. "If the inflationary forces continue to abate during the year, what program would you recommend as to priority and specific actions in the fiscal and monetary fields?"

Everyone hopes that any recession will be moderate and short-lived.

One possibility for the year ahead is that revival may develop without renewed inflation, at least in its early stages. Under such circumstances, the task of monetary policy would be to foster revival and resumed growth, but to be ever alert to the potentials of inflationary pressures and to take prompt action should they recur.

Another possibility is that recession may be deeper and more protracted than many now anticipate, with a greater degree of under-utilization of manpower and industrial resources and with manifest deflationary tendencies. In such an eventuality, further monetary action would need to be considered, both to increase the liquidity of the economy and to encourage expansion of spending financed by credit. Monetary policy by itself, however, cannot assure resumption of high-level employment and sustainable economic growth, although ready availability of credit at reasonable cost is an essential condition for recovery.

This country is now in the process of re-evaluating what share of its potential productive capacity to devote to current consumption and what share to devote to investment in its future--in the form of outlays not only for defense and capital equipment but also for research, education, and foreign assistance. This process of reappraisal will continue for some time and in our thinking we ought not to forget the enormous growth potential that we have over the longer run and the need that we shall have for an adequate volume of savings to finance it.

With respect to fiscal policy, should the present recession appear to justify some action in this field, I should like to emphasize that we should weigh carefully both the need to meet the challenge to our defensive strength and the need to keep our economy strong and progressive.

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TREASURY DEPARTMENT
Washington

Statement by Treasury Secretary
Robert B. Anderson before the
Joint Economic Committee, 10:00 A.M.,
E.S.T., Friday, February 7, 1958.

I am glad to have this opportunity to appear before the Joint Economic Committee. The Economic Report of the President and the deliberations and reports of this Committee and its subcommittees, together with the work of the Council of Economic Advisers, are of great value in developing and maintaining coordinated economic policies which will facilitate, to the greatest extent possible, strong and balanced economic growth in our dynamic economy.

Perhaps the one characteristic of our American economy which has persisted since the beginning of our history has been growth by means of constant change. Fluctuations and dislocations are typical of a dynamic, competitive system in which the energies of free individuals have full scope. We must expect that the momentum of our economy will not be the same in all sectors of activity at the same time. Throughout our economic history there has been constant evolution of both our needs and wants and our means of satisfying them. We have firm grounds for our belief that our Nation possesses the basic ingredients of an economic system which will insure a sound maintainable rate of economic growth.

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At present we are passing through a period which is presenting certain difficulties and problems. This requires our continued and careful evaluation. But we must recognize that the need for appraisal -- for considered judgment and action -- is one of the responsibilities of membership in a free society. One of our great strengths is the dedication of our government and our people to the task of maintaining the basic health of our economy. Neither inflation nor deflation will be allowed to run a ruinous course.

Our judgments last December in arriving at our estimated budgetary receipts for the period 18 months in advance were admittedly difficult. They took into consideration both the current problems of our economy and a confidence in the strength of the underlying forces of our system contributing to growth. A further consideration was the fact that each of our governmental departments and our monetary agencies would continue to conduct their operations so as to contribute renewed vitality to our economy.

Some of the specific factors contributing to our judgments will be discussed later on.

We have not endeavored to judge the movements of our economic system with exact nicety nor to estimate shifts in the economy at precise moments. Rather, our judgments are predicated upon the belief that the restrictive phases of economic fluctuations would not continue for a protracted period.

It seems most important to us that our economic outlook in terms of future growth should be evaluated from the standpoint of long range factors as well as those of a shorter term.

Let us first review some of the forces underlying our belief in long-term progress.

We have a growing, vigorous population. We have a highly competitive, productive economy. Rapid technological advances have created new products and processes. Long range and careful planning is becoming more predominant. All of these forces are generating new demands and new needs. In order to satisfy these and like requirements, we must look to our natural resources, our expanded industrial capacity, our growing skills, our managerial capacity, and other like contributors to our productive machinery.

When we view our long-term situation in perspective, therefore, it is clear that we have on the one side the expanding needs and wants of our growing population and on the other side the capacity and skill for meeting these wants and needs with an expanding volume of output.

Moreover, we have the two further essentials of continued high level activity in a free enterprise economy -- a relatively stable currency and an efficient financial system.

Our financial system is demonstrating an ability to provide short-term and long-term financing necessary for increasing activity and growth. We must continue to exert every effort to achieve stability in the purchasing power of our dollar.

In order to see just where we stand, it is worthwhile examining the elements of our current strength a little more closely.

First of all, what are the expanding needs of the American economy?

To answer that question, we have only to look around us. Our population is growing at the rate of approximately three million a year -- the equivalent of adding a state the size of Kentucky to our consumer population every 12 months. We have constantly increasing demands for new products and materials from American business, as the result of scientific and technological advances taking place in almost every area of activity throughout the economy. We have a constant desire on the part of all of our people to improve their standards of living and to expand the opportunities available to their children.

Turning now to our capacity for meeting these needs -- America has demonstrated that we have in this country an industrial mechanism capable of meeting any reasonable demands that may be made upon it, both military and civilian. The urgencies of World War II unlocked many new productive powers in the American industrial machine. Nevertheless, in the period since the end of World War II, American industry has made an unprecedented investment in plant and equipment. From 1946 through 1957 such investment totaled over $300 billion -- a total outlay equal to United States military expenditures during World War II, 1941-45. And this investment is continuing. Business plans for fixed investment in the calendar year 1958 exceed actual spending in any previous year except 1956 and 1957.

Along with our expanding plant and equipment, our labor force is growing by three-quarters of a million workers a year -- a part of our growth in population. Yet we are constantly making more efficient use of the contribution of American workers to output. Output per man hour in the private nonfarm sector of the economy has been increasing at an average rate of more than 3 percent a year for the postwar period, reflecting again the tremendous expansion of plant and equipment and improved techniques and working conditions. Moreover, agricultural productivity has been increasing even more rapidly than that of industry.

A further -- and very important -- factor in the long-term situation is the willingness of our people and our Government to use the mechanisms at our command so as to employ our economic strength in a way which will help assure sustainable growth.

In the short-term area, a number of favorable factors can be discerned. First of all, part of the readjustment has occurred. Reduction of inventory in some lines and certain adjustments in output and prices have already taken place. Possibly in reflection of this fact, both sensitive industrial material prices and the prices reflected in the all-commodity index of the Bureau of Labor Statistics have recently showed considerable stability.

The level of personal income has held up well. There has been prompt and responsive readjustment in certain stock and bond yield and interest rate relationships, and the stock market has shown some elements of strength during the past month.

Residential housing construction has turned upward slightly, and mortgage money is becoming more readily available. A sustaining influence can be expected from the stepped-up pace of certain federal programs such as highway building, and from a number of state and local projects having to do with community facilities. Increased defense spending and contract placement will also have a stimulating effect on the economy.

Perhaps one of the most important considerations, however -- either long-term or short-term -- is the fact that the confidence of the American people in the basic strength of our economy has remained strong. There is evidence that this confidence is increasing. The American people are recognizing that the period of adjustment we are now going through is in part the consequence of our rapid expansion during the past several years. Our power for growth remains unimpaired, and justifies a belief that we have the elements needed for a continuing healthy economy, capable of expanding and adapting itself to any new demands which it may be called upon to fulfill.

You are familiar with the contents of the Budget Message and its recommendations for a continuation of existing tax rates on corporation income and excises on liquor, tobacco and automobiles for another year.

The economic assumptions underlying our revenue estimates in the 1959 budget, which you requested in your letter of January 20th, are as follows:

> Personal income was assumed to be $343 billion in the calendar year 1957 and $352 billion in the calendar year 1958.
>
> Corporate profits were assumed to be $42 billion in each of the two years.
>
> We do not assume any change in prices from the present.

I should now like to discuss for a moment some of the problems involved in making the basic assumptions which we must make in estimating the Government's income from taxes.

The problem of projecting our revenue receipts, which is a part of the budgetary process, in always difficult. In the months of November and December it becomes necessary, as a part of this operation, to arrive at certain determinations with reference to income tax receipts for a period 18 months in advance.

This task would be much simpler if we could be content with a range of estimates. However, the budget-making process does not permit such a procedure. We are required to use a degree of preciseness which involves a number of specific judgments made with the help of the best evidence and the best experts available.

The difficulties inherent in making precise determinations of future tax income are clearly evident in the historical records. These show that various relationships between tax receipts and major economic indicators which might be expected to be fairly constant over the years do not in fact remain constant. They change considerably from one year to the next. The individual income tax and the corporate tax provide the bulk of our revenues; and personal income and corporate profits are the two most important bases for estimating receipts from these two tax sources. Corporate profits, however, are not uniformly related to any single indicator or combination of economic indicators. There is even a lack of correspondence as to the direction of change between corporate profits and the gross national product.

In 1952, for example, there was a large decrease in corporate profits in spite of a substantial increase in the gross national product.

I might add in passing that the best current data on corporate profits are themselves estimates which are subject to substantial revision, after taxes are collected and tax returns tabulated in Statistics of Income. Again referring to 1952, estimated corporate profits were reported at the end of the year as $40.8 billion. This figure was finally revised to $35.9 billion, long after the end of the year.

Our estimate of $42 billion for corporate profits in both 1957 and 1958 is based on our own best appraisal and on advice which we have sought from staff experts in the Department of Commerce, the Council of Economic Advisers, and the Federal Reserve Board. The estimate is, of course, subject to the same hazards as have been manifest in the past but it represents our best judgment.

With respect to the individual income tax, we have estimated increases in receipts from this source, although these expected increases are substantially less than those which occurred in recent years. Our estimate took into account current economic conditions, as well as our judgment that growth would be resumed during the year 1958 and continued on into 1959. Specifically, the increase estimated for the individual income tax estimated for fiscal 1958 over fiscal 1957 is $1.6 billion; and the increase for 1959 over 1958 is $1.3 billion. Individual income tax receipts increased $3.4 billion in each of the fiscal years 1956 and 1957. Thus the total increase for the <u>two</u> years 1958 and 1959 of $2.9 billion in individual income taxes is substantially less than the increase in this category which took place in either <u>one</u> of the years 1956 and 1957.

The personal income level for the calendar year 1958 underlying the budget estimate assumes a rise of $9 billion over the personal income of the preceding calendar year. This is about one-half of the annual rate of increase of preceding years.

As in the case of corporate tax estimates and the economic indicators on which they are based, the historical record shows that there have been substantial variations in the relationship between individual income tax receipts and their major determinant, personal income.

These variations reflect changes in the distribution of personal income at different income levels, including varying proportions in the taxable and nontaxable categories, and in the realization of capital gains which affect tax receipts but are not included in the statistical concept of personal income. They indicate the difficulty of attempting to project tax receipts with complete accuracy, even if the underlying figure for personal income could be estimated accurately.

In the Committee's invitation to appear before you, you asked that I give attention to four questions. With your permission, I should like to address myself to three of them and ask Under Secretary Baird to address himself to the final question on our outlook for debt management for the coming year.

With reference to your question as to the proper division of labor between tax policy and monetary policy as instruments of economic stabilization during the current year, I should like to suggest the following: 1

The power of taxation should always first be critically examined as an instrument to provide revenue for the government upon the most equitable basis possible. Tax changes should be utilized for purposes of economic stimulation only when economic conditions are sufficiently adverse to warrant it.

I have heretofore stated that I can conceive of situations where tax reductions might appropriately be brought into play in order to help the resumption of economic growth. It is our judgment that the present condition of the economy does not warrant such action now. We continue to believe that growth in our economic system will reassert itself. We continue to be concerned that we should avoid if possible adding to our already burdensome debt during periods of high production. However, we must continue to examine developments as they progress from month to month with a willingness to use this or other methods of stimulation if conditions should require them.

Monetary and credit policy can be used more appropriately during periods of economic change such as we are now experiencing. The recent sharp reduction in interest rates, plus an increase in availability of credit, provides easier financing of business and local government capital projects and projects in other areas of growth, such as residential housing.

With reference to your second question concerning recommendations for general or structural revisions in tax policy at this time, I should like to advise that we are following closely the material which is being developed in the hearings of the House Committee on Ways and Means and our staff is currently reviewing the hearings with the staffs of the House and Joint Committees. These cooperative efforts will continue. 2

We have recently reaffirmed the recommendation of the Budget Message for a continuation of the existing corporation income tax rates and the excises on liquor, tobacco and automobiles for another year. There is about $3 billion in revenue involved. We have also recommended that H.R. 8381 to make certain technical revisions and eliminate some unintended benefits and hardships be enacted with some modifications. This bill has now passed the House and is before the Senate Finance Committee.

We have also suggested to the House Committee on Ways and Means that the question of tax simplification is in our judgment exceedingly important. I have asked the staffs of the Treasury and the Internal Revenue Service to work closely with the staffs of the Joint Committee on Internal Revenue Taxation and the Committee on Ways and Means to determine the most effective way of dealing with this problem. It seems to me to go to the very heart of our voluntary tax system. I hope that we will be able to develop a mechanism for giving effective consideration to this important matter in the near future.

On the third question as to the relative importance of encouragement of investment and encouragement of consumption, let me be frank to say that our system of competitive enterprise should be such as to encourage increased investment and to provide the generation through savings of adequate capital to finance both replacement and expansion. At the same time, the utilization of the products of our enterprise is dependent upon effective demand which, of course, is the basis for consumption. It would seem, therefore, that any consideration of tax policy should give weight to both the development of effective capital and the stimulation of effective demand. Here again, in order to maintain our voluntary tax system we must be concerned not only with the objectives of economic stimulation, but at the same time so act as to insure fairness to all taxpayers and the (3) development of a system of tax forms and calculations which can be fully understood and prepared without undue complications.

I shall now ask Mr. Julian Baird, the Under Secretary for Monetary Affairs, to speak on the fourth and final question concerning our outlook for debt management for the coming year.

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Press attendance down sharply.

10:10 — Sparkman, Curtis, Bolling, Kilburn — O'mahoney — Douglas — Talle
Baird, Sen. Smith, Mayo, Lennartson & 2 or 3 others.

10:12 — Anderson starts.
10:30 — Baird (O'm broke in at 10:42-10:57 - 15 min interruption - to suggest Pub. Debt been growing, & no progress in lengthening, & Treas. achieved fear of going abt 26 biln above debt ceiling by "gimmick" devices. Protests Def Dept stalled on paying bills. Risked
Anderson enters: re debt ceiling problems - Admits costly expedients" used to get around.
O'm: U S can carry heavier debt load if debt properly managed. Not satisfied FRB has "collaborated fully with T. on handling pub debt)

10:57 Baird finished.

Q.

11 am. Curtis: Q imposed debt limit on Treas. Those who want save money shd do thru appropriation process rather than debt limit.
Rev. Estimates - what margin of error - Anything being done to improve statistics on which estimates made.

11:08 Douglas — B/t estimates based on Nov-Dec figs. In view subsequent drops - rise in empl - aren't receipt figs too high.
A - We continue to believe estimates reasonably good, tho recognize be some changes in economy.
D: you expect this recession to follow pattern of 49-50 & 53-54 - not just inventory recession, but cap investment being scaled down.
You'll be very embarrassed to come back again & ask 2nd raise in debt limit - tho I'll vote to raise to $280 B. Shd ask all at one time — I think you're heading for the rocks.
A: I wd not be surprised to see even more bad news in some sectors of our ec - Douglas: B/t didn't foresee the emerg. request for $76 miln merely to process increased unemp. benefit claims.
A - I will not be surprised by some additional bad news in the short-run.

O'm - you got telegram from GM auto dealer in Mass. Criticizes Anderson Curtice for saying posn of distributors was good.
[Kilburn - Cars too big, too long]
A: Const run high. Bond issues large - Some industries expanding -

11:52 Talle - Dem & Kilburn - Rep recess after 29 - Kilburn - Dem recess 49 -
Unempl. amts to abt 5% - for Dec. Quotes D. Dec 1952 - "Econy & Natl Govt" - Shdn't run deficit unless empl 8% or slightly more - when under 6%, shd have govt surplus" - you still stand - D: almost, but not quite - Shd also take into consideration part-time unempl. - Also, Jan rate be abt 6.5% - If I rewrote, prob wd reduce fig to 7.5%

1145 – Om – Insert Table F48 for Pres Ec report.
I shd have asked ~~[illegible]~~ earlier for inc in debt limit
+ shd have bn more "coop" betw FR + T.
Why do you fig 9B inc in pers inc rate (p 7)
+ none in corp. profits –

A = Influenced by long term + short term factors –
Pop increased – Home construct needs. Scientific + Technology – ability – Energetic people – Growing labor force – a g[illegible]
Thru periodic ups + dns, mon. auths + others trying promote flex mon. conditions – Invent. reduction have in part taken place. etc – good side items –

Om – To justify yr rev estimates wd have be speedy drop in unempl + speedy recovery in bus.

A – Jan–March – low seas period + I wd not be surprised of further rise in unempl in Jan –

Om – ptd to Sec Weeks optimistic forecasts about upturn in early + middle 1958 – But if the supposed recov doesn't come till mid-58, it wd have to be almost astronomical to justify yr estimates –

A – difficulty of being precise

Om – Tax question – Is admin considering anything need to stimulate empl?

A – Refers to posn in statem.

Om – Outlook in domest petroleum in dis – get lots letters saying situ going from bad to worse – Some indep refiners in Calif compelled close – dissatisfaction with "vol" import control –

1221 Kilburn – Hi

1222 Bolling = Tax dodging – (Prentice-Hall)

1225 Sparkman =
Tax reduc matter of X gov – not adm –
How abt a standby tax redn bill – G!

End =

TREASURY DEPARTMENT
Washington

Statement by Under Secretary of the Treasury Julian B. Baird, following testimony by Secretary Anderson, before the Joint Economic Committee, 10:00 A.M., E.S.T., Friday, February 7, 1958.

I am glad to have the opportunity to discuss with you today what we in the Treasury consider to be our most important debt management problems during 1958.

Debt management, of course, does not take place in a vacuum. If it is to make its maximum contribution to sound financial management it must work effectively with the budget and tax policies of the Government and the monetary policies of an independent Federal Reserve System. Even though the Treasury's debt operations run well over $100 billion a year in terms of over-all issuances or retirements, good debt management rarely makes headlines. The Treasury is making every effort to handle this very technical and complicated phase of fiscal policy in a way that will contribute to sound and sustainable economic growth and stability.

The environment in which debt management operates consists of many factors, the first of which is the budget outlook. If other conditions are favorable, the debt tends to be more easily managed at times when the Government is taking in more than it is spending. As a result of the budget surpluses during the past two years, the public debt has been reduced from $281 billion in December 1955, to $275 billion in December 1957.

As you know, however, the present budget outlook does not allow for further debt reduction in the year ahead, other than the usual seasonal down-swing under the impact of heavy tax collections this spring, which

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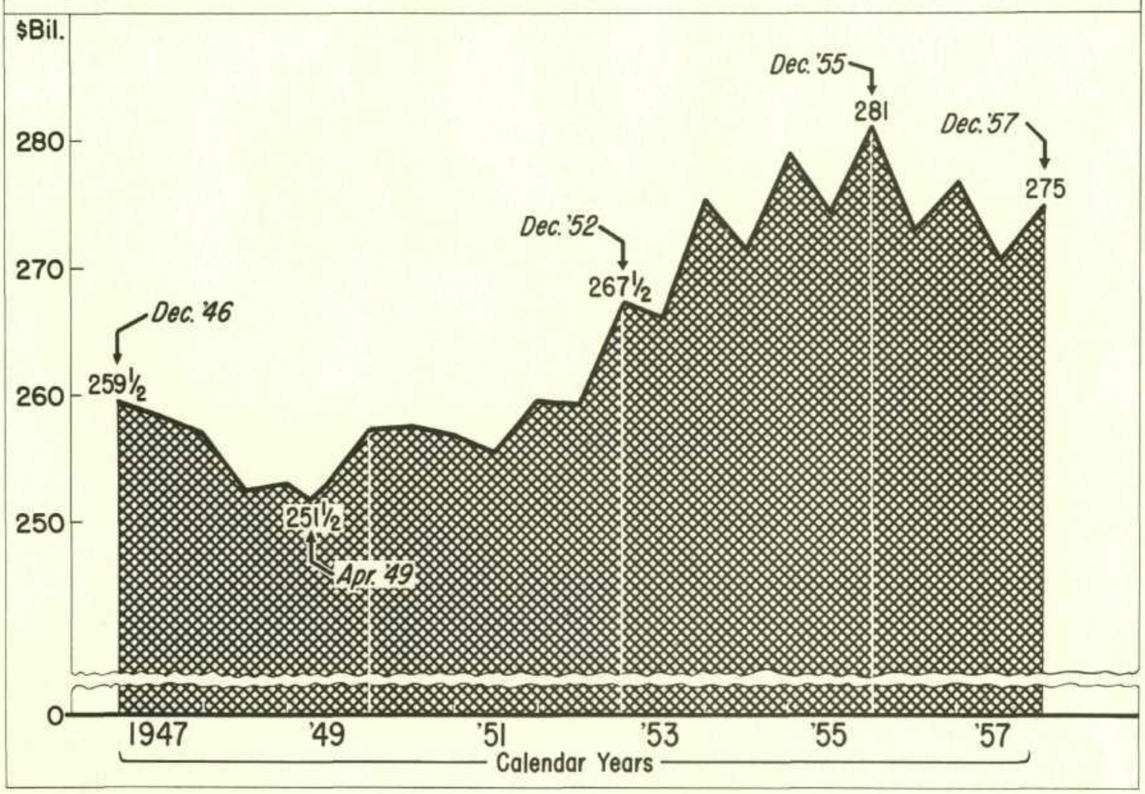
will be followed by a seasonal increase in the debt again next fall. Even with a balanced budget, the Treasury has substantial amounts of cash financing to do during the July-December period each year in anticipation of heavy tax payments in the January-June period. The seasonal swings in Treasury receipts are being moderated somewhat from year to year as a result of corporations paying their taxes more currently as provided for in the Revenue Code of 1954, but substantial seasonal movements still occur.

Chart I

THE PUBLIC DEBT



Office of the Secretary of the Treasury

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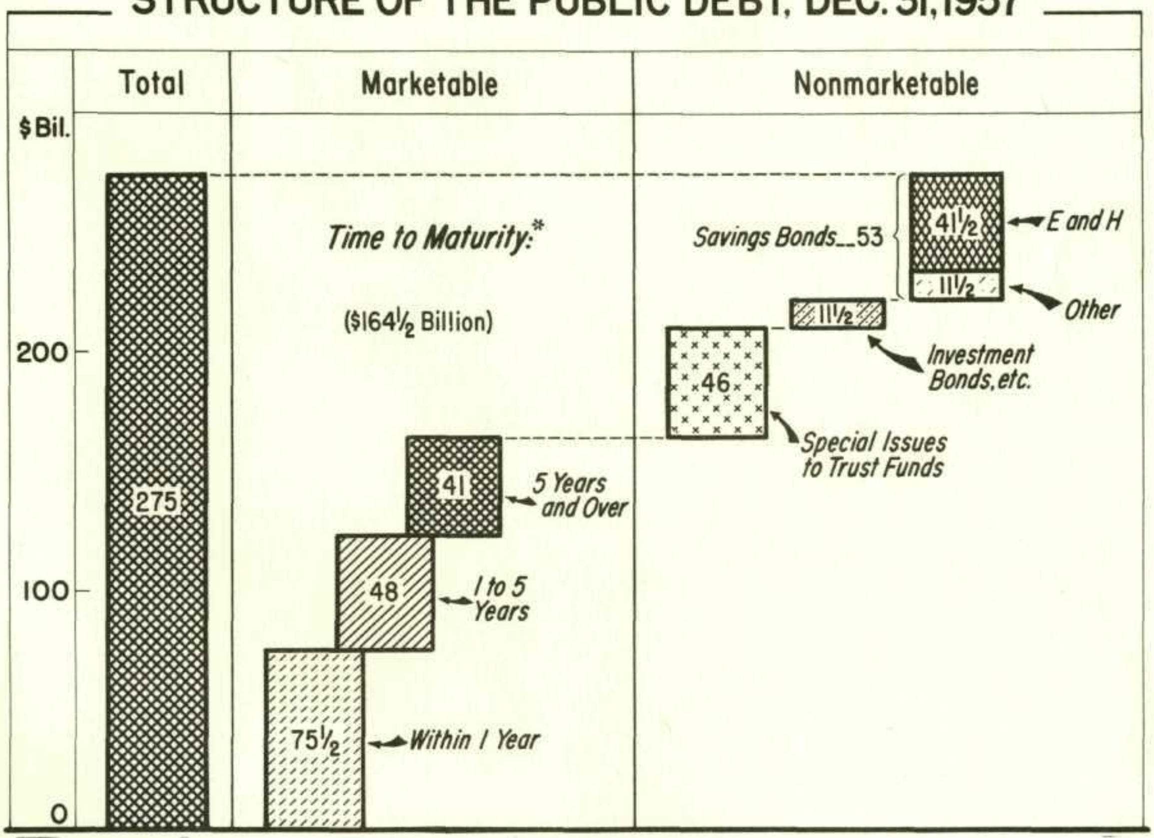
As Chart 1 indicates, there have been only two periods since the end of World War II in which sizable debt reduction out of budget surplus has been realized -- a reduction of $8 billion in 1947, 1948, and early 1949, and a reduction of $6 billion during the last two years. We fully expect, of course, that further debt reduction will be possible as we move beyond the period of time covered by the present budget, always keeping in mind that important as it is, the goal of debt reduction should not interfere with whatever steps are necessary to assure the security of our country.

One of the Treasury's major responsibilities in the field of debt management is to work toward a better structure of the debt within the over-all total whenever conditions permit. Chart 2 shows the structure of the debt as of December 31, 1957.

Chart 2

STRUCTURE OF THE PUBLIC DEBT, DEC. 31, 1957



*Partially tax-exempt bonds to earliest call date.

Office of the Secretary of the Treasury

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Most of the Treasury's effect on the structure of the public debt is achieved through its financing decisions affecting the marketable debt, which, on December 31, 1957, accounted for $164-1/2 billion of the total $275 billion debt. These marketable issues consist of 91-day bills, 1-year certificates of indebtedness, 1- to 5-year notes, and longer-term bonds -- issues which are freely traded in the Government securities market every day.

It would be better to have less of the public debt coming due each year. If the $75-1/2 billion of under one-year debt, which is shown as the bottom bar on Chart 2, can be cut down, there will be a reduction in both the frequency and volume of Treasury financing. To the extent that progress is made toward this objective, the Treasury will be contributing to a smoother flow of corporate and municipal financing to the capital markets. It also will add to the free time which the Federal Reserve will have to take effective monetary steps without always having to be concerned with a new Treasury financing which is coming up or financing which is still in the process of being lodged with the eventual holders of the securities. The Treasury would prefer to go to the market less frequently than it had to in 1957. Last year there were financing operations, other than the regular roll-over of Treasury bills, in every month except April, a frequency which reflected in large part the pressure of an increasingly restrictive debt limit.

The remaining $110-1/2 billion of the public debt is not marketable. As shown on the right side of Chart 2, this part of the debt includes securities issued to the social security and other Government trust funds. It also includes our savings bonds -- which are at the heart of our efforts to achieve a broader distribution of the public debt.

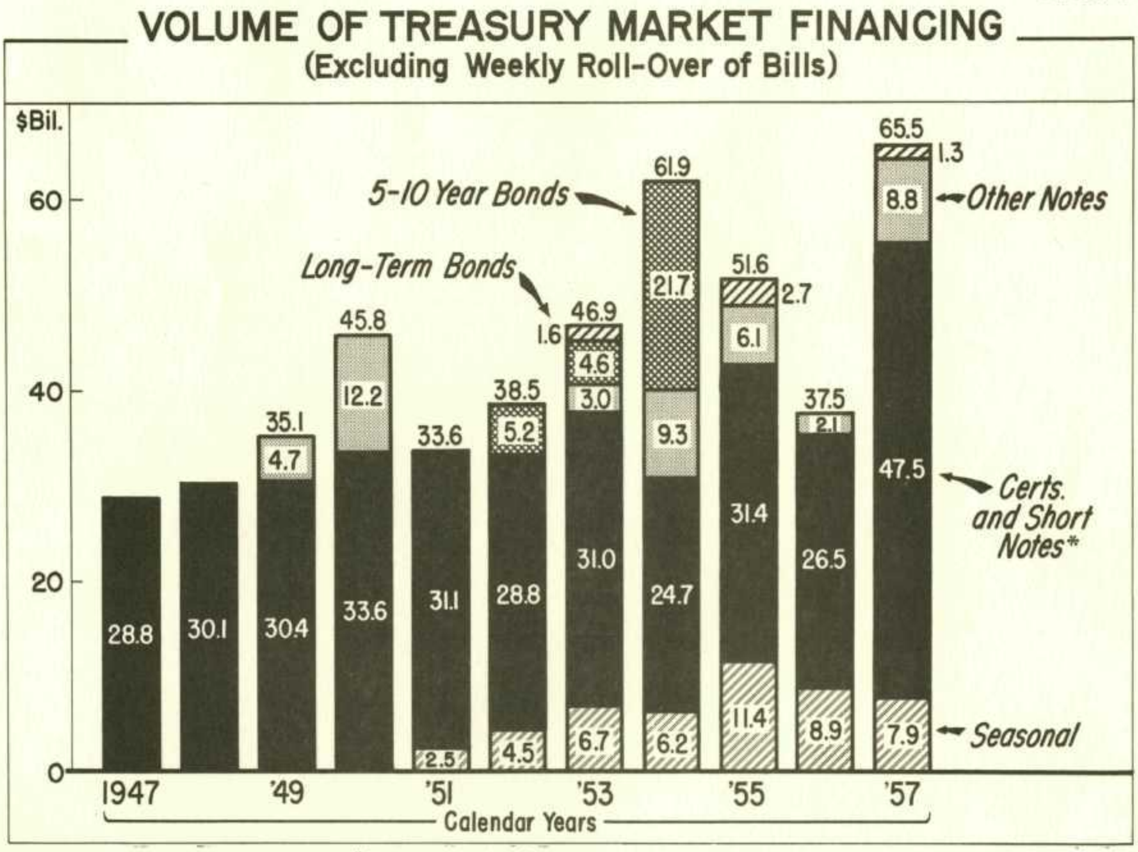
At the present time, approximately 40 million Americans own $41-1/2 billion of E and H savings bonds. We estimate that something like eight million people are buying savings bonds regularly through payroll savings plans where they work or through the thousands of financial institutions around the country that sell these bonds for us as a public service.

As you know, the rates of interest on Series E and H savings bonds were raised last winter from 3% to 3-1/4%, along with a substantial improvement in earlier yields in case a bondholder redeems his security before it is due. This added attractiveness of E and H bonds, together with their proven appeal of convenience, safety, indestructibility, and a guaranteed interest rate over a period of years, is already showing up in improved sales. Our sales in January 1958 were $510 million, up 10% over January a year ago.

We are now conducting a number of intensive campaigns in leading cities across the Nation to encourage further sales of savings bonds. We are reminding Americans again that they are adding not only to their own financial well-being, but also to that of their Nation, when they buy savings bonds. Even though E and H bonds may be redeemed on short notice by the holder, they in fact remain outstanding about seven years on the average. As a result, they help to achieve a broader distribution of the debt beyond the short-term area.

The only way, of course, in which the Treasury can reduce the amount of marketable debt coming due within one year -- short of over-all debt retirement -- is by replacing some of the maturing short-term debt with new issues that will come due over a longer period of time. That is what we mean by extending the debt, and we try to do that whenever conditions are favorable. The simple passage of time brings more and more of the debt into the one-year area so that a substantial amount of debt extension is required even if we are to prevent the under one-year debt from growing. As has been so often said, we operate in something like Alice's Wonderland, and have to run fast in order to stay in the same place -- and even faster if we want to get some place.

Chart 3



*Notes originally 20 months or less to maturity.

Office of the Secretary of the Treasury

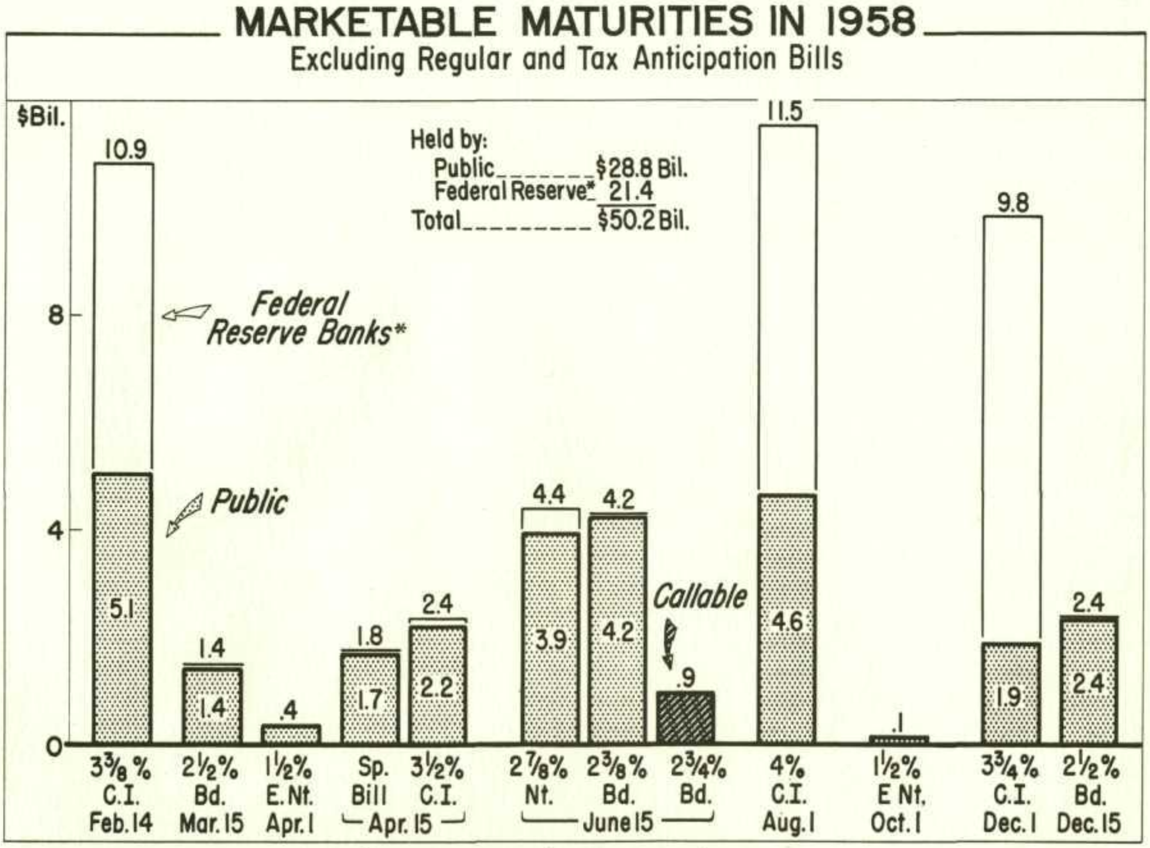
8-1319-3

Chart 3 shows what has been done during the last 11 years not only in terms of the total amount of Treasury financing that has been required, other than the roll-over of Treasury bills, but also the amount of debt extension which has been accomplished.

There was some debt extension back in 1949 and 1950, which helped reduce the size of the financing job in 1951 and 1952. There was further debt extension in 1952 and even more in 1953, but the most substantial debt lengthening that has taken place since the war occurred in the calendar year 1954. During a year when the Treasury had a $62 billion financing job to do, $31 billion -- half of the total -- was extended into securities running more than one year to maturity, with almost $22 billion of the extension in 5- to 10-year bonds. This in turn helped to reduce the volume of market financing in 1955 and 1956, but the relatively small amount of debt extension which the Treasury was able to accomplish under the conditions which existed in 1955 and 1956 meant that again in 1957 our problem was more difficult. The $65-1/2 billion figure shown on this chart for 1957 Treasury financing is inflated by the fact that $10 billion of the August maturities (mostly held by Federal Reserve banks) were rolled over into a December maturity and were, therefore, counted twice during the year. The fact remains, however, that even if this doubling-up were excluded, the 1957 job was among the largest in history.

Our financing job in 1958 -- including our current financing -- is expected to be somewhat smaller than in 1957. Chart 4 indicates the marketable maturities, issue by issue, which are facing us during this calendar year. The subscription books on the Treasury refinancing this year have just closed and we hope to be able to announce shortly the results on our offering of a 1-year certificate, a 6-year bond, and a 32-year bond, which was made to the holders of the five issues maturing from February 14 through April 15, as shown on this chart.

Chart 4



*Including Government Investment Accounts.

Office of the Secretary of the Treasury

B-1164-E-3

Although the Treasury decision to include a large block of maturities in the current financing helps to take some of the burden off of our debt management activities in the spring, we still face a heavy schedule. Total maturities of Treasury certificates, notes and bonds this year amount to $50 billion, of which $29 billion is held by the public. In addition to this $50 billion, the Treasury has an issue of $3 billion of tax anticipation bills coming due in March (to be paid off in cash), and $22-1/2 billion of regular 91-day Treasury bills which will be rolled over four times during the course of the year. This total of $75-1/2 billion outlines the basic dimensions of our job in 1958. {O'Mahoney breaks in: 15 minutes of Q & A before Baird resumed}

Chart 5

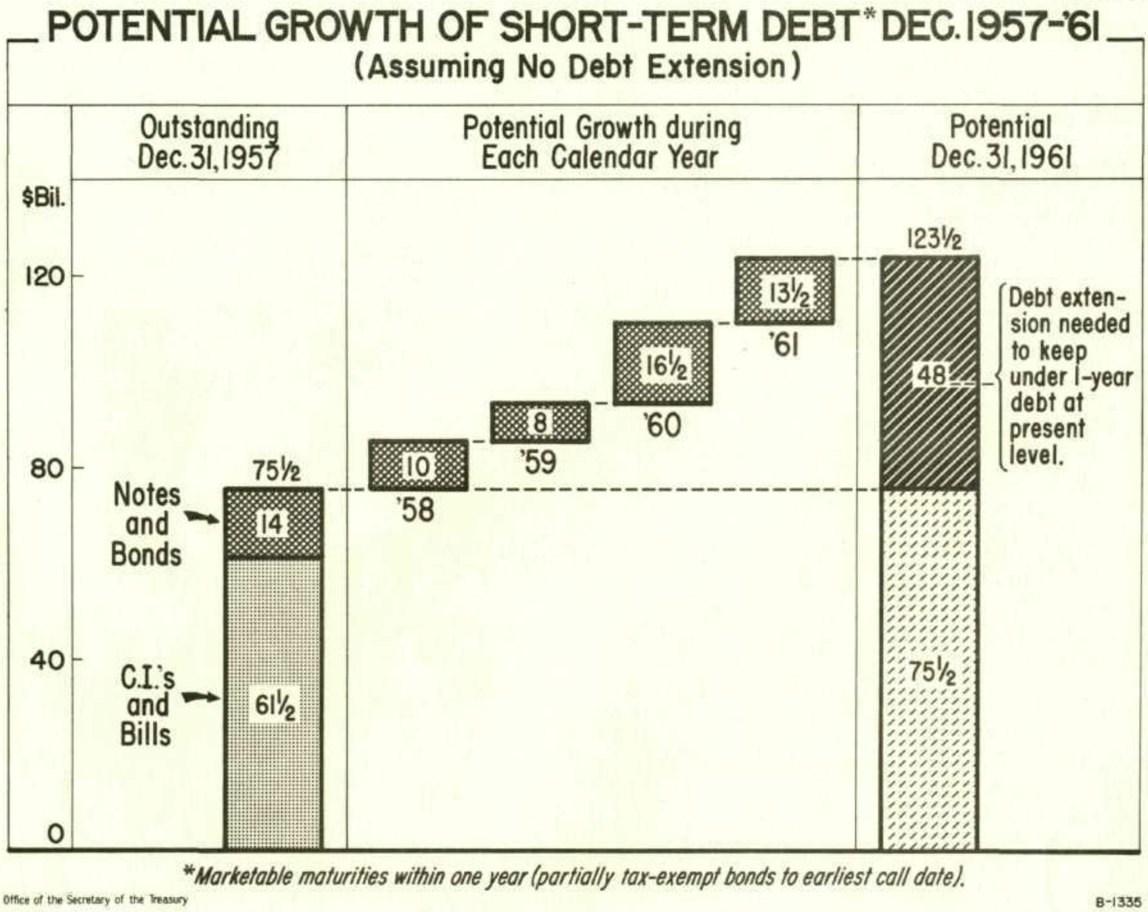


Chart 5 spells out our problem of the passage of time adding to the short-term debt over the next few years, on the basis of the total amount of marketable debt as it now stands. If we add up all of the debt that will come into the under one-year category in 1958, 1959, 1960, and 1961, we would find that the amount of under one-year debt four years from now, instead of being $75-1/2 billion, would be $123-1/2 billion, if all refinancing in those years was in the one-year area. That would mean about 75% of the entire marketable debt would be due within one year in 1961, as compared with 45% at the present time.

To put it another way, we need a net amount of $48 billion of debt extension in the next four years in order to keep even -- and more than that if we are to make any progress in cutting down the size of our short-term debt.

We continue to believe that it is in the long-range best interest of this country to offer intermediate- and long-term securities over the next few years whenever conditions are favorable. Our recent refunding operation was based on this principle. It is obvious, however, that a great deal more remains to be done.

In conclusion, I can assure you that the Treasury will continue to discharge its responsibilities of debt management with broad national interest as the first consideration.

Lehman 5321 FOR IMMEDIATE RELEASE

CONGRESS OF THE UNITED STATES
JOINT ECONOMIC COMMITTEE

Chairman Patman Announces Change in Date of Appearances at Hearings on the President's Economic Report

Representative Wright Patman (Democrat, Texas), chairman of the Joint Economic Committee, has announced that a conflict in engagements has necessitated a change in the order of appearances of witnesses at the hearings currently in progress on the President's Economic Report. The corrected schedule follows:

February 6 (Thursday) - 10:00 A.M. - 457 Senate Office Building

WILLIAM McC. MARTIN, JR., Chairman, Board of Governors of the Federal Reserve System

February 7 (Friday) - 10:00 A.M. - 457 Senate Office Building

ROBERT B. ANDERSON, Secretary of the Treasury

Jan. 31,1958

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CONGRESS OF THE UNITED STATES
JOINT ECONOMIC COMMITTEE

January 20, 1958

Mr. William McC. Martin, Jr.
Chairman
Board of Governors of the
Federal Reserve System
Washington, D. C.

Dear Mr. Martin:

This will confirm our invitation and the arrangements which our staff has made with you to appear as a witness before the Joint Economic Committee at hearings on the Economic Report of the President. You are scheduled to appear Friday morning, February 7, at 10:00 o'clock, in Room 457 Senate Office Building. The discussion will deal with monetary policy for the coming year.

We suggest that you confine your introductory remarks to thirty minutes or less so that substantial time will be available for discussion and questions.

It would aid the Committee and the press if we could have 75 to 100 copies of your opening statement not later than the day before the hearing. All copies should be sent to Mr. John Lehman, Joint Economic Committee, Room 23-B, Senate Office Building, Washington 25, D. C.

Attached is a schedule of hearings listing those participating in the hearings. For each topic there is a list of suggested questions which are intended to indicate the framework of the hearing rather than to limit its content.

Sincerely yours,

(Sgd.) Wright Patman

Wright Patman
Chairman

Note: Date changed from February 7 to February 6

1/22

Mr. Martin

This is the press release on the hearings on the President's Economic Report.

The page marked with the paper clip contains questions which will be addressed to you.

Mr. Shay has a copy of this, of course.

mnm

Lehman - 5321

FOR A.M. RELEASE
Tuesday, January 21, 1958

CONGRESS OF THE UNITED STATES
JOINT ECONOMIC COMMITTEE

Chairman Patman Announces Hearings
on the President's Economic Report

Representative Wright Patman (Democrat, Texas), chairman of the Joint Economic Committee, has announced plans of the Joint Committee to hold 10 days of hearings, commencing January 27, on the President's Economic Report which was transmitted to Congress yesterday.

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

At its meeting on January 13, the committee approved a plan for hearings as set forth in the attached schedule of witnesses and subjects with lists of questions intended to suggest the content rather than limit the particular hearing.

CONGRESS OF THE UNITED STATES
JOINT ECONOMIC COMMITTEE

HEARINGS ON THE PRESIDENT'S 1958 ECONOMIC REPORT
Dates, Witnesses, Topics and Suggestive Lists of Questions

January 27 [Monday] -- 10:00 AM - Senate District Committee Room (P-38)

Council of Economic Advisers - [Executive Session]

RAYMOND J. SAULNIER, Chairman, accompanied by

JOSEPH S. DAVIS, and

PAUL W. McCRACKEN, Members

1. What are the levels of employment, production, and purchasing power needed in 1958 to carry out the objectives of the Employment Act?

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

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

4. Are these assumptions consistent with those in the President's Budget Message.

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

January 28 [Tuesday] -- House Caucus Room -- 362 Old House Office Bldg.
10:00 AM

Panel: Economic Outlook for the Coming Year

1. What is the outlook for labor force, hours of work, and productivity in comparison with long-run trends?

2. What are the likely trends in receipts and expenditures of Federal, State and local governments?

3. What is the outlook for business fixed investment; for residential construction; for inventories?

4. What is the outlook for consumer buying of durables, nondurables and services?

5. What is the outlook for prices?

Labor Force, etc.

EWAN CLAGUE, Commissioner, Bureau of Labor Statistics, Department of Labor

Government Demand

LOUIS J. PARADISO, Asst. Director & Chief Statistician, Office of Business Economics, Department of Commerce

Housing Investment and Demand

MILES L. COLEAN, Consulting Economist, Washington, D.C.

Investment Demand

DOUGLAS GREENWALD, Chief Statistician, Department of Economics, McGraw - Hill Publishing Company

Inventories and Consumer Demand

MYRON S. SILBERT, Vice President, Federated Department Stores, Inc. Cincinnati, Ohio

International Trade and Investment

EDWARD M. BERNSTEIN, Consultant; formerly Director, Research & Statistics Department, International Monetary Fund

Agriculture

ORIS V. WELLS, Administrator, Agricultural Marketing Service, Department of Agriculture

January 29 [Wednesday] -- 10:00 A. M. - House Caucus Room, 362 O.H.B.

Interpretation and Policy Implications of the Current Outlook:

1. What factors account for the apparent slowing-up in the rate of investment in plant, equipment, and construction?

2. How significant is this slowing-up to short-run stability?

3. What, if any, evidence is there of existing or threatened over-capacity in plant, equipment, commercial construction, and housing?

4. What, if any, changes in governmental economic policies are called for in the year ahead in relation to investment prospects and plans?

5. What would you regard as the proper division of labor between tax policy and monetary policy as instruments of economic stabilization during the coming year?

6. Can fiscal and monetary policies stem any prospective deflationary trends?

GERHARD COLM, Chief Economist, National Planning Association

JAMES DUESENBERRY, Professor, Department of Economics, Harvard University

WALTER D. FACKLER, Assistant Director, Economic Research Department, U. S. Chamber of Commerce

MARTIN R. GAINSBRUGH, Chief Economist, National Industrial Conference Board

JEWELL J. RASMUSSEN, Professor, Department of Economics, University of Utah

STANLEY RUTTENBERG, Director, Department of Research, American Federation of Labor and Congress of Industrial Organizations

January 30 [Thursday] -- House Caucus Room -- 362 Old House Office Bldg.
10:00 AM

Invited panel: Organizations

AGRICULTURE

The National Grange
The National Farmers Union

BUSINESS

National Association of Manufacturers
Committee for Economic Development

LABOR

American Federation of Labor and
Congress of Industrial Organizations

February 3 [Monday] -- 457 Senate Office Building
10:00 AM

The Federal Budget

PERCIVAL F. BRUNDAGE, Director, U.S. Bureau of the Budget

1. What are the major changes in expenditures and revenues contemplated in the President's budget for fiscal year 1959?

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

3. What commitments extending beyond fiscal year 1959 are contemplated by the budget?

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

February 4 [Tuesday] -- Room 457 - Senate Office Building
10:00 AM

Invited Panel: Organizations

AGRICULTURE

American Farm Bureau Federation

BUSINESS

Chamber of Commerce of the United States
of America

LABOR

Railway Labor Executive Association
United Mine Workers of America
National Independent Union Council

GENERAL

Federal Statistics Users' Conference

February 5 [Wednesday] -- 457 Senate Office Building
10:00 AM

The Defense Department Budget and Plans

W. J. McNEIL, Assistant Secretary of Defense (Comptroller)

1. Given the President's budget proposals for defense expenditures, what may be anticipated as to the rate of new contracting and of expenditures especially for "hardware" for the remainder of the current and succeeding fiscal years?

2. What criteria were followed in arriving at the total budget proposed for national defense?

3. What criteria are used for apportioning this total among various programs?

February 6 [Thursday] -- 457 Senate Office Building
10:00 AM

Fiscal Policy for the Coming Year

ROBERT B. ANDERSON, Secretary of the Treasury

1. What would you regard as the proper division of labor between tax policy and monetary policy as instruments of economic stabilization during the coming year?

2. Do you have any recommendations for general or structural revisions in tax policy at this time?

3. If the economic situation made a tax reduction possible or expedient, should emphasis be given to the encouragement of investment or the encouragement of consumption in the current circumstances?

4. What do you foresee as the Treasury's principal debt-management problems in the year ahead?

February 7 [Friday] -- 457 Senate Office Building
10:00 A.M.

Monetary Policy for the Coming Year

WILLIAM McC. MARTIN, JR., Chairman, Federal Reserve Board

1. What would you regard as the proper division of labor between tax policy and monetary policy as instruments of economic stabilization during the coming year?

2. What is the current policy of the monetary authorities?

3. What, if any, elements exist in the current situation which suggest or might permit a resurgence of inflationary forces in the next 12 or 15 months?

4. If the inflationary forces continue to abate during the year, what program would you recommend as to priority and specific actions in the fiscal and monetary fields?

February 10 (Monday) -- Room 318 - Senate Office Building
10:00 AM

Panel: Application of the Employment Act of 1946 to the Current Situation and Prospects

1. How significant to short-run stability is the recent slowing up of economic activity? What, if any, are the implications to long-run stability and growth?

2. What, if any, changes in governmental economic policies are called for in the year ahead?

3. What would you regard as the proper division of labor between tax policy and monetary policy as instruments of economic stabilization during the coming year?

4. Can fiscal and monetary policies stem any prospective deflationary trends?

ROY BLOUGH, Professor, Graduate School of Business, Columbia University

YALE BROZEN, Professor, Department of Economics, University of Chicago

LESTER V. CHANDLER, Professor, Department of Economics and Sociology, Princeton University

JOHN KENNETH GALBRAITH, Professor of Economics, Harvard University

RALPH J. WATKINS, Director of Economic Studies, Brookings Institution

(39)

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FEDERAL RESERVE MONETARY POLICIES

HEARING

BEFORE A

SUBCOMMITTEE OF THE

COMMITTEE ON BANKING AND CURRENCY

UNITED STATES SENATE

EIGHTY-FIFTH CONGRESS

SECOND SESSION

TO DISCUSS THE MONETARY POLICIES AND ACTIONS OF THE FEDERAL RESERVE BOARD WITH REFERENCE TO THEIR IMPACT ON THE NATIONAL ECONOMY

FEBRUARY 19, 1958

Printed for the use of the Committee on Banking and Currency

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FEDERAL RESERVE MONETARY POLICIES

WEDNESDAY, FEBRUARY 19, 1958

UNITED STATES SENATE,
COMMITTEE ON BANKING AND CURRENCY,
SUBCOMMITTSS ON THE FEDERAL RESERVE,
Washington, D. C.

The subcommittee met, pursuant to call, at 10:10 a. m., in room 301, Senate Office Building, Senator J. Allen Frear, Jr., (chairman of the subcommittee) presiding.

Present: Senators Frear, Robertson, Douglas, Proxmire, Bricker, and Bennett.

Also present: Senators Fulbright, Clark, Bush, and Case.

Senator FREAR. The subcommittee will come to order.

For several years the Senate Banking and Currency Committee has called upon the staff of the Federal Reserve Board to furnish the committee with an up-to-date economic briefing at the beginning of each new session of Congress. This we have found helpful and necessary because of the vital role played by Congress, and especially this committee, in the formulation of policies which have great impact on the national economy.

We are told that the briefing which the Board's staff has given us is essentially the same presentation it gives every month to the Federal Reserve Board's Open Market Committee. It consists of a comprehensive report of the latest Economic Indicators in the major sectors of the American economy and the status of the business picture in the other major countries of the world.

These briefings have been professionally competent and a considerable help to us as we consider the legislative measures which fall within our jurisdiction.

During our last briefing session with the Board's staff, which was held on January 24, several members of the committee expressed a desire to discuss the policy aspects of the economic picture as well as the factual data which the staff presented. Obviously, the Board's staff could not discuss policy issues, with sufficient responsibility, as members of this committee desired. Therefore, we have requested the Chairman of the Board of Governors of the Federal Reserve System, the Honorable William McChesney Martin, Jr., to appear before us to discuss these matters, and he has kindly consented.

Chairman Martin, we are very pleased to have you with us this morning. I assume that you have a statement prepared to give us. And then there will certainly be some questions from the members of the committee.

Mr. MARTIN. That will be fine, Mr. Chairman. May I proceed?

Senator FREAR. You may.

STATEMENT OF WILLIAM McCHESNEY MARTIN, JR., CHAIRMAN, BOARD OF GOVERNORS, ACCOMPANIED BY RALPH A. YOUNG, DIRECTOR, DIVISION OF RESEARCH AND STATISTICS, FEDERAL RESERVE SYSTEM

Mr. MARTIN. The year 1957 was a difficult one for those of us charged with appraising financial and economic events and formulating appropriate monetary policy. From its opening and on during much of the year, inflationary pressures were dominant in this country and abroad.

In commodity markets, industrial prices were continuing to advance despite generally downward reaction in prices of some internationally traded basic materials following the Suez crisis. In consumer markets, prices of goods and services were advancing at a very rapid pace for a nonwar period.

Prices of common stocks, which had tended down from mid-1956 to early 1957, rose sharply to new highs in midsummer under the influence of creeping inflation doctrine and of widening confidence that the large capital expansion in which business was engaging would be adequately supported by the demands of a rapidly growing population for a rising standard of living.

The strength of inflationary pressures was exemplified by the marked advances being recorded in the gross national product measured in current dollars as compared with the relatively modest gains that were being obtained in the physical volume of total output.

In spite of Federal Reserve actions taken to resist inflationary trends—including six increases of Federal Reserve bank discount rates in 1955 and 1956 and the pursuance of a restrictive credit policy—money lost its value at a rate that was a matter of great concern to all. Inflationary excesses had clearly gotten ahead of us, and the economy stood in danger of an inflation crisis. The adjustment problems that the economy is confronting today are the aftermath of those excesses.

As a nation, we were trying to do too much too fast, and heavy pressure was exerted against the available supply of savings.

In retrospect, we underestimated the speed and force of the inflationary boom and the widespread growth in speculative attitudes and commitments.

Consumer installment credit rose substantially in 1955 when terms were sharply relaxed, and consumers used credit more freely than ever before in the purchase of record numbers of new automobiles. Businesses greatly increased their expenditures for plant and equipment. The rise from 1955 to 1956 amounted to more than one-fifth for business as a whole, and this advanced level was further exceeded in 1957. Stock investors were too optimistic in capitalizing the income and dividends which this investment might yield. Bankers and other lenders greatly expanded their commitments to lend in these years.

Furthermore, liquidity positions of banks and businesses were being reduced as their short-term liabilities were increasing faster than their holdings of cash and Government securities. Labor unions sought wage increases—and commitments for future increases—that pressed against or exceeded gains in productivity. State and local governments borrowed record amounts through the capital markets in an effort to meet the needs of their citizens for community facilities and services.

Inflationary trends continued through the summer months of last year. There was an alarming spread of the belief, not only in this country but also abroad, that creeping inflation under modern economic conditions was a chronic and, indeed, an inevitable condition. Reflecting this view, common stocks, the most popular hedge against inflation, rose sharply in price in July to a level where for the first time in two decades their yields fell below the yields on high-grade bonds.

Also, credit demands generally continued to show great strength, and interest rates were rising. Large city banks on August 7 raised their lending rate to prime business borrowers from 4 to 4½ percent. In this situation, Federal Reserve bank discount rates, which were below market rates by a widening margin, were raised in mid-August from 3 to 3½ percent, thus increasing costs to member banks which were operating on the basis of borrowed reserves.

In late summer and early autumn, developing uncertainties here and abroad began to affect the short-term economic outlook. In European exchange markets, widespread expectations of changes in exchange rates fostered large speculative movements of funds between European centers. These expectations in part reflected further accentuation of inflationary developments in some key countries, despite actions to tighten credit that were taken in various countries during the summer.

It was not until late September, after the Bank of England established a 7-percent discount rate, that it became clear that key foreign currency values would be maintained and that inflation would be strongly resisted.

In this country, the unexpected curtailment in defense payments and changes in procurement policies that were inaugurated during the summer, partly to avoid breaking through the debt ceiling, had an unsettling effect on business.

In September, nonagricultural employment, which had been at a record level in August, began to show signs of slackening. The Board's index of industrial production declined slightly. Reflecting these and other developments, common stock prices in late September broke through the trading range that had prevailed during the past 2 years.

With changing attitudes toward the economic outlook, production and other adjustments that had been occurring for some months in various lines of activity, including some capital goods lines, came to be reappraised by businessmen, investors, and the public generally. In contrast to earlier indications of strong credit demands, bank loans to business during early autumn decreased contrary to usual seasonal tendencies.

The pace of business was maintained for a time in spite of these uncertainties. By late October, the composite of most recent economic information suggested that inflationary pressures were abating, and open-market operations were modified to lessen restraint on bank credit and monetary expansion. By mid-November, information becoming available, incomplete though it was, indicated that a general downward adjustment was setting in.

In response to this change in basic economic conditions, Federal Reserve bank discount rates were reduced from 3½ to 3 percent.

Since that time, the use of open-market and discount policies has been complementary. Open-market operations have provided sufficient reserves to permit member banks not only to repay a substantial portion of their indebtedness to the Reserve banks, but also to accumulate some addition to reserves available for bank credit expansion. Discount rates were lowered again in mid-January, from 3 to 2¾ percent.

At the end of 1957, stock-market credit to customers of brokers and banks for purchasing and carrying listed securities was less than at midyear and back to the level of early 1955. Thus, the need for using the higher level of margin requirements, established in early 1955, to prevent an excessive expansion of stock-market credit had abated. The Board of Governors in mid-January reduced margin requirements for purchasing or carrying listed securities from 70 to 50 percent.

System actions have contributed to a marked easing in the credit and capital markets. This is illustrated dramatically by the very sharp drop in market rates of interest, the sharpest drop for any comparable period of which I have knowledge. Yields on Treasury 90-day bills dropped nearly 2 percentage points—from over 3½ to a recent low of 1½ percent.

This adjustment in credit and capital markets is helping to facilitate and cushion other adjustments in the economy as well as to strengthen demands in important areas dependent on credit financing. It is thus, along with other Government programs, helping to set the stage for recovery in activity and employment.

We all share the hope that recession will be moderate and short lived, but it is not possible to be completely certain about the future course of economic activity. There is a range of views currently held regarding the duration and extent of this recession and of the timing and vigor of the ensuing recovery.

In my own view, the underlying strengths of the economy are many. The inflationary trends seem to have halted before creating maladjustments of such severity as to lead to a protracted period of liquidation and structural realinement in the economy. After not too long a period of readjustment, healthy revival should set in, progressing to new records of economic performance and new high levels of national well-being. A great deal depends upon the speed with which needed readjustments are made.

We are all, of course, well aware that reasoning by analogy may be misleading and that history does not repeat itself. Nevertheless, it may be noted that the downward movement from the third quarter 1957 peak has been reminiscent in many ways of the declines that occurred in 1948–49 and in 1953–54. In these two postwar recessions, lows in activity were reached in less than a year from the cyclical peak, and recovery to new high levels of output, demands, and employment was rapid and substantial. In both recessions, the industrial production decline was limited to about 10 percent from high to low. With the exception of the catastrophic depression of the early 1930's, the downward phase of every cycle since Warld War I has been over or virtually over in the course of about a year.

There are many basic forces in the present situation favorable to hopes for recovery. These include:

(1) Credit and capital market conditions have already responded to relaxed monetary policy and are much easier than they were a few months ago. Other important financial adjustments have already been made or started. Stock yields, for example, have adjusted to a more normal relationship with highgrade bond yields. By borrowing from the capital market, moreover, business firms have been repaying bank debt, thus rebuilding the liquidity positions of both financing institutions and business enterprises.

(2) Consumer incentives to achieve still higher standards of living are strong, and research continues to provide new products of wide consumer appeal. As a group, businessmen and consumers continue to have confidence in the long-term growth prospects for our economy. Total retail sales advanced both in December and January and were at levels well above those a year earlier despite lower sales of new automobiles.

(3) Population increase has been maintained at a rapid pace—the rise of 1.8 percent in 1957 compares with a postwar average of 1.7 percent, and hence the market is expanding steadily.

(4) Consumer incomes have shown some cyclical decline recently, but the decline has been small and moderated by unemployment compensation benefits. Consumer demands are supported by a record volume of financial assets, the ownership of which is widely distributed. Growth in such assets was rapid in 1956 and 1957, while growth in consumer instalment and mortgage debt, though not small, was at a much slower rate than in 1955. The availability and terms of mortgage credit have recently become more favorable to borrowers. New housing starts increased in January and were moderately above their low in the spring of 1957.

(5) At the State and local government level, community demands for schools and teachers, for roads, public buildings, and other community facilities are continuing large and insistent. Bond issues of State and local government authorities have advanced to record levels.

(6) For the Federal Government, postwar budgets have been dominated by the need to cope with critical international stresses and tensions and to provide adequate defense under conditions of major scientific advance and rapid technological change. National security and related problems continue to be urgent.

(7) Insofar as international economic developments are concerned, Western Europe still shows strength. Industrial activity, while no longer expanding, has generally been maintained at or close to record levels. In general, balance of payments positions have improved although in several countries reserves of gold and foreign exchange are not as large as might be desired. Outside Europe, however, raw materials-producing countries are facing difficulties because of declines in volume and prices of their exports.

A primary uncertainty with respect to the timing of economic revival and renewed growth relates to the course of business outlays for new plant and equipment. Some observers view the business capital goods boom of the past three years as having provided a margin of industrial capacity over prospective demands greater than can be absorbed quickly. These observers tend to expect a more protracted period of adjustment than took place in the two preceding cycles.

This concern may turn out to have been well-founded, but it may be noted that capacity never appears more excessive than in the midst of receding activity. Recovery, in due course, can certainly be expected to be accompanied by effective and profitable use of the economy's capacity to produce and by still further additions to capacity. The important factors working to expand business capital investment in the period ahead should not be minimized. The advance in the technology of production, in part the result of the huge investment in research of recent years, has been rapid and can be expected to continue. Incentives to reduce costs, to meet competition, and to sustain or improve profitability are strong.

History shows that our market economy has cyclical characteristics, and the consequences of this irregularity in terms of hardship and unemployment are of deep concern to everyone. When downward readjustment becomes unavoidable, it is incumbent on business enterprises, financial institutions and labor organizations, as well as Government generally, to adjust policies and programs to foster recovery.

We have been concerned, for example, about the decline in output and employment while prices generally have been maintained and some prices even have risen further. Currently, it may be noted, consumer prices reached a new high in November and remained at about that high in December and January.

How soon recession is checked and recovery is resumed will be influenced by the rapidity with which economic corrections and adaptations are made in factors beyond the province of monetary policy—that is to say, in business-pricing policies, selling practices, and productive efficiency; in wage bargaining; in various financing arrangements; and in the incentives to consumers to buy.

In the past, price reductions during periods of contraction served to stimulate increased buying and output and thus to contribute to general recovery and expansion. Undoubtedly, lower prices now would prove to have expansive benefits for economic activity generally.

If needed adjustments are promptly made, the current recession may be moderate and short lived. Furthermore, there will be the possibility that revival may develop without renewed inflationary tendencies. Under such circumstances, the task of monetary policy would be to foster such revival and to encourage the resumption of orderly growth.

If revival in overall economic activity becomes exuberant, however, there will be an accompanying danger of resurgence of inflationary pressures. Our postwar experience has demonstrated that, in a period of expanding demand, upward pressures on prices and costs can develop very quickly. Once under way, inflationary movements tend to spread themselves throughout the economy, not only because of normal market reactions, but also because of a variety of institutional arrangements.

When contractive tendencies in economic activity set in, there is always the hazard that recession may be deeper and more protracted than many anticipate, with a greater degree of underutilization of manpower and industrial resources and with manifest deflationary tendencies. In such an eventuality further monetary action would need to be considered, both to increase the liquidity of the economy and to encourage expansion of spending financed by credit.

Monetary policy by itself, however, cannot assure resumption of high-level employment and sustainable economic growth, although ready availability of credit at reasonable cost is certainly an essential ingredient for recovery.

Those of us charged with responsibility for national economic policies must at all times reckon with the dangers both of inflation and of deflation. The central policy problem, in one sense, is to prevent either inflationary trends or deflationary trends from becoming dominant. Public policies for one objective or another can have effects that go far beyond those that are intended. Both fiscal and monetary policies must be carefully formulated to exert enough pressure or ease but not too much. That is certainly a difficult task. It is one that you and I both must live with every day and do the very best we can to reach the judgments and come to the decisions which in the long run will prove to have been wise.

As I have said on many occasions, anti-inflationary policies and antideflationary policies are inseparably linked. Excesses on the up side must be avoided in order to avoid the heavy costs and personal hardships that unfortunately develop during the ensuing contraction. Now that we are in the contractive phase, we must take whatever actions are needed to minimze the hardships and to foster vigorous recovery. But in so doing we also must recognize that excessive stimulus during recession can sow seeds of inflation that can grow to jeopardize our long-run stability and our economic strength at a time when as a Nation we are confronted with a special urgency to maintain all the productive strength we can muster on a sustainable basis.

That covers my prepared statement.

Senator FREAR. Thank you.

Mr. Chairman, as has been stated before in your appearances before this subcommittee and the full committee, I believe it might again be worth noting that on any questions that may be asked of you by our members, that would tend to have an improper stimulus or adverse action in any manner, you might reserve your comments for an executive session.

Mr. Chairman, do you think an economic upturn will occur in March?

Mr. MARTIN. I have to answer that by saying I do not know.

Senator FREAR. There has been a great deal of publicity regarding March as the month of upturn.

Mr. MARTIN. Well, I have tried to keep out of the prediction business.

Senator FREAR. The Federal Reserve Board has been given various tools which it can employ to promote economic stability. Perhaps it would be helpful, Mr. Chairman, if you would briefly outline what your main tools are, along with, if you care to, your opinion as to the relative value of these tools and under what circumstances they can be most helpful.

Mr. MARTIN. Well, I think the three tools that we have are well known to you.

The discount rate is the rate that we charge the member banks that borrow reserves from us.

Our open market operations by the purchase or sale of Government securities supply or absorb reserves in the market.

With respect to reserve requirements, we are given authority in the Federal Reserve Act to vary reserve requirements by classes of banks. There are central Reserve city banks, Reserve city banks, and country banks designated under the act, and the reserves for each of those are 13, 10, and 7 in the act. And we can double that. In other words, we have a range between 13, 10, and 7 up to 26, 20, and 14.

At the present time they stand at 20, 18, and 12.

With regard to time deposits, the rate set in the act is 3 percent, and we can double that to 6 percent. At the present time the requirement against time deposits is 5 percent.

Concerning the use of these instruments, I think you have to evaluate the position that its economy is in at a given time. We have felt that the reserve requirements is probably the bluntest of our instruments. There has been quite a bit of discussion during the restrictive monetary policy of, "Why didn't you raise reserve requirements?"

Reserve requirements, in my judgment, got too high for the type of monetary policy we are now trying to operate, during the period when we had a pegged market. They were being asked to do things that were not contemplated.

Fundamentally, reserve requirements are the fulcrum around which monetary policy becomes effective.

In looking back at the reserve requirement changes during the 1953–54 period, we reduced reserve requirements twice. We did it each time when we wanted to inject massive reserves into the market with a minimum of disturbance to the money market. And both of those steps were, I think, helpful and useful.

I want to make it clear, Mr. Chairman, that I am not forecasting what the Federal Reserve will or will not do tomorrow or the next day when I discuss this, but I say that a change in reserve requirements, blunt or not blunt, is one of the instruments that we have not utilized recently, but we are studying this instrument every day.

Certainly the press would make up our minds for us if we would let them. At the moment they are discussing the subject freely, and I am discussing it equally freely with you. It is one of the instruments that we have at our disposal. But, like all others, its use has to be appropriately timed.

Senator FREAR. What is its relative importance to the others, in your opinion?

Mr. MARTIN. The way I would put it is this: We would probably be better off if we made only major adjustments in reserve requirements. But first, we need to arrive at some better system of reserve requirements than we have at the present time. That has been a most difficult thing for us to achieve because of the disagreements between bankers, which represent, I am sure, honest differences of view.

I think the geographic classification is largely outmoded today. But I do not think it is totally outmoded. What I would like to see is an ultimate reserve requirement that would be based on size of bank, velicity or turnover, and the nature of the business, in preference to mere geographic distinctions.

But in the act today we have these three geographic classifications.

Now, as a fulcrum, we have tried to have an overall reserve of about 16½ percent. I am pulling all of these ratios together in an average here. I think it would be desirable if we had a little different system of reserve requirements. But, since we do not have a different system of reserve requirements, I think we have to be careful and not favor one class of banks against another competitively just because at that particular point it looks like you would reasonably inject more reserves into the money market. We should not favor one group or another group, but try to look at the national policy as a whole.

The reserve requirement instrument is one that we have labored with about as strenuously as we possibly can, but we still have differences of opinion in our own Board and among our presidents as to the exact way in which it should be used.

Senator FREAR. That is stimulating also. The differences of opinion are stimulating.

Mr. MARTIN. That is indeed. I am very glad to say we have differences in the Federal Reserve.

Senator FREAR. Do you think Federal Reserve actions can be as helpful in stimulating investment during a recession as they are in retarding investment during a period of inflation?

Mr. MARTIN. I do not think they can be quite as helpful because of the human factor.

Let me put it this way: They may be equally as effective in either direction, but it is harder to put people under restraint, even though it may be desirable in an expanding economy, and it is easier to get people to ease money in a declining economy.

If you operated without those human factors, I would think that you would be much more effective in restraining than you are in stimulating. But I think that those human factors have a tendency to even up the effectiveness.

Senator FREAR. How do you account for the 1956–57 inflation despite the Federal Reserve's strict credit policies?

Mr. MARTIN. Well, I account for it by the fact that all of us underestimated the strength of the boom, and I think that we went on a spending spree and an expanding spree. Where I think Federal Reserve policy is vulnerable is that we should have been tighter—not that we were too tight in the policy. And I think that we should have had more support from a larger budget surplus and from other restraining factors in the economy, including the management of the Federal debt.

I think we tended to be slow in our start, and then the momentum gathered up on us, and then, at the tail end of it, it was perfectly obvious to a lot of us that it was being overdone.

When you lose more than $10 billion of your gross national product in a markup in prices without any additional goods and services, you know something has gone wrong.

The cost of living index was going up every month on us. It just got away from us. And, I think as the result, we are now suffering from the inevitable aftermath.

Senator FREAR. I have several questions that I would like to put that you have given me the idea to ask, but I think it is unfair to the other members of the committee for the chairman of the subcommittee to monopolize the questioning of the Chairman of the Federal Reserve while he is here.

My final question, Mr. Chairman, is: Do you think the Federal Reserve Board has all the authority it needs to promote stability, or are there other powers you would like to have Congress give you?

Just a short while ago you mentioned something that you may want to elaborate on now on powers you might want Congress to give you.

Mr. MARTIN. Well, outside of the possibility of our coming up with a request for legislation on reserve requirements, which is fundamentally a change in the nature of the requirements, I think we have the authority that is required. I hope we have the wisdom to exercise that authority properly.

Senator FREAR. Do you have an idea that you may bring up within this session of Congress a request for a change in reserve requirements?

Mr. MARTIN. I think we may come up with legislation suggesting a change in reserve requirements before this session of Congress is over.

Senator FREAR. Thank you.

Chairman Fulbright?

Senator FULBRIGHT. Mr. Chairman, I have 1 or 2 questions.

I would like to pursue a bit your last observation that you did not act soon enough or fast enough and your only criticism of your policy was you were not tough enough.

You recall this committee had a hearing in the spring of 1955, did it not, on this subject?

Mr. MARTIN. You did.

Senator FULBRIGHT. Did the committee not try to urge you and others to take note of the inflationary tendencies in our economy?

Mr. MARTIN. I think that hearing was very helpful, and we did take some action subsequently. We did not take as——

Senator FULBRIGHT. You took some, but did any other agencies in the Government? Did the Treasury take any note of it or do anything in respect to their policies?

Mr. MARTIN. Well, they did not do enough. Let's put it that way.

Senator FULBRIGHT. Would you not say that the tax bill of 1954 contributed to the overexpansion of the productive capacity?

Mr. MARTIN. As things developed; yes.

Senator FULBRIGHT. It was quite clear in 1955 that that would be the effect, was it not? That is what this committee—certain members at least—alleged; was it not?

Mr. MARTIN. Well, I am inclined to agree with you, but it is a matter of judgment there.

Senator FULBRIGHT. But it is not a matter of judgment now. The facts bore out the views of the committee at that time; did they not?

Mr. MARTIN. I think subsequent events did.

Senator FULBRIGHT. Is that not the proof that they were correct at the time?

Mr. MARTIN. Well, for that period; yes.

Senator FULBRIGHT. That hearing did not amount to shouting "Fire" in a crowded theater and did not cause an undermining of the economy of the country; did it?

Mr. MARTIN. No.

Senator FULBRIGHT. You recall the committee was accused of doing that; do you not? You remember that; do you not?

Mr. MARTIN. I remember it very well.

Senator FULBRIGHT. Recently Mr. Burns, who was, as you know, formerly Chairman of the President's Council of Economic Advisers, was reported to have said in the New York Times on Sunday, February 16, and I quote for the record:

> Professor Burns believes that the recession which began after the peak in July and August 1957 will continue "at least for some weeks or months." The contraction will not be ended by a revival of business investment, of export demand, or any other economic development but only by "massive" Government intervention.

Do you agree with that statement?

Mr. MARTIN. No; I do not think I do.

Senator FULBRIGHT. I wish you would comment on it. I would like to see your difference of view about it.

Mr. MARTIN. Well, I have some question about massive Government intervention. To me, I have no question about the strength and vitality of this American economy. And I think that recovery is assured.

As I have stated recently, I look on it as a patient—to put it in those terms—who has overexerted himself. You want to do all you can to help that patient. You do not want to punish him on account of the fact that he has overexerted himself; you want to give him all the solace and comfort and whatever medication you can give him.

But you have got to be very careful that you do not rush in with a hypodermic that will temporarily create stimulus that will cause him to get up and run a 100-yard dash and then fall back in a worse state than he was before.

Now, I think that that is where you have to watch massive Government intervention. And I think what is required here is that our recovery is assured on a sustainable basis—provided we do not engage in too much foolishness about it and we just go about it in an orderly, sensible, intelligent way.

Senator FULBRIGHT. Are you recommending one way or the other about a tax reduction at this time?

Mr. MARTIN. I am not recommending one way or another because I think that that would have to await the unfolding scene. But if a tax cut should come, it should be carefully weighed as to the deficit that would be created as against the time element of recovery and all the factors that are involved in that.

There might come a period here where you would have to consider fiscal policy as one of the legitimate things to do. But if you are going to have an offsetting deficit created by that, and deficit financing, you have got to weigh that very carefully.

Senator FULBRIGHT. Let me put it this way: As of today you do not see the need for a substantial tax cut?

Mr. MARTIN. I do not as of today.

Senator FULBRIGHT. How about substantial expansion of Government expenditures on public works?

Mr. MARTIN. I do not see that as of today.

Senator FULBRIGHT. As between those two, would you have any preference if you had to make a choice today? Would you have any preference between one or the other procedure?

Mr. MARTIN. No; I would not think either one of them would be—I think that public works expenditures would be preferable to a tax cut.

Senator FULBRIGHT. That is what I mean.

Mr. MARTIN. Yes.

Senator FULBRIGHT. Supposing you had to make a choice.

Mr. MARTIN. If I had to take one——

Senator FULBRIGHT. You would take public works over taxes?

Mr. MARTIN. Right.

Senator FULBRIGHT. In fairness to Mr. Burns, I believe his whole statement suggests this would be a temporary tax cut or temporary expenditures that he felt might be resorted to, if I recall correctly.

Mr. MARTIN. I want to say I have not read his whole statement either.

Senator FULBRIGHT. I did not care to read it all into the record.

Senator BRICKER. Let's put it in the record.

Senator FULBRIGHT. I would be glad to.

Senator FREAR. Without objection, it may be made part of the record.

Senator FULBRIGHT. The whole statement will be in the record.

(The statement referred to follows:)

[From the New York Times, Sunday, February 16, 1958]

BURNS FORESEES LAG IN BUSINESS—PRESIDENT'S FORECAST OF RISE IN MARCH IS DOUBTED BY EX-ADVISER AT COLUMBIA

(By Will Lissner)

President Eisenhower's former chief economic adviser said yesterday that the President's recent forecast of a business pickup beginning next month was not backed by compelling evidence.

The economist is Prof. Arthur F. Burns, of Columbia University, one of the world's authorities on the business cycle. He declared that as yet there was insufficient evidence to justify any prediction of an early end to the current business recession.

Dr. Burns spoke at Columbia College on the Morningside Heights campus at the annual dean's day fete. About 1,000 of his fellow alumni and members of their families attended lectures by 17 faculty members and a reception for Dean Lawrence H. Chamberlain at the academic homecoming.

Dr. Burns, Chairman of the President's Council of Economic Advisers during Mr. Eisenhower's first term, is president of the National Bureau of Economic Research, a center of business-cycle study. He spoke, however, as a Columbia economics professor and not as an officer of the research agency.

PRESENT CHAIRMAN

The present council chairman, Dr. Raymond J. Saulnier, is on leave from the bureau and its facilities have been available to the council. The bureau does not publish short-term forecasts.

Professor Burns believes that the recession, which began after the peak in July and August 1957, will continue "at least for some weeks or months." The contraction will not be ended by a revival of business investment, of export demand, or any other economic development, but only by "massive" Government intervention, he declared.

The Communist world, he held, would reap vast benefits and international political advantage from a prolonged and severe slump here. Because of that, he predicted, the Government will intervene "on a large scale before very long." He said he was "very confident that this intervention would end the decline and restore full employment."

The professor refused to speculate about the counterdepression measures the administration probably would invoke. But in defending Government intervention against the charge that it was necessarily inflationary, he indicated that at least two courses of action were uppermost in his thinking.

TAX CUT AND SPENDING

"There is no doubt that a temporary tax cut of $4 billion to $5 billion for consumers and businesses would revivify the economy," Dr. Burns said, adding: "That doesn't mean that today is necessarily the time to do that." The timing and the selective basis of tax reduction would determine its substantial effect, he explained.

Expanded Government spending on public-works projects that will be completed in 6 or 9 months, rather than on water-resource projects that would run for 5 to 15 years, would also help to revive the economy while holding the risk of reviving inflation to a minimum, the economist said.

Dr. Burns contended that political spokesmen had exaggerated the extent of the decline. Statistics show that steel output has fallen 45 percent, automobiles between 20 and 25 percent, and industrial production as a whole 9½ percent. But the professor estimated that overall output had declined so far between 2 and 2½ percent.

His estimate would mean that gross national output of goods and services, which amounted to about $435 billion in 1957, would be about $426 billion in 1958 if economic activity got no better or no worse in the remainder of the year. Allowing for recent inflation, that would put 1958 on a par with 1955 and a little behind 1956 as well as 1957.

UNEMPLOYMENT FIGURES

Unemployment figures also have been misinterpreted, Dr. Burns held. Currently the jobless figure is between 4.5 million and 5 million, he said. However, December, January, and February are the months of highest seasonal unemployment. Allowing for the normal seasonal increase in unemployment, the economist estimated that the loss of jobs due to the current business contraction between 1,250,000 and 1,500,000.

Professor Burns said a study of slumps going back to World War I showed that the current decline was rather mild or moderate. He explained that it resembled far more closely the recession of 1953–54 and 1948–49, which were very mild, than those of 1920–21 and 1937–38, "to say nothing of that of 1929–33."

From another tack, the economist said, comparison of the changes in activity from July through December 1957, with those of the first 6 months of every previous contraction, showed that the last period resembled the minor contractions of the past rather than the ones that were more severe.

Dean Courtney C. Brown of the Columbia Graduate School of Business told the alumni and guests that the United States faced long-range problems that were not unlike those that handicapped underdeveloped countries.

He said growth of bureaucracy and redtape—not only in Government but in private sectors—emergence of a caste system and declining initiative and scope for individual development were among the problems with which the country must deal.

Senator FULBRIGHT. One last thing. I thought it would be helpful to the committee if in addition to your discussion of reserve requirements you could say a little about your open-market operations. They go hand in hand, do they not, as to their effect?

Mr. MARTIN. Yes. Well, with our open-market operations, as indicated in the paper, we began to lessen pressure in that way in mid-October. Then after the cut in the discount rate——

Senator FULBRIGHT. You began to buy bonds, did you?

Mr. MARTIN. That is correct.

Senator FULBRIGHT. What happened? Would you describe it a little?

Mr. MARTIN. We had a minus reserve, net borrowed reserve, of about $500 million that we were running in late October and early November, and today we have free reserves. This has been done over a gradual period of time by purchases of bonds in the market. We have free reserves of $200 million, approximately. So that is about a $700 million swing in a period of about less than 3 months.

Senator FULBRIGHT. What has been the effect on prices of Governments?

Mr. MARTIN. It has been a very sharp decline in rates generally.

Senator FULBRIGHT. Putting it in other words, an increase in the price of Governments on the market?

Mr. MARTIN. That is right.

Senator FULBRIGHT. About what percentage? Could you say? Just to indicate the magnitude of it for the record?

Mr. MARTIN. Well, percentagewise I am not good at figuring those, but they have gone up to 104 and 105—some that were down at 94 and 95. And all across the board there has been a strong recovery. The Treasury recently sold a long-term 32-year bond for 3½ percent—sold $1,700 million—which is the first substantial lengthening of the debt that has taken place, and in the short end of the market, which is the real payoff here. You have had your bill rate drop from about 3½ percent to 1½ percent. It is now a little bit higher than that.

Senator FULBRIGHT. I will conclude by saying that within your jurisdiction, the Federal Reserve, I think you all have done a very good job, with the exception that you were a little slow in 1955, as you have already stated, in taking hold.

Mr. MARTIN. We have not been perfect by any means.

Senator FULBRIGHT. Otherwise I have not had any reason to quarrel with you, as you know.

That is all, Mr. Chairman.

Senator FREAR. Senator Bricker?

Senator BRICKER. Nothing, except I would like to ask one question. What do you estimate the capital expenditures will be for this year by industry?

Mr. MARTIN. By industry? I might ask Mr. Young. Would you comment on what you think capital expenditures would be, Mr. Young? They are running about 15 percent less than——

Mr. YOUNG. Not 15 percent. About 5 percent down for the first quarter, it is estimated, from a rate, an annual rate, of around $37.5 billion, I believe, toward the end of the year. Then what they will do in the rest of the year we do not know, except that we have the McGraw-Hill survey of the fall which estimated a decline for the year of around 11 percent. But I do not——

Senator BRICKER. From the 37½?

Mr. YOUNG. From the 37½.

Senator BRICKER. That is billions?

Mr. YOUNG. Yes.

Senator FREAR. Senator Robertson?

Senator ROBERTSON. Governor, since you are an independent agency responsible only to the Congress and you do not have to run for any office this year or any other year, I think the statement you have given us this morning will be well received by the public generally. They know that you know about the conditions that you have described here, and they will appreciate the rather temperate position you have taken with respect to methods of easing what you have clearly defined as a temporary recession.

Of course, you did not blink at the fact that we have a recession from the high of 1956 and the spring of 1957.

I understand that when some people have high blood pressure they will have a stroke, and if the blood gets back to the brain cells within 24 or 48 hours they will say it is a slight stroke and they recover. If the blood does not get back to a certain portion of the brain in 2 or 3 days, that brain cell dies, and there is permanent injury to whatever that brain cell controlled.

You say that the high blood pressure caused by excessive borrowing for plant expansion, for home building, and the purchase of automobiles did not cause a dislocation, when the recssion came, involving permanent injury?

Mr. MARTIN. That is correct.

Senator ROBERTSON. Therefore, you said the pattern of this recession should follow all of our other recessions—except the big one of the thirties when it was worldwide—lasting not over a year.

Then you give us seven encouraging things on the side of a recovery, without saying whether it is going to be March, April, May, June, or July. You say there is going to be recovery, and here are the reasons you think so:

There is an ample supply of credit.

There is a population increase.

Consumer incomes have held up mighty well.

There will be large Federal and local spending.

There will be a big defense budget.

And there is no depression in Western Europe.

Those things are on the favorable side—at least you think—and there will be a recovery.

Then you wind up with a statement leaving us, of course, to make the application, as pointed out by Senator Fulbright. You say that we must take whatever actions are needed to minimize the hardships but avoid excessive stimulation.

I heard a story once about a good old Methodist sister who complained that her preacher smoked a pipe, and she said:

"Now, Doctor, don't you think that is wrong?"

He said, "No, Sister, not unless he smokes to excess."

"Well," said the sister, "what would you call excess?"

He said, "Smoking two pipes at once."

I understand that for the time being the 7 pipes that you have lit on the recovery side are all that you think are needed, and that if we were to light, for example, big deficit spending or a tax cut, which certainly would go first to consumer spending such as a $100 increase in personal exemptions, that would be smoking 2 pipes at once? It would be excessive at the present time?

Mr. MARTIN. At the moment I think so; yes, sir.

Senator ROBERTSON. Is that the proper application of your philosophy?

Mr. MARTIN. Yes. I do not have any——

Senator ROBERTSON. You did say recovery would be stimulated by a reduction in prices. The last presentation of the economic picture by your experts was that there had been no cut, no appreciable cut, in wholesale prices although there was considerable unemployment. There had been a reduction in production, yet wholesale prices held up.

How are we going to get any reduction in prices if the manufacturers do not cut, if the wholesale houses do not cut? You cannot expect the retailer to take it all, can you?

Mr. MARTIN. Well, that is the market process. I think the pressure will force some reductions. And, of course, you are on unpopular ground with anybody when you suggest he cut prices if he has got a stock that he hopes to be bailed out of either by waiting until the recovery gets a little bit further ahead or some other stimulus will come in and save him.

Senator ROBERTSON. Some of my banker friends tell me that a cut in the reserve rate would be more stimulating to them than a cut in the rediscount rate. Have you had many requests from member banks that you cut reserve rates?

Mr. MARTIN. Yes; we have heard that. We have had the story on both sides. If you took our mail, we have a good many people who think we should not have cut the rediscount rate. There is a smaller number as time goes on, but you have some. There are some who think the way to have handled it would have been to reduce reserve requirements.

Senator ROBERTSON. In other words, do you think that credit at the present time is sufficiently easing to take care of creditworthy risks that are applying for capital?

Mr. MARTIN. I think that the availability of credit has been steadily improving, Senator.

Now, I do not say that it has been totally adequate. I think that is something you have to measure from day to day and week to week. And that is one of our major concerns right now. If we had a sudden resurgence of activity, a real boom, we would consider reversing monetary policy in the direction of putting the discount rate back up. But if, on the other hand, the decline continues, we have got to look at the situation as it is and be certain that there is availability of credit.

There is no question that the availability of credit has improved. You can see it in the mortgage market. It has been steadily improving there.

Now, it is not running out everyone's ears yet, but I think you have got to be very careful that you do not force credit. This is borrowed money.

Senator ROBERTSON. According to the records of the State unemployment offices, we have over 4 million unemployed at the present time, and for them this is a real depression. They are suffering hardships, but, as you pointed out, we have a better system of unemployment compensation than we had in any previous real depression and that is helping to tide us over. But there are some hardships.

And you say that we should take action to minimize the hardships. But you said an immediate tax cut is not one of them. Pump priming is not one of them. You said reducing prices would be one of them, but that is something we cannot in Congress control.

What would you specifically recommend?

Mr. MARTIN. Well, I have no recommendation at the moment, Senator. I think we have got to watch the situation. I think that the patient, to get back to that, needs convalescence. I do not know that my medical knowledge is very good, but I think a certain period of convalescence is required, and you have to gage the patient on the basis of that.

Now, I think that in terms of minimizing hardships through credit and monetary policy——

Senator ROBERTSON. This language that "we must take whatever actions are needed to minimize the hardships" largely indicates a sympathetic attitude on your part, but you do not have anything particularly in mind?

Mr. MARTIN. The Federal Reserve Board is very distressed at any unemployment. We want to do everything within our power to be helpful.

Senator ROBERTSON. But you say that monetary policy alone will not either put it up or bring it down but that you can do a better job in keeping it from going too high than you can bringing it up again.

The question I raise is this: I pointed out that some bankers think money is not yet easy enough and that if you did not tie up as much of their reserves as you do at the present time they would feel a little easier on making greater loans.

Mr. MARTIN. That is a matter of judgment that we have to weigh very carefully in the System; and if we come to the conclusion that that is correct, you can be sure that we will act.

Senator ROBERTSON. You would not hold back, if that would be a remedy, until we get forced into a tax bill, would you?

Mr. MARTIN. I would not hold back 1 minute. The minute the Board is convinced—and we are studying this every day—that that would be helpful and would do something for the economy, we are going to do it.

Senator ROBERTSON. I agree with Chairman Fulbright. I think you have been doing a good job.

Thank you, Mr. Chairman.

Senator FREAR. Senator Bennett?

Senator BENNETT. I would like to go back, Mr. Martin, to the sentence on page 9 which Senator Robertson mentioned and refer to the comment about the maintenance of prices.

All last summer and fall the Finance Committee, of which three members of this committee are also members, was engaged in a hearing on what was then the current economic situation—a situation of inflation. It was obvious to me as a member of the committee that there is a philosophy in this country which suggests that the way to cure inflation is to raise wages—on the theory that then the wage earner will be able to buy more merchandise and that will prime the pump.

There is some evidence that within the next 2 or 3 weeks we are going to be visited here in Congress as a part of an organized campaign to support that theory that the minimum wage should be raised to $1.25 and current collective-bargaining programs should produce massive wage increases. Do you believe that that is sound policy in a situation where we have unemployment and prices are still rising?

Mr. MARTIN. Well, as I pointed out in this statement, Senator, wage rates were pressing against productivity and exceeding productivity in some instances, and that was one of the reasons for the inflation getting ahead of us. And I think that is one of the factors that has to be considered at the present time.

I do not think that you can justify wage increases beyond productivity and——

Senator BENNETT. Can you do that at any time?

Mr. MARTIN. I do not think you can at any time. And I do not think you can spend yourself prosperous. I just do not agree with that theory.

Senator BENNETT. Sitting in on those hearings, it was obvious to me that there is a line of thinking in this country which says that the way to cure inflation is more inflation, that in periods of inflation the policy of the Federal Reserve Board should be to ease money, thus producing more purchasing power, which presumably would fill up the gap produced by the current underuse of productive facilities.

Is it not logical, to follow that same reasoning, to assume that in a period of recession like this the correct policy should be a tight monetary policy? And would you believe that in your position as Governor of the Federal Reserve System you would recommend tight monetary policies in time of recession?

Mr. MARTIN. I certainly would not.

Senator BENNETT. Then you believe you really were following the correct program during the inflationary period, and that by releasing more capital or more reserves now that business has fallen off a little you are also following the correct policy?

Mr. MARTIN. I do.

Senator BENNETT. I think the record would not be injured too much if I asked you if you ever heard the story of the man and the lions? You have not so I will proceed to tell it to you.

The story is that there was a man in an automobile going through the main thoroughfare of a busy town, and about every half block he threw out half a newspaper. Finally the traffic policeman caught up with him and said, "Here, what are you doing? You can't do that. That's against the law."

He said, "I'm protecting this community against wild lions."

The policeman said, "There aren't any wild lions around here."

The man said, "See. My program works."

I wonder if this theory that in periods of inflation we should have more inflation is not based a little bit on that same kind of reasoning?

Mr. MARTIN. Well, I think it is an incorrect theory.

Senator BENNETT. I was very interested in your earlier comment in response to questions by Senator Fulbright that there is a possibility that you might come to this committee with proposals for basic alteration in the pattern of reserve requirements. Do you think this committee should take some initiative to hasten the time when that should be considered, or do you feel that you are not quite ready yet?

Mr. MARTIN. I do not think we are quite ready yet, Senator. But we are working on that. We have been working on it for months, as some of you know. And I am hopeful we will come up with something before too long now.

Senator BENNETT. Would an indication of interest by this committee hasten the day when some of the differences among your members might be resolved?

Mr. MARTIN. I do not think it would do any harm, but I do not really think it would advance things very much at the moment, because we are making progress at the moment.

Senator BENNETT. That is all.

Senator BRICKER. Along what line?

Mr. MARTIN. Along the lines of a proposal.

Senator BRICKER. I know, but do you know now what the nature of the proposal might be in the readjustment of your reserve requirements?

Mr. MARTIN. I would not want to discuss that today, Senator, because I have not got agreement on it yet with our own people. But we have been, as I discussed earlier, considering this thing from the level, the overall level, of reserve requirements.

Senator BRICKER. Doing away with the geographical limitations?

Mr. MARTIN. And doing away with the geographical. But not so much worrying about that as worrying about how we make the transition to a sounder reserve level for the long-range growth and development of the country that we think is going to be with us in the not too distant future. Certainly in the 1960's we are going to have a terrific need for financing. If the current growth occurs, you are going to have need for substantially more reserves than we presently have. We want that financed on the right basis.

We know that part of our problem today is that a lot of the people who were very generous and going all out on supplying credit when things were very good get equally tight when things get bad.

Senator BRICKER. Yet the geographical expansion of the country has not been limited to any one area.

Mr. MARTIN. That is correct.

Senator BRICKER. So the tendency would be, you think, to apply certain reserve requirements across the country rather than by geographical limitations?

Mr. MARTIN. Well, I am certain that intellectually it is not, in my judgment, possible to defend the geographic distinctions per se. But when it comes to writing a reserve requirement plan on the basis of velocity of deposits, you have administrative problems, and you also, I think, have a distinction between a very large bank and a very small bank. I think that the large bank ought to have higher reserve requirements than the very small bank.

I think you have got these distinctions that have got to be weighed.

In moving toward uniformity, you have got to have some uniformity that will stand up. And when it comes to defining it or administering it, it certainly is the most difficult problem the Reserve Board has ever had from the inception of the System.

You see, what happened is that up to 1935–36 we had virtually fixed reserve requirements. In 1936 you had the 13, 10, 7, and 3 area that is the minimum now. And then you had the big gold inflow, you see, in the period of the 1930's. So in 1936 we gave the big upswing permitted in the Banking Act of 1935 for the increase, and we got the reserves up to 26 percent. Now we no longer have that gold swing, and you know all the ins and outs of gold policy since that time, including the devaluation of 1934. So that, in a sense, we are working with reserve requirements that are adapted to a different period and a different gold setup.

Senator FREAR. Does that finish your questions, Senator Bennett?

Senator BENNETT. Yes.

Senator FREAR. Senator Douglas?

Senator DOUGLAS. Mr. Martin, like you, I believe in a flexible monetary and credit policy. In a period of undue boom there should be some dampening down on the creation of bank credit—particularly use of commercial credit for investment purposes. Also in a period of recession or depression there should be a loosening of credit.

But it is highly important for those who apply this policy to know what period they are in when they apply it. Namely, you should not follow a restrictive policy when you are on the downgrade.

And I would like to ask you whether, looking at things in retrospect—and I want to accord you full honesty of your judgment—you think you should have increased the rediscount rate in August from 3 to 3½ percent?

Mr. MARTIN. Senator, I do not think we had any alternative, because that was a technical problem in the money market. You will recall that the prime rate at the banks was raised on August 7 to 4½ percent. Now, the demand for credit was still very strong. We had some apprehensions in February. We also had difficult Treasury financing over quite a period of time there or we might have moved the discount rate up as early as December of 1956.

Senator DOUGLAS. As a matter of fact, however, all the statistical indexes indicate that the present recession began in August. In other words, things started to slip in precisely the month that you increased the rediscount rate. The situation became even more obvious long before you lowered the rate in November.

Mr. MARTIN. Well, I just cannot agree with you on that. You, see—

Senator DOUGLAS. What about the index of production? The index was 145 in August and by November had fallen to 139. It was falling steadily during that period. Unemployment was rising.

Mr. MARTIN. Look at the preceding period, Senator—May, June, July. You have the index there in front of you, do you not?

Senator DOUGLAS. I have the indicators, yes. Which index? Production?

Mr. MARTIN. Our production index.

Senator DOUGLAS. Yes, I have one.

Mr. MARTIN. Well, you see May, June, July it held steady.

Senator DOUGLAS. That is right.

Mr. MARTIN. In August it went up.

Senator DOUGLAS. One point. But you did not get your August figures until September.

Mr. MARTIN. Oh, but we are in the making of them all the time. And then in September there was a slight decline. And we were watching clearly because we were thinking about a fall upturn.

Senator DOUGLAS. Is it not true that the recession really gathered weight in August and began to move down so that from August to November you had a higher rediscount rate in the face of falling production and falling employment?

Mr. YOUNG. You did not have falling employment in August. You had pretty close to the peak, Senator. I believe.

Senator DOUGLAS. I say from August to November.

Mr. YOUNG. It is on page 11.

Senator DOUGLAS. Would you give the Governor——

Mr. MARTIN. Have you got it, Mr. Young?

Mr. YOUNG. Total civilian employment, nonagricultural in August was 59,562,000, which was up.

Senator DOUGLAS. You mean there was no increase in unemployment during the fall? There was no decrease in employment during the fall?

Mr. YOUNG. Of course, this is a technical problem. You had the little bit of advance in the summer in industrial production from June to August. Retail sales had been showing up very strongly in that period, and employment had been rising moderately.

Senator DOUGLAS. Now, just a minute. If you look at these figures you have cited, nonagricultural civilian employment in August is listed at 59,562,000 and in November at 59,057,000, or a decrease of half a million. So that my earlier statement, which you questioned, was correct, namely, there was a fall in production and in employment during this period.

Mr. YOUNG. Oh, there was from August.

Senator DOUGLAS. That is right.

Mr. YOUNG. It was not declining in August. And in September there was some question.

Senator DOUGLAS. What I am asking is this: In retrospect—I am first going to ask in retrospect—is it not true that the rediscount rate was raised at the very time the economy began to slip?

Mr. MARTIN. In the first place, I think the discount rate was just a technical move. But I do not agree with you on that because there is hindsight and future there. There are at least a dozen times from 1955 to 1957, Senator, where you could have seen the same pattern developing.

And I think one of the things as to why our policy was less effective than it might have been was that we were scared off a number of times into not doing something that should have been done.

Senator DOUGLAS. What you are now uttering is really a plea in mitigation? You are saying, "Yes, perhaps we made a mistake, but we could not have told at the time"?

Mr. MARTIN. No, no. Well, I will answer you categorically I do not think it was a mistake.

Senator DOUGLAS. In other words, you think the increase in the rediscount rate was proper?

Mr. MARTIN. I do indeed.

Senator DOUGLAS. Despite the fact that you had a falling off in production and employment immediately after it was increased?

Mr. MARTIN. Which I insist no one could have been certain of until after it began.

Senator DOUGLAS. What you are saying now is we could not have foreseen it?

Mr. MARTIN. Certainly.

Senator DOUGLAS. Therefore, it was not your fault? But if you could have foreseen it, would you have increased it? If you could have foreseen the decrease in production, the falling off of employment that would have occurred, would you have raised the rediscount rate from 3 to 3½ percent in August?

Mr. MARTIN. I would have if the money market was in a situation where the prime rate at the banks could have stayed at 4½ percent with us having a discount rate of 3.

Senator DOUGLAS. Now, there is another question I want to ask. Namely, was it possible to foresee what was going to happen? You people spend your full time down there studying business conditions and are in touch with the situation very closely. You have a large group of economists. I take it that you were afraid of inflation during this period?

Mr. MARTIN. I certainly was.

Senator DOUGLAS. And, therefore, you increased the rediscount rate because you wanted to check inflation, and you were measuring inflation by the consumer's price index? Is that not true?

Mr. MARTIN. It was one of the measures.

Senator DOUGLAS. What was happening to spot prices in the daily quotations? You know the Bureau of Labor Statistics computes an index of daily spot prices of raw materials—copper, lead, zinc, iron, oil, wool, wheat, corn, and so forth. This is the most sensitive index of all. What was happening to that index in the period prior to August?

Mr. MARTIN. It was erratic with a slight tendency down.

Senator DOUGLAS. I have here the list of monthly indexes of these spot prices which I should like to read now which have been phoned up from the Bureau of Labor Statistics.

December 1956: 100.4.

January 1957: 97.8.

February: 94.7.

March: 94.4.

April: 93.5.

May: 92.7.

June: 93.3.

July: 92.7.

You undoubtedly were watching this closely.

August: 92.1, or a fall of 8.3 percent in the course of 7 months.

Here you have spot prices going down—generally. It is not merely an erratic movement, Mr. Martin. A downward slope. A rather steady downward slope at the rate of 1 percent a month.

Should this not have warned you that there might be trouble coming?

Mr. MARTIN. I did not have the slightest doubt in my mind, Senator, as I testified up here several times, that we were in trouble once the gross national product began to rise at the rate it did without any additional goods and services.

Senator DOUGLAS. But you thought the trouble was inflation, whereas, as a matter of fact, what was happening was a decrease in spot prices on raw materials?

Mr. MARTIN. No; I just do not agree with you. That is just a judgment. I am not——

Senator DOUGLAS. Do you disagree with the figures?

Mr. MARTIN. I am not quarreling with your figures. I studied those figures, too, just as——

Senator DOUGLAS. Do you think that you should not have paid any attention to them?

Mr. MARTIN. I think they were one of the factors to be concerned with, and we kept them in front of us all the time.

Senator DOUGLAS. May I ask what importance you would give to the decline in the balance of exports over imports? Would you give any importance to that?

Mr. MARTIN. Do you have the export figures?

Senator DOUGLAS. On page 22 of the indicators it gives excess of exports over imports excluding grant-in-aid shipments. And you will find that in December the excess of exports over imports was $822 million. It declined in January to $470 million. In February it was $497 million. It went up in March to $890 million. It went down in April to $661 million. It went down in May to $607 million. In June it was $669 million. And in July it was $358 million.

In other words, there was a steady decline in our exports. And this was partially due, as you know, to the fact that the countries producing raw materials, since their prices were falling, were unable to purchase goods in the same quantity from us. And this has been one of the factors in the recession.

It is true, as you say, Western Europe has held steady—steadier than we—but the countries outside of Western Europe, the tropical countries and the oriental countries, for example, have been experiencing a fall in prices of primary products and, therefore, increased inability on their part to purchase from us.

So here were at least two danger signals that were up: The fall in primary prices—very sharp, very precipitous. A decrease in exports, which would inevitably kick back on our production. And yet you went through the danger signals, went through the danger signals with the best intentions in the world, Mr. Martin.

Mr. MARTIN. Never have I claimed perfection for policy.

Senator DOUGLAS. No; but this——

Mr. MARTIN. I just would disagree with your analysis of those danger signals against the cost of living. I am not quarreling with your figures. I studied those figures all the time. But I would disagree with your analysis of it. In my judgment it was an inflationary trend. The cost of living was rising. There are always erratic price movements.

Senator DOUGLAS. But, Mr. Martin, you know perfectly well from your study of price movements that the cost of living always lags. It is more of a result of forces rather than a primary force. The first thing that happens is the movement of primary products. Then come movements of wholesale products, fabricated wool, fabricated cotton, and so on. Then, at the tail end, comes the movement of retail prices and the cost of living.

This is historically the movement of prices.

What you were taking was the end product, which took into account past increases and disregarded the fact that underneath the ground was shaky.

Senator FULBRIGHT. Will the Senator yield for a question for clarification?

Senator DOUGLAS. Certainly.

Senator FULBRIGHT. You picked out December 1956 to make your comparison.

Senator DOUGLAS. Yes.

Senator FULBRIGHT. Take October of 1956. It is 440. October of 1957 is 459. Actually, between those two there is an increase. For some reason which I do not understand, December is almost twice what November and October were.

Senator DOUGLAS. That is right.

Senator FULBRIGHT. It is that 1 month that stands out, indicating something unusual happening there. Actually, as between October and October there is an increase in exports. I do not understand myself why that should happen. It is just that 1 month that shows that most unusual change.

Mr. YOUNG. That was the Suez crisis, sir.

Senator FULBRIGHT. What was it?

Mr. YOUNG. The Suez crisis.

Senator FULBRIGHT. December?

Mr. YOUNG. Which gave us the bulge at the end of 1956.

Senator FULBRIGHT. Just that 1 month?

Mr. YOUNG. Yes. That was very heavily petroleum shipments.

Senator DOUGLAS. If you take the average of 1956 you find it was approximately $400 million a month.

Senator FULBRIGHT. Actually, in 1957 you have month by month much higher than that—except for the 1 month of December. I do not know what the significance is.

It just occurred to me that that does not really reveal any substantial decrease except by comparison to the 1 month of December.

Mr. YOUNG. Well, we were watching the export figures very closely at that time. They were at a quite high level through the summer.

Now, you have to remember that our export figures lag in their receipt by us. We are getting figures now for December.

Senator DOUGLAS. Two months.

Mr. YOUNG. Two months' lag.

Senator DOUGLAS. Of course, there was also a downward movement, a slight downward movement, in the index of production, which was 147 for December, 144 for July, a slight rise to 145 in August. A slight dip in production. Certainly production was not increasing. A fall in primary prices, which I think is the most sensitive index. What was happening to new orders during this period?

Mr. MARTIN. New orders were sliding off.

Senator DOUGLAS. That is right. From January 1957 to August 1957.

Mr. MARTIN. Right.

Senator DOUGLAS. Did this make any impression on you?

Mr. MARTIN. It certainly did.

Senator DOUGLAS. Yet, in spite of this, you increased the rediscount rate?

Mr. MARTIN. Well, in my judgment, that increase in the rediscount rate was necessary for technical reasons.

Senator DOUGLAS. It was defended at the time not merely for technical reasons but to check inflation.

Mr. MARTIN. I do not know who defended it that way.

Senator DOUGLAS. I think you defended it and certainly Mr. Humphrey defended it in our hearings.

Mr. MARTIN. Any increase I suppose could be interpreted, let's say, in that direction.

Senator DOUGLAS. I think it was actually defended on that ground, not merely on technical grounds but as a part of policy.

Mr. MARTIN. When you have seven members of the Board, each one of them might have a different reason for voting for the increase in the discount rate. To me it was untenable to have a prime rate for the banks with a heavy credit demand at $4\frac{1}{2}$ and a 3-percent discount rate.

Senator DOUGLAS. This is the whole point. I am not trying to put you in the hole. I agree with the principle of a flexible credit policy. But it is highly important that the pilot or the engineer read the signals. And if you restrict credit at a time when business is sliding, that is the wrong kind of a credit policy.

As I say, I am sure you moved honestly, but we only learn how to behave in the future, frequently, out of the mistakes that we make in the past. The sole burden of my song is this: Do you not think it would be wise in the future not to place so much reliance on the cost-of-living index?

Mr. MARTIN. Well, the cost-of-living index may not be the most accurate index that we have. And I question a lot of our indexes.

Senator DOUGLAS. As a matter of fact, the cost-of-living index was going up in November when you reduced the rediscount rate back again to 3 percent, so obviously you had been a little bit disillusioned with it by November, although you were in love with it in August.

Mr. MARTIN. I just do not—Well, let's put it this way: I would be the first one to admit a mistake if I thought I had made a mistake. But I do not think we made a mistake there.

Senator DOUGLAS. All I ask is that you read the questions and answers tomorrow morning and let them sink into the subconscious.

Mr. MARTIN. I will be very glad to do that. I will paste it on the mirror, Senator.

Senator DOUGLAS. There was one other question I should like to ask. Am I exceeding my time, Mr. Chairman?

Senator FREAR. You have plenty of time.

Senator DOUGLAS. I will be very glad to stop if I am exceeding my time.

Senator FREAR. No, continue.

Senator DOUGLAS. You mentioned at the end of your statement, on page 10, that monetary policy by itself cannot assure resumption of high-level employment and sustainable economic growth. In other words, there is a place for fiscal policy too?

Mr. MARTIN. Yes, under certain conditions.

Senator DOUGLAS. What would those conditions be? You say now is not the time, but there might be a future time. What criteria do you have for determining when you should add fiscal policy to monetary policy? Fiscal policy could consist either of an increase in expenditures or a reduction in tax receipts.

Mr. MARTIN. Well, I think it would have to be dependent primarily on whether you think the decline is spiraling and coming in——

Senator DOUGLAS. What indexes would you use to determine whether the decline was spiraling?

Mr. MARTIN. I would not use any one index. I would——

Senator DOUGLAS. What group, what family of indexes would you use?

Mr. MARTIN. Well, I think we would have to cover the whole waterfront on that.

Senator DOUGLAS. Let's get to some of the docks on the waterfront. Production?

Mr. MARTIN. Production index.

Senator DOUGLAS. Employment?

Mr. MARTIN. Employment.

Senator DOUGLAS. Unemployment?

Mr. MARTIN. Unemployment.

Senator DOUGLAS. What else?

Mr. MARTIN. Mr. Young, what would you——

Mr. YOUNG. I think you would go across the board—on new orders——

Senator DOUGLAS. What?

Mr. YOUNG. You would go across the board on new orders and inventories——

Senator DOUGLAS. If you go across the broad, what would you look at?

Mr. MARTIN. New orders, inventories——

Mr. YOUNG. What is happening in the securities markets?

Senator DOUGLAS. What is happening to production? It was 145 in August.

Mr. MARTIN. January, 133.

Senator DOUGLAS. A fall of 12 points. What is that?

Mr. YOUNG. Around 8 percent.

Mr. MARTIN. Seven to eight percent.

Senator DOUGLAS. If it should go down below 10 percent would you regard that as significant?

Mr. YOUNG. I think you would want to look at the movement against typical patterns in the past also.

Senator DOUGLAS. You say in past recessions the fall in production has not exceeded 10 percent?

Mr. YOUNG. For a moderate recession it is something like 10 percent.

Senator DOUGLAS. All right. Now, then, suppose it exceeds 10 percent. What I am trying to get at is that you are the doctor, one of the doctors, sitting by the bedside of the patient. And that is your own analogy; that is not mine. I did not say the patient was sick; you said the patient was sick.

Now, you feel his pulse. You find out what his temperature is. An M. D. has certain standards. If the temperature rises to, say, 103, something is wrong. He does not worry very much at 99½.

Do you have anything in the back of your mind as to where you might have a critical point? Would you say a fall of 10 percent in production should begin to——

Mr. MARTIN. I would not want to be pinned to a level. I think that you have got to——

Senator DOUGLAS. Suppose you had a fall of 15 percent. Would you worry?

Mr. MARTIN. The further the fall——

Senator DOUGLAS. You do not think fiscal policy should come in if production fell 15 percent?

Mr. MARTIN. I would not—just could not answer that on a specific basis.

Senator DOUGLAS. Suppose it fell 20 percent?

Mr. MARTIN. I am not——

Senator DOUGLAS. Twenty-five percent? You would not be concerned with 25 percent?

Mr. MARTIN. Senator, I am sorry but I just cannot say that I——

Senator DOUGLAS. You see, you are the doctor. You say, "Have faith in me."

Mr. MARTIN. No; I——

Senator DOUGLAS. We want to find out what you are having faith in, what indexes you are watching.

Mr. MARTIN. I am not saying, "Have faith in me."

Senator DOUGLAS. Let's turn to unemployment. The census says we have 4½ million unemployed. If you add the part-time workers to this you get an equivalent of 1.2 million more or 5.7 million. The total working force is a little less than 67 million. That is 8.5 percent. But this 67 million includes the self-employed, 9 million self-employed plus a million more wives and elder sons or elder daughters, self-employed. So you really have to deduct them in getting an index of unemployment. And when you come to the number of wage and salary workers in the country, a little less than 57 million, then you have 5.7 million equivalent unemployed. That is a 10-percent unemployment ratio. Do you think that is significant?

Mr. MARTIN. I certainly do. I think that——

Senator DOUGLAS. But you say it is not yet time for fiscal action. By how much would it have to increase before you think it would be time?

Mr. MARTIN. Well, I cannot answer that categorically, but I want to say that these unemployment figures ought to be studied awfully carefully too. You have questioned the Consumer Price Index. I think all of these indexes have got to be put in the context of what is the truth about it.

Senator DOUGLAS. You see, here is the point. You will say, "I am moving because the Consumer Price Index is this way." Then you will shift. The pea will be under another thimble, and so on. You chase these around. What I am trying to do is assemble these various indexes and try to see when you would believe that fiscal policy should be carried out.

Mr. MARTIN. Well, I cannot tell you precisely.

Senator DOUGLAS. You are not in control of fiscal policy. We are in control of fiscal policy. Presumably we have to make up our minds. We are coming to you for advice.

Mr. MARTIN. Well, I am not trying to be presumptuous in what I am saying now, but I am saying that I think you, in studying your problem, just as we in studying our problem, should look at the whole picture and not just at one index or the trend in a few indexes.

Senator DOUGLAS. Oh, that is my whole quarrel with you—that you looked at only one index, the Consumer Price Index, and ignored export figures, ignored the spot price figures, and ignored the employment figures. I think we should look at employment and production as well as the Consumer Price Index.

Mr. MARTIN. Well, I do not want to belabor it, but I did not look at just one price index.

Senator DOUGLAS. You made up your decision on the basis of the Consumer Price Index.

Mr. MARTIN. No; I would not say that. I made it on the basis of overall inflation.

Senator DOUGLAS. There was no inflation in primary products.

Mr. MARTIN. There was a——

Senator DOUGLAS. On the contrary, there was deflation in primary products.

Mr. MARTIN. Now, go back to 1955.

Senator DOUGLAS. No; I prefer to take 1957.

Mr. MARTIN. Well, I think it started in 1955. We had price instability from the middle of 1955 on. And one of the reasons we had it was that farm products had stability for the last half of 1955 but we had it at the expense of the farmer during that period, and all of those factors have to be taken into account. I do not think we had price stability from the middle of 1955 till the end.

Senator DOUGLAS. I quite agree with you. The farmer was taking it on the chin. Industrial prices were going up.

Mr. MARTIN. At the present time——

Senator DOUGLAS. As a matter of fact, I made your friend Mr. Humphrey very angry by pointing out in his testimony that it was not really industrial price stability at all.

Mr. Chairman, I think I have taken up more than my quota of time.

Senator FREAR. It has been interesting.

Senator DOUGLAS. I apologize to the chairman for talking so long.

Senator FREAR. The chairman of the subcommittee has attempted to follow our usual subcommittee line of procedure, except extending the courtesy to the chairman of the full committee, in calling on the Senators, I hope that any Senator who has higher seniority in the full committee will forgive me for following the procedure of going down the subcommittee.

Senator Proxmire.

Senator PROXMIRE. Did I understand you, Mr. Martin, to say that we have a situation now in which there is adequate credit available so that banks can make sound loans generally throughout the economy? You did not make that statement precisely but is that a fair interpretation of your position?

Mr. MARTIN. I would say up to today the Federal Reserve Board has not felt that it would be wise to move any further in the policy of easing credit than we have.

Senator PROXMIRE. Well, that is——

Mr. MARTIN. I do not want to be held beyond today, now.

Senator PROXMIRE. I understand your answer, but what I asked is: Do you feel that generally throughout the economy banks are in the position to make whatever sound loans are available?

Mr. MARTIN. I do. Let me——

Senator PROXMIRE. In the light of that, let me ask what is there further that the Federal Reserve Board can do except slightly reduce the interest rate, which you already have reduced substantially, if the banks are in a position to make whatever loans are available. Is not the monetary situation, as far as you can control it, such that it is about as easy as it can get?

Mr. MARTIN. Except this is a process, Senator. One of the most striking things at the time of the reversal of credit policy was the decline in the demand for loans that began in October. Over a period of 5 weeks, at a time when the loan demand would normally be rising, there was a sharp contraction. There was a swing of about a billion dollars there, compared with the previous year, in the contraction of loans.

Now, the loan demand at the present time may pick up very quickly. If you are talking about it this week or next week you may say that the availability of credit has been steadily improving. Just yesterday we asked a group of bankers if they knew of any area of the country—this was a group from all over the country—where there was in the aggregate, not an individual bank but in the aggregate, nonavailability of funds. They said they did not know in the aggregate but they knew of a good many individual banks.

You may want this to get down to the level at some point so there would not be individual banks holding back on making loans because of shortage of credit facilities. That would be the ultimate, you see, that we are moving toward.

Senator PROXMIRE. I understand.

Now, there are some banks then which cannot make sound loans at the present time because their reserves are inadequate and they are not in position to make them, but they are very few?

Mr. MARTIN. They are relatively few.

Senator PROXMIRE. Relatively a small proportion of the economy?

Mr. MARTIN. That is right. And without criticizing our banker friends, some of them are those who were the most aggressive at the peak, you see.

Senator PROXMIRE. I see.

Mr. MARTIN. And so they have to go through a process of digestion before they——

Senator PROXMIRE. The reason I am asking these questions is that it seems to me, in view of that answer, that we have reached about as far as we can go in stimulating the economy through monetary policy.

Mr. MARTIN. I would not say entirely.

Senator PROXMIRE. It may be in the future that more loans can be made if the economy for some other reason starts moving upward. But at the present time through monetary policy, through making more reserves available, and so forth, there is not very much that the Federal Reserve Board can do; is that not correct?

Mr. MARTIN. There is very little additional that the Federal Reserve can do at the moment.

Senator PROXMIRE. So if something is going to be done to stimulate the economy, we cannot rely on monetary policy at this point. We have to go ahead with fiscal policy, if we are convinced something should be done?

Mr. MARTIN. Well, I would not go quite that far, because I think monetary policy takes some time to work. I am not quarreling with your major thesis, but I am trying to point out that this process is one where first you have a decline of the demand for credit. Then as this process goes on you have the banks taking a new look at the picture and you have credit reassessment taking place around the picture.

And there may be another opportunity when we could be helpful in the picture without endangering banking equilibrium.

Monetary and credit policy has already made some contribution, but its major contribution will come probably in the course of the next few months because of the timelag.

Senator PROXMIRE. I see. The contribution may develop later from the steps that have been taken already?

Mr. MARTIN. That is right. I would not say every step that could be taken.

Senator PROXMIRE. I understand.

Mr. MARTIN. I do not want to——

Senator PROXMIRE. You made the statement that because of the big increase in the gross national product we had a situation in which the economy was perhaps racing ahead too fast and monetary restraints were necessary in order to keep it in balance. You did not say that, but that is roughly a paraphrase of your position.

Mr. MARTIN. That is correct.

Senator PROXMIRE. And the reason was because it was increasing much faster than the actual physical production of goods and services?

Mr. MARTIN. The dollar volume of the GNP was going up but the physical volume was not.

Senator PROXMIRE. I am going to ask a question that I am deeply concerned about and I have not heard any real answers to, but I think it is a fundamental question in our economy. That is, how can we develop a more ambitious standard in view of the challenge we are up against with the Soviet economy which has been advancing not at a rate of 2 or 4 percent in the physical production of their goods but 8, 10, or 12 percent according to the most reliable estimates we can get?

Now, is it your judgment that if we are going to have a free economy this is something we just have not solved? Do you feel we cannot do this without excessive inflationary pains?

Mr. MARTIN. No; I would not say you cannot. I think that what you are trying to build is strength that can be sustained. Now, when you look at the Soviet economy, you must not think that they do not suffer from the same problems we do. Take this matter of losses.

Senator PROXMIRE. I am sure they suffer a great deal more than we do.

Mr. MARTIN. I think so too. But take the problem of losses, which I find the most difficult to deal with. We have a profit and a loss economy. Now, when losses come, the difference between the Soviet economy and ours is that they socialize their losses and we do not. But now when you talk about the rate of growth over there, I spent several months in Russia in 1943 and I went down to Magnitogorsk and looked at the steel mills and was very much impressed with their progress at that time. I know it must have been colossal since then.

Unquestionably, if you are talking about the overall standard of living—and here I do not know what I am talking about in terms of Russia—I think they are faced with the same problems that we have. You saw the breakdown of their farm program probably a year ago in a broad sense.

So that I question a little bit whether you can say—on individual lines they have run 8 or 10 percent ahead of us. Maybe in steel, you see, compared to our expansion there. But if you take the overall economy, I just question it.

We are talking about our technology and development. We may have to emphasize more some things in this country that we have not been emphasizing. We may have to have less of some popularly advertised products that people like and more basic research and make some sacrifices in current luxuries, you see, in order to get the long-range development and technological progress that the Russians with the mailed first have been able to do without too much trouble. But, in a free society, we have possibly gone somewhat soft.

Senator PROXMIRE. You do not feel that in the last few years our rate of productivity development has slowed down?

Mr. MARTIN. No, I do not; at least no more than temporarily.

Senator PROXMIRE. Historically it is all right? It is just in comparison with a totalitarian country which has this capacity to depress its people and keep its standard of living down and then enormously increase its productive plant?

Mr. MARTIN. And the figures that we get from them emphasize certain things like steel, for example, or armament production, to the exclusion of the general——

Senator PROXMIRE. Their whole productive plant. For instance, the most startling increase I have seen is in cement, which they have increased thirteenfold since 1945. They have had an enormous increase as compared to ours in electric power, in coal production, in almost everything you can mention as far as their productive plant is concerned.

Let me get into something a little more related to your testimony. You talked about the fact that we had a price rise in the face of a stationary output recently, or relatively stationary, and I wonder if we can expect in your judgment to prevent this without adopting some kind of policies we do not have now.

What I am concerned about is the fact the studies I have seen by Gardiner Means and others indicate a great deal of our inflation has been in the so-called administered price section of our economy, sections in which a few companies dominate an industry and in which they have not had a price reduction for over 25 years.

In view of the fact of life that these units are going to exist in our American economy and make a great contribution, do you see that there is any way that we can prevent this sort of administered inflation by the kind of policies that we have now, or do we have to adopt something new, take a different look at it?

Mr. MARTIN. Well, I do not know. The tail end of any boom period has people struggling to hold on to price levels—the reason for it being the expectation of higher prices that frequently galvanized them into additional activity to beat their competitors. So that the profit squeeze gets rougher and rougher for them. And nobody likes to take a loss. You get back to this loss operation.

The unfortunate thing about private enterprise—and I happen to believe in private enterprise—is that many people who practice private enterprise are not willing to take losses when the going gets tough. They come running down to the Government or the Federal Reserve Board or someone else to make the adjustments for them, or they hope against hope that they can borrow enough money so that they can stave off the adjustment that would move their inventory and create new demand.

Now, I happen to be one who believes that you can interfere with the laws of supply and demand for limited periods of time, but only for limited periods of time, and that in the long run they catch up with you.

Of course, it would be nice if we had some mechanism where these adjustments could be more delicate.

Senator PROXMIRE. We have been interfering with the laws of supply and demand, and we are going to for a long, long time, as long as we have an industry like the steel industry where they keep increasing their prices whether the demand is going up or down and have consistently.

Mr. MARTIN. Well, I do not know enough about——

Senator PROXMIRE. And many other industries with which you are familiar.

Mr. MARTIN. Well, I do not think they can do it indefinitely, though, any more than any of us. The laws of supply and demand in the long run will have their impact with all of us. You can hold it for a certain length of time, and then it gets too big for you. That has been the past history.

And I think it certainly occurs in the Soviet Union as well as here. It just means that the loss when it comes has to be absorbed in some other way than by private companies.

Senator PROXMIRE. At any rate, another weapon in combating inflation along with monetary and fiscal policy could be an antitrust policy which would attempt to create conditions that would be more amenable to the effect of supply and demand.

Mr. MARTIN. The maintenance of sound competitive enterprise as an antitrust policy is certainly a vital part of our system.

Senator PROXMIRE. Thank you, Mr. Chairman.

Senator FREAR. Senator Case?

Senator CASE. Mr. Martin, I have just one question on the matter of dealing with combating the recession. May I say, of course, I recognize that we are asking—and I am here asking—something outside of your particular responsibility.

But you do have a cautionary note—I think it is proper to have the caution—that we should not take action which might very well lead to aggravating an inflation which might get under way as a result of our activities.

Is it not possible, however, to take massive action to turn the tide and still have that action temporary so it would not have the dangers of adding cumulative effect to an inflationary spiral that is always a danger when you get things going up again? As far as we have a responsibility, or any sector of the Government has a responsibility, should it not be for that sort of thing that we are looking?

A big tax cut if you like, but for a temporary period? Or public works that can be immediately put into effect but accomplished within a rather quick period pending a decision as to whether they should be renewed or what not?

Would not much of your objection to Government action be dissipated if the actions we took were of that nature?

Mr. MARTIN. Oh, yes indeed, I think so. But I think even there you have to emphasize the size of the action in terms of my illustration, which may not be a good one, in taking a hypodermic. There is a period perhaps where the patient can take a little bit of drug. "Drug" is a poor simile, but I am sure you follow me. And if you do too much, it may become self-defeating.

Now, the problem, of course, on the temporary action is judging the timing of it, and that is a very difficult thing. I am just talking about the Federal Reserve Board. I find one of the problems in the Federal Reserve System is that we like to maintain the status quo. We say, "Well, we will be flexible," you see, and so we finally debate something for a long period of time and we come out with a decision and we say, "Well, now we will be flexible." But then, having done it, we sit by for weeks and think just a little bit more time should pass.

And I think that is the problem you have with fiscal policy or anything else.

But I agree with you on the temporary nature of it.

Senator CASE. But again, at the risk of appearing not to understand it—I think generally I do—why can we not have massive action that will have temporary effect? There will always be some danger that a boom once started will get out of hand. But why can we not have it without having the effect of that complicate the ordinary problem which always exists in any period of even reasonably full employment, not necessarily an inflation, but inflationary tendencies, price rises that continue?

For my own self I have been persuaded at least theoretically that it should be possible to devise actions of this kind and, subject to institutional difficulties and human frailties and all the rest, which of course come into the picture, and political difficulties too, that we ought to be able, if we could surmount those, to find the technical remedy for a situation like that which we are in now.

Mr. MARTIN. Well, I think it would be fine if you could. But you have got the problem of psychology. I do not know any other word to use for it. You have this problem in massive action.

It is like anything you take. I have got a cold at the moment, for example. My doctor gave me some acromycin. Well, he told me, "You can take that for a certain period of time. It knocks the cold on the head. But if you take it too long it is self-defeating."

Well, now, I think in your timing of this or your use of massive action it has got to be related to something of that sort. And I think that is very difficult to gage.

I think at the present time, to get back to my thinking at the moment about the economy, the patient needs a little period of convalescence here, irrespective of what happens. There are some points that you get into where I think you need a little rest cure, and there is no other thing that you can get for it. You need to contemplate your situation and think about it.

Now, I think we made some bad mistakes. We let inflation get so far ahead of us that now when we try to unravel the knots it is a painful process. And I do not know any pain killer we have that will completely absolve the necessity of unraveling those knots.

Senator CASE. Well, let me then, if I may, just for a couple of minutes—is it all right to go ahead?

Senator FREAR. Yes. The Senate is in session. I do not want to limit anybody, however, Senator.

Senator CASE. To get to the side of restraint of inflationary tendencies, I think it is true, is it not, that the area within which the Board can effectively operate has been considerably narrowed over the last 25 years?

Mr. MARTIN. Yes indeed.

Senator CASE. For a number of reasons, such as, well, the fact that the private sector of the economy on which you operate is a smaller part of the whole economy, maybe almost a hundred per cent smaller.

Mr. MARTIN. That is right.

Senator CASE. The fact that other than commercial banks have assumed a larger part of transfering people's savings into productive activity. The fact that corporations themselves out of their own resources—depreciation reserves and what not—do a great deal larger part of their own financing than they used to in relation to the part from borrowing from the public and through various institutions.

In view of this, is there any desirability in your judgment and that of your colleagues of enlarging your area of control to make more effective the kinds of indirect restraints which you have the instruments to apply?

This is a subject that I know you have been thinking about. You cannot answer it in 2 minutes, or anything of that sort, but in general is that not a problem that it would be useful for us to get your considered advice on—and continuously?

Mr. MARTIN. Well, this is a real problem and it is why I have welcomed all these efforts to have a real review, a long, careful review, of our monetary and credit problem.

But in the final analysis, where I come out on parts of it is that you say the private sector is influenced, you see, as against the public sector. Now, part of my problem comes in helping finance the Government, and we must help finance the Government, so that if you were to transfer to the Board—we have plenty of headaches as it is now—authority that would help us control the appropriations outcome of the Congress, for example, we just could not operate because——

Senator CASE. I do not really think I had that in mind.

Mr. MARTIN. Yes.

Senator CASE. There are private sectors of monetary operations where your influence is only indirect, and——

Mr. MARTIN. It is indirect; that is right. And we have had long discussions about selective controls, you see. I do not think we have had the final answer on that by any means.

Senator CASE. Just a couple of other questions. There is increasing concern, of course, and discussion about whether monetary policy and fiscal policy too can adequately do the job of preventing creeping inflation. Many suggestions have been made.

One of them recently was that we will have to come to direct controls. A particular suggestion of that sort recently came to my attention that in substance, as I understand it, we should not control each specific price but that we should at least in certain times or under general authority, which could be exercised perhaps by the Federal Reserve or some other agency, fix limits beyond which prices or wages would not be permitted to ride. Presumably ceilings.

Have you any general comment on the possibility of a ceiling-floor operation as opposed to a fixing of specific prices? Does that suggestion offer any possibility of consideration beyond those which would be involved in direct and complete, precise price controls?

Mr. MARTIN. Well, I think the administrative enforcement problem in a free country is almost insuperable.

Senator CASE. My question specifically is: Do the same difficulties apply to a system in which ceilings on prices and floors——

Mr. MARTIN. I think so. I think so.

Senator CASE. So that there is no particular light cast by that suggestion as far as you are concerned?

Mr. MARTIN. That would be my personal thinking.

Senator CASE. Just one other point. On this question of prices, and wages too, it has been suggested that, while they are sticky, certainly insofar as money terms are concerned, a very substantial price reduction in effect is given by an increase in quality and an increase in service, at periods such as those we are in now. Also increased productivity on the part of the wage earner.

Mr. MARTIN. Yes.

Senator CASE. Is this, first of all, significant in your judgment?

Mr. MARTIN. Yes, I think it is.

Senator CASE. As an adjustment not appearing on the indexes, but actual. Does it have a significant value as far as controlling the economy is concerned?

Mr. MARTIN. Yes, I think so, but it is very difficult to measure.

Senator CASE. Of course, it is indeed difficult to measure. But in your judgment this kind of adjustment is, for example, going on at the present time?

Mr. MARTIN. Going on right now. No question of it. That is one of the encouraging signs.

Senator CASE. Just one other and a general question. The complaint is made that we have attempted to use this instrument of monetary policy, credit control policy, beyond its potential, to rely too exclusively on it, and that we had better not only modify our use of that but search until we find some other complementary means of general control if possible, and, if not, specific control.

I am no expert in the field. I guess it would certainly be right that to continue too long any kind of controls would mean they lose their effectiveness and would have adverse effects. Certainly that applies, does it not, to credit stringencies?

Mr. MARTIN. It does indeed. It certainly does.

Senator CASE. Have you any comments about your general role? I do not mean to ask you to talk it down. But is it true that what we have done in effect is, as I think some prominent economist said, to get back to the best thinking of the 1920's but not progress beyond that in this general field?

Mr. MARTIN. I think a review of the whole thing would be very useful. I am probably too close to it to have as objective a view as one should. I think we tend in our own shop to either exaggerate our possibilities or to underestimate them, and I think it is awfully hard when you are as close to something as we are too really get an objective appraisal of it.

Take, for example, the question as to whether you could by monetary policy halt inflation in its tracks. If you were willing to just starve the money stream so it would dry up you could produce chaos, but I do not think anybody contemplates that type of money and credit policy.

Now, if you are talking about using money and credit policy to achieve against a whole lot of other things, such as slow expenditure stream, then I do not think it is equal to the task. I do not think it should be expected to be equal to the task. It can be a red flag and it can help hold back the water in some respect.

Senator CASE. Thank you, Mr. Chairman.

Senator FREAR. Senator Clark?

Senator CLARK. Mr. Martin, I want to congratulate you on what seems to me to be a very clear and lucid and extremely helpful presentation this morning.

I would like to note that I have no criticism of your actions in the past. I think within the limits of human frailty your board has done a first-class job.

I want to indicate agreement with you that we should not look for a tax cut at this time.

And having therefore established somewhat of a rapport, I wonder whether you would agree that a deficit for the current fiscal year is practically inevitable and is quite probable for the next fiscal year.

Mr. MARTIN. I think it is probable, yes.

Senator CLARK. In view of that, is it not important we increase the debt limit ceiling promptly?

Mr. MARTIN. Well, I think you have no alternative.

Senator CLARK. And, therefore, you would favor it?

Mr. MARTIN. I would favor it.

Senator CLARK. Do you not think in the interest of flexibility the sooner it is done the better?

Mr. MARTIN. I do.

Senator CLARK. I agree with you too that the patient needs a rest. I suggest that while he is resting he needs some nourishment, and I think a good way to give him some nourishment would be to make him work for it and create some wealth in the public sector of the economy where it is badly needed.

I am speaking in terms of housing, schools, and highways; just to mention a few categories.

Last year you will recall there were many—I do not recall whether you were one or not—who said that Federal, State, and local public works should be postponed to prevent adding to inflation. I wonder if you would agree that at this time there is no further need to keep the brakes on Federal, State, and local public works in view of the substantial decrease in spending in the private sector of the economy?

Mr. MARTIN. I would agree with that. I would say that there ought not to be at this juncture created works just for the sake of creating employment. They should be items that are needed and necessary and going to contribute something. They should not be just strawmen.

Senator CLARK. I agree with you completely on that. We do not want to get back into a leaf-raking program.

Mr. MARTIN. That is right.

Senator CLARK. But I think my State is the third hardest hit of the 48 in terms of unemployment. It is really very serious. We have 435,000 Pennsylvanians entirely out of work and another 100,000 working half time or less. And we are trying to get going at the local, State, and National level an expediting process for already-authorized public-works programs with special emphasis in the three areas I mentioned, which are schools, housing, and roads.

There is nothing in your philosophy which would indicate that was an unsound move, is there?

Mr. MARTIN. No.

Senator CLARK. I was interested to note your reference in passing, in answer I think to Senator Case's questions, which I think indicated a philosophy very similar to my own, about selective controls. You will recall that you and I and Mr. Riefler had a little discussion about that last year.

Mr. MARTIN. Yes.

Senator CLARK. I hope you have not given up a careful consideration of the possibility of selective controls and that you will keep on thinking about the possibility of finding some way of free credit for areas in the public sector of the economy where we are very backward if not obsolete. Where the need is very clear, and where for the past 2 years we have been able to do so little because your own monetary policies, taken I am sure conscientiously and probably correctly in regard to the overall economy, have made it impossible to move ahead with badly needed construction and improvements in the public sector of the economy.

Has your thinking progressed at all as to how we can move ahead to get more houses and more schools in a situation where you have to put monetary brakes on because you are afraid of inflation on the overall picture?

Mr. MARTIN. No, I am afraid you would not think it had moved forward at all, because I think that the market is pretty nearly the only way you can do it.

Now, take the matter of schools, for example. We discussed that before. Naturally we are not against school construction. But it was the cost of the school building, not the cost of financing, that in my judgment was getting the better of the school program. The inflation was just mounting on all sides, you see.

Now, the interest rate did postpone I think some buildings of that sort because they said, "Well, we will not pay more than 3 percent," or something of that sort. Now, those can come back in at the present time. They have been postponed.

And you can say, "Would there not have been some way of keeping these luxury apartments from going up over here and transferring it over there?"

Well, there you are up against the problem of who does it and would we have a more satisfactory society administered that way. And you can have differences of judgment on that.

But I think, by and large, we will be happier and get more in the long run by the market process, although I frequently dislike it just as much as you do.

Senator CLARK. I wonder if you would go so far in your free-market philosophy as to oppose the present low interest rate on the college-loan program which was created, as you know, under the auspices of the chairman of this committee, to enable some very badly needed college dormitories and other buildings to be built at very low rate of interest.

Mr. MARTIN. Well, if that low cost is maintained, as I think it was in the last couple of years, at the cost of having the price of building materials and all the things that go into the college housing program going up somewhat more—there is no mathematical ratio on this—I would say that that is a pretty heavy expense to pay for something that is an ideally good thing.

Senator CLARK. Would you not agree that had that interest rate been allowed to reach its market level we just would not have gotten any of these dormitories built?

Perhaps you would not agree. But that is certainly my judgment based on the evidence we have had before this committee.

Mr. MARTIN. Well, I question that. I am enough of a free-market man to believe there might have been more.

Senator CLARK. I guess you are still pretty unregenerate, Mr. Martin. I will leave you on that subject.

I am glad to note a little change in attitude. Maybe the erosive process over the years will result in some change.

Let me shift to just one more question and then I will be through. I am concerned with the fact that there appears to be so great a lag between the reduction in your interest and rediscount rates and the spread of those cuts through the free market. I am particularly concerned because I understood you to say that you thought there had been a substantial easing in the mortgage market—and it may well be that there are national statistics to back that up.

All I can say is that I still am having a very rough time getting a mortgage at what I consider to be an appropriate rate of interest on my own house, and I see no indication that the change in the Federal policy has resulted in any real easing in the mortgage market.

I wondered on what you based your view that it has. I am sure you have some statistics to show that I am just dealing with a stubborn pack.

Mr. MARTIN. Well, I have no very convincing statistics at the moment, but the reports we get from all over the country have certainly changed in character from what we were getting 4 months ago. And we also have a slight increase in housing starts, and we have more and more indication from various areas that money is available.

In fact, I have even talked to a number of people who were seeking out——

Senator CLARK. Let's hope that turns out to be right. Certainly one man's experience is no trend. But I think you would agree, would you not, that low interest rates are essential to the creation of an effective demand in the low and moderately priced housing market?

To rephrase it another way, you cannot build a house and finance it at a price which at least half the number of American families can afford unless they can finance it at a far cheaper interest rate than was available while your tight-money policies were in effect last year?

Mr. MARTIN. Well, I question whether you could afford to go on with the increase in building materials and other components in the house also.

Now, here is a $13,000 house that cost $15,000. I would much rather do something on that area than worry about a half percent interest on the financing.

Senator CLARK. I know you would, and that is one place where we differ a bit. My point there would be that history would seem to indicate, recent history would seem to indicate, that there are no effective measures by which decrease in those costs can be induced either by monetary policy, by fiscal policy, by antitrust policy, or by any other means. And that is what gives me such great concern. I do not see how we are going to fight ourselves out of this administered price tradition which seems to be spreading from the automobile and steel industries into bank rates on mortgages and into the price of everything that we buy.

The end result, I fear, is going to be we are just not going to create the wealth we must have if we are going to keep up, as Senator Proxmire said, with the material as well as the intellectual leadership of the world in competition with Russia.

I do not suppose I am really asking you a question. I am just hoping that that first-class mind of yours is going to continue to think about these problems.

Mr. MARTIN. Well, let me just reiterate my own thinking on this. I have never favored high interest rates per se. I would like to see interest rates as low as you can have them without having inflationary counterparts, because I believe that will contribute the most to the capital formation. And I want that capital formation to proceed just as rapidly as it can in this country.

But I think we have to recognize that we have to have savings, and the saver is entitled to some consideration also. He has to have a wage for his saving.

Senator CLARK. I agree with that. But now we have noted that the spending for plant and improvements and other capital facilities in the private sector of the economy has dried up pretty rapidly in the last 6 months. Would you not agree?

Mr. MARTIN. It has declined sharply, yes.

Senator CLARK. Well, now, in order to help cure this recession, could we not afford to put a good many billions of dollars into public improvements in the public sector of the economy without running into a renewed threat of inflation?

Mr. MARTIN. I think at the moment you can, but the point I am trying to stress there is that I would not be too discouraged on your point, because time does quite a lot in this. This is a process—the sort of movement that does not occur in a 30-day swing or a 90-day swing. It reverses itself over a period of 6 months to a year.

Senator CLARK. That I understand.

Mr. Chairman, I will wind it up with just the note that I hope and I am sure that our very good and most able friend is not going to come down here and tell us we should not move very fast indeed with a strong housing program and, if we can get it through the Congress, a strong school construction program, not only because we need them so desperately for our civilization but because it is going to help us get out of this recession.

This is your last chance to say no.

Mr. MARTIN. I will reserve comment.

Senator CLARK. Thank you, Mr. Chairman. That you very much.

Senator FREAR. Thank you.

Mr. Chairman, we are indebted to you for spending some time with us this morning and answering the questions in very enlightening manner. I think most of the members of this committee—as a matter of fact, I believe all of them—have great confidence in you. Especially the chairman of this subcommittee is always happy when you come down. I think we get a stimulus from your answers, and we like the manner of disagreement at times.

It has been nice to have you with us, sir, and any time this committee, or especially this subcommittee, can be of assistance to the Federal Reserve System—which is probably a suggestion in reverse—we offer our services.

Mr. MARTIN. Thank you very much.

Senator FREAR. The subcommittee is adjourned.

(Whereupon, at 12:25 p. m., the subcommittee was adjourned, subject to the call of the chairman.)

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For release on delivery

Statement of

William McChesney Martin, Jr.,

Chairman, Board of Governors of the Federal Reserve System

before the

Subcommittee on the Federal Reserve

of the Senate Committee on Banking and Currency

February 19, 1958

The year 1957 was a difficult one for those of us charged with appraising financial and economic events and formulating appropriate monetary policy. From its opening and on during much of the year, inflationary pressures were dominant in this country and abroad. In commodity markets, industrial prices were continuing to advance despite generally downward reaction in prices of some internationally traded basic materials following the Suez crisis. In consumer markets, prices of goods and services were advancing at a very rapid pace for a non-war period. Prices of common stocks, which had tended down from mid-1956 to early 1957, rose sharply to new highs in mid-summer under the influence of creeping inflation doctrine and of widening confidence that the large capital expansion in which business was engaging would be adequately supported by the demands of a rapidly growing population for a rising standard of living. The strength of inflationary pressures was exemplified by the marked advances being recorded in the gross national product measured in current dollars as compared with the relatively modest gains that were being obtained in the physical volume of total output.

In spite of Federal Reserve actions taken to resist inflationary trends--including six increases of Federal Reserve Bank discount rates in 1955 and 1956 and the pursuance of a restrictive credit policy--money lost its value at a rate that was a matter of great concern to all. Inflationary excesses had clearly gotten ahead of us and the economy stood in danger of an inflation crisis. The adjustment problems that the economy is confronting today are the aftermath of those excesses.

As a nation, we were trying to do too much too fast, and heavy pressure was exerted against the available supply of savings. In retrospect, we underestimated the speed and force of the inflationary boom and the widespread growth in speculative attitudes and commitments. Consumer instalment credit rose substantially in 1955 when terms were sharply relaxed and consumers used credit more freely than ever before in the purchase of record number of new automobiles. Businesses greatly increased their expenditures for plant and equipment. The rise from 1955 to 1956 amounted to more than one-fifth for business as a whole and this advanced level was further exceeded in 1957. Stock investors were too optimistic in capitalizing the income and dividends which this investment might yield. Bankers and other lenders greatly expanded their commitments to lend in these years. Also, liquidity positions of banks and businesses were being reduced as their short-term liabilities were increasing faster than their holdings of cash and Government securities. Labor unions sought wage increases--and commitments for future increases--that pressed against or exceeded gains in productivity. State and local governments borrowed record amounts through the capital markets in an effort to meet the needs of their citizens for community facilities and services.

Inflationary trends continued through the summer months of last year. There was an alarming spread of the belief, not only in this country but also abroad, that creeping inflation under modern economic conditions was a chronic and inevitable condition. Reflecting this view, common stocks, the most popular hedge against inflation, rose sharply in price in July to a level where for the first time in two decades their yields fell below the yields on high-grade bonds. Also, credit demands generally continued to show great strength, and interest rates were rising. Large city banks on August 7 raised their lending rate to prime business borrowers from 4 to 4-1/2 per cent. In this situation, Federal Reserve Bank discount rates, which were below market rates by a widening margin, were raised in mid-August from 3 to 3-1/2 per cent, thus increasing costs to member banks operating on the basis of borrowed reserves.

In late summer and early autumn, developing uncertainties here and abroad began to affect the short-term economic outlook. In European exchange markets, widespread expectations of changes in exchange rates fostered large speculative movements of funds between European centers. These expectations in part reflected further accentuation of inflationary developments in some key countries, despite actions to tighten credit that were taken in various countries during the summer. It was not until late September, after the Bank of England established a 7 per cent discount rate, that it became clear that key foreign currency values would be maintained and that inflation would be strongly resisted.

In this country, the unexpected curtailment in defense payments and changes in procurement policies that were inaugurated during the summer, partly to avoid breaking through the debt ceiling, had an unsettling effect on business. In September, nonagricultural employment, which had been at a record level in August, began to show signs of slackening. The Board's index of industrial production declined slightly. Reflecting these and other developments, common stock prices in late September broke through the trading range that had prevailed during the past two years. With changing attitudes toward the economic outlook, production and other adjustments that had been occurring for some months in various lines of activity, including some capital goods lines, came to be reappraised by businessmen, investors, and the public generally. In contrast to earlier indications of strong credit demands, bank loans to business during early autumn decreased contrary to usual seasonal tendencies.

The pace of business was maintained for a time despite these uncertainties. By late October, the composite of most recent economic information suggested that inflationary pressures were abating, and open market operations were modified to lessen restraint on bank credit and monetary expansion. By mid-November, information becoming available, incomplete though it was, indicated that a general downward adjustment was setting in. In response to this change in basic economic conditions, Federal Reserve Bank discount rates were reduced from 3-1/2 to 3 per cent.

Since that time, the use of open market and discount policies has been complementary. Open market operations have provided sufficient reserves to permit member banks not only to repay a substantial portion of their indebtedness to the Reserve Banks, but also to accumulate some addition to reserves available for bank credit expansion. Discount rates were lowered again in mid-January, from 3 to 2-3/4 per cent.

At the end of 1957, stock market credit to customers of brokers and banks for purchasing and carrying listed securities was less than at midyear and back to the level of early 1955. Thus, the need for using the higher level of margin requirements, established in early 1955, to prevent an excessive expansion of stock market credit had abated. The Board of Governors in mid-January reduced margin requirements for purchasing or carrying listed securities from 70 to 50 per cent.

System actions have contributed to a marked easing in the credit and capital markets. This is illustrated dramatically by the very sharp drop in market rates of interest, the sharpest drop for any comparable period of which I have knowledge. Yields on Treasury 90-day bills dropped nearly two percentage points--from over 3-1/2 to a recent low of 1-1/2 per cent. This adjustment in credit and capital markets is helping to facilitate and cushion other adjustments in the economy as well as to strengthen demands in important areas dependent on credit financing. It is thus, along with other Government programs, helping to set the stage for recovery in activity and employment.

We all share the hope that recession will be moderate and short-lived, but it is not possible to be completely certain about the future course of economic activity. There is a range of views currently held regarding the duration and extent of this recession and of the timing and vigor of the ensuing recovery. In my own view, the underlying strengths of the economy are many. The inflationary trends seem to have halted before creating maladjustments of such severity as to lead to a protracted period of liquidation and structural realignment in the economy. After not too long a period of readjustment, healthy revival should set in, progressing to new records of economic performance and new high levels of national well being. A great deal depends upon the speed with which needed readjustments are made.

We are all, of course, well aware that reasoning by analogy may be misleading and that history does not repeat itself. Nevertheless, it may be noted that the downward movement from the third quarter 1957 peak has been reminiscent in many ways of the declines that occurred in 1948-49 and in 1953-54. In these two postwar recessions, lows in activity were reached in less than a year from the cyclical peak and recovery to new high levels of output, demands, and employment was rapid and substantial. In both recessions, the industrial production decline was limited to about 10 per cent from high to low. With the exception of the catastrophic depression of the early 1930's, the downward phase of every cycle since World War I has been over or virtually over in the course of about a year.

Many basic forces in the present situation are favorable to hopes for recovery. These include:

(1) Credit and capital market conditions have already responded to relaxed monetary policy and are much easier than they were a few months ago. Other important financial adjustments have already been made or started. Stock yields, for example, have adjusted to a more normal relationship with high grade bond yields. By borrowing from the capital market, moreover, business firms have been repaying bank debt, thus rebuilding the liquidity positions of both financing institutions and business enterprises.

(2) Consumer incentives to achieve still higher standards of living are strong, and research continues to

provide new products of wide consumer appeal. As a group, businessmen and consumers continue to have confidence in the long-term growth prospects for our economy. Total retail sales advanced both in December and January and were at levels well above those a year earlier despite lower sales of new automobiles.

(3) Population increase has been maintained at a rapid pace--the rise of 1.8 per cent in 1957 compares with a postwar average of 1.7 per cent, and hence the market is expanding steadily.

(4) Consumer incomes have shown some cyclical decline recently, but the decline has been small and moderated by unemployment compensation benefits. Consumer demands are supported by a record volume of financial assets, the ownership of which is widely distributed. Growth in such assets was rapid in 1956 and 1957, while growth in consumer instalment and mortgage debt, though not small, was at a much slower rate than in 1955. The availability and terms of mortgage credit have recently become more favorable to borrowers. New housing starts increased in January and were moderately above their low in the spring of 1957.

(5) At the State and local government level, community demands for schools and teachers, for roads, public buildings, and other community facilities are

continuing large and insistent. Bond issues of State and local government authorities have advanced to record levels.

(6) For the Federal Government, postwar budgets have been dominated by the need to cope with critical international stresses and tensions and to provide adequate defense under conditions of major scientific advance and rapid technological change. National security and related problems continue to be urgent.

(7) Insofar as international economic developments are concerned, Western Europe still shows strength. Industrial activity, while no longer expanding, has generally been maintained at or close to record levels. In general, balance of payments positions have improved although in several countries reserves of gold and foreign exchange are not as large as might be desired. Outside Europe, however, raw materials producing countries are facing difficulties because of declines in volume and prices of their exports.

A primary uncertainty with respect to the timing of economic revival and renewed growth relates to the course of business outlays for new plant and equipment. Some observers view the business capital goods boom of the past three years as having provided a margin of industrial capacity over prospective demands greater than can be absorbed quickly. These observers tend to expect a more protracted period of adjustment than took place in the two preceding cycles.

This concern may turn out to have been well founded, but it may be noted that capacity never appears more excessive than in the midst of receding activity. Recovery, in due course, can certainly be expected to be accompanied by effective and profitable use of the economy's capacity to produce and by still further additions to capacity. The important factors working to expand business capital investment in the period ahead should not be minimized. The advance in the technology of production, in part the result of the huge investment in research of recent years, has been rapid and can be expected to continue. Incentives to reduce costs, to meet competition, and to sustain or improve profitability, are strong.

History shows that our market economy has cyclical characteristics, and the consequences of this irregularity in terms of hardship and unemployment are of deep concern to everyone. When downward readjustment becomes unavoidable, it is incumbent on business enterprises, financial institutions, and labor organizations, as well as Government generally, to adjust policies and programs to foster recovery. We have been concerned, for example, at the decline in output and employment while prices generally have been maintained and some prices even have risen further. Currently, it may be noted, consumer prices reached a new high in November and remained at about that high in December and January. How soon recession is checked and recovery is resumed will be influenced by the rapidity with which economic corrections and adaptations are made in factors beyond the province of monetary policy, that is to say, in business pricing policies, selling practices and productive efficiency; in wage bargaining; in various financing arrangements; and in the incentives to consumers to buy. In the past, price reductions during periods of contraction served to stimulate increased buying and output and thus to contribute to general recovery and expansion. Undoubtedly, lower prices now would prove to have expansive benefits for economic activity generally.

If needed adjustments are promptly made, the current recession may be moderate and short-lived. Furthermore, there will be the possibility that revival may develop without renewed inflationary tendencies. Under such circumstances, the task of monetary policy would be to foster such revival and to encourage the resumption of orderly growth.

If revival in over-all economic activity becomes exuberant, however, there will be an accompanying danger of resurgence of inflationary pressures. Postwar experience has demonstrated that, in a period of expanding demand, upward pressures on prices and costs can develop quickly. Once under way, inflationary movements tend to spread themselves throughout the economy, not only because of normal market reactions, but also because of a variety of institutional arrangements.

When contractive tendencies in economic activity set it, there is always the hazard that recession may be deeper and more protracted than many anticipate, with a greater degree of underutilization of manpower and industrial resources and with manifest deflationary tendencies. In such an eventuality, further monetary action would need to be considered, both to increase the liquidity of the economy and to encourage expansion of spending financed by credit. Monetary policy by itself, however, cannot assure resumption of high-level employment and sustainable economic growth, although ready availability of credit at reasonable cost is an essential ingredient for recovery.

Those charged with responsibility for national economic policies must at all times reckon with the dangers both of inflation and of deflation. The central policy problem, in one sense, is to prevent either inflationary trends or deflationary trends from becoming dominant. Public policies for one objective or another can have effects that go far beyond those that are intended. Both fiscal and monetary policies must be carefully formulated to exert enough pressure or ease but not too much. That is a difficult task. It is one that you and I both must live with every day, and do the very best we can to reach the judgments and come to the decisions which in the long run will prove to have been wise.

As I have said on many occasions, anti-inflationary policies and anti-deflationary policies are inseparably linked. Excesses on the upside must be avoided in order to avoid the heavy costs and personal hardships that unfortunately develop during the ensuing contraction. Now that we are in the contractive phase, we must take whatever actions are needed to minimize the hardships and to foster vigorous recovery. But in so doing we also must recognize that excessive stimulus during recession can sow seeds of inflation that can grow to jeopardize our long-run stability and our economic strength at a time when as a nation we are confronted with a special urgency to maintain all the productive strength we can muster on a sustainable basis.

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Subcommittee on Small Business of the
Senate Banking and Currency Committee

Joseph S. Clark, Jr. (Pa.) - Chairman

J. W. Fulbright (Ark.)	Homer E. Capehart (Ind.)
A. Willis Robertson (Va.)	J. Glenn Beall (Md.)
John J. Sparkman (Ala.)	Frederick G. Payne (Maine)
William Proxmire (Wis.)	Clifford P. Case (N. J.)

Miss Muehlhau

APR 25 1958

The Honorable Joseph S. Clark,
United States Senate,
Washington 25, D.C.

Dear Senator Clark:

At the conclusion of my testimony before the Small Business Subcommittee of the Senate Banking and Currency Committee, you asked for my views as to the most appropriate form and amount of the Government portion of funds of any new program of small business financing.

As I understand the provisions of the bill drafted by your Committee staff, it would permit Government subscriptions to the capital of any one small business investment company of up to $250,000, or half the minimum capital required to start such a company, and Government loans of up to 50 per cent of the company's total paid-in capital and surplus. The maximum Government contribution, through both capital subscriptions and loans, could therefore equal two times the amount of funds raised initially from private sources. As private capital increased, the proportion of Government to private funds would decline; staff calculations indicate that when private capital subscriptions reached $750,000, the maximum Government contribution would then be on a matching basis.

Recognizing that there may be a need for initial Government capital subscriptions to stimulate the formation of investment companies, I would nevertheless prefer to see the maximum total Government financing involved limited to an amount no larger than the capital subscribed by private investors. To this end, I would suggest that the formula might be revised to limit Government subscriptions to capital stock to a smaller sum than provided for in the Committee-staff bill, say, to $100,000 or $150,000, but maintaining the provisions permitting Government loans up to 50 per cent of total paid-in capital.

This would keep the Government contributions to approximately the same amount as the capital contributed by private investors. It would also have the advantage of keeping the Government stock interest a minority one.

I stress the need for private investment not only because I feel this is the soundest approach to the problems of obtaining financing for small businesses, but also for the collateral benefits that will accrue from private participation in the program. Moreover, if Government financing were to dominate the program, there would undoubtedly have to be restrictions on the operations of the investment companies that might seriously hamper their ability to operate successfully.

Sincerely yours,

(Signed) Wm. McC. Martin, Jr.
Wm. McC. Martin, Jr.,
Chairman.

ARK/RAY:mjk
4/21/58

April 28, 1958.

Dear Harry:

Thank you for your nice letter of April 25 with respect to my statement before the Subcommittee on Small Business.

I am delighted you are continuing your interest in this subject and appreciate your taking the trouble to write.

With all good wishes,

Sincerely yours,

Wm. McC. Martin, Jr.

Mr. Harry W. Besse,
President,
Boston Stock Exchange,
53 State Street,
Boston, Massachusetts.

BOSTON STOCK EXCHANGE

53 State Street

BOSTON

OFFICE OF THE
PRESIDENT

April 25, 1958

Mr. William McChesney Martin, Jr.
Chairman, Board of Governors
Federal Reserve System
Washington, D. C.

Dear Bill:

I have just finished reading a copy of the statement to the Subcommittee on Small Business and I want to commend you for the coverage of this rather complicated subject. I have interested myself in the problem in the hope that the stock exchanges, especially the regional exchanges, might be able to devise a procedure for arranging equity capital for smaller enterprises while contributing marketability to the shares. Numerous obstacles have developed, many of which will be immediately apparent to you, but I have not entirely given up thinking along these lines.

Once again, congratulations and kindest regards.

Yours very truly,

Harry

Harry W. Besse, President

HWB:jg

Article Title: Martin Urges U. S. Support Private Small Business Aid: Administration Long-Term Capital Bill Filed

Journal Title: American Banker

Date: September 22, 1958

Early last fall, the Federal Reserve System initiated a comprehensive study of small business financing. This has long been a subject of public discussion and Congressional attention. One prominent feature of the discussion has been a questioning of the adequacy of facilities to serve the financing needs of small business.

Today we are reporting to you what the completed parts of the inquiry show with respect to this problem. One of the parts consists of background studies developed out of a re-examination of existing materials and data relating to small business finance. A second part comprises a set of special surveys of existing credit facilities and credit practices in serving small business financing needs. Both university and independent scholars as well as System specialists participated in the preparation of the background studies of Part I, but the special surveys in Part II were conducted and analyzed by Federal Reserve System staff exclusively.

The plan for the entire investigation contemplates a third avenue of inquiry, namely, a direct survey of the financial structure and experience of smaller businesses, developed through a national sampling approach. This part of the program is still in the category of work in progress. Because of the complexity of the task, extensive preparatory work is now under way; it will be another year before detailed plans can be executed and the results analyzed and made available. In our planning activity for this part of the study, we are receiving cooperative help from the technical staffs of the Bureau of the Census, the Federal Trade Commission, the Securities and Exchange Commission, and the Bureau of the Budget.

Major Findings of Study

In reviewing the findings of the study, it is essential to distinguish clearly among the various forms of business financing. These include short-term credit, intermediate-term credit, long-term credit, and equity or ownership capital.

Short-term credit. With respect to short-term credit, the evidence indicates that there is a large volume of such credit available to small businesses in a variety of forms from a number of sources. By order of importance according to volume of credit extended, the principal sources are: commercial banks; large manufacturing and wholesale suppliers; and finance companies and factors.

In late 1957, all commercial banks had about 1-3/4 million business loans outstanding aggregating over $40 billion. There was almost one loan outstanding to every two business enterprises in existence at the time. To be sure, some companies had several notes outstanding to different banks, and some had more than one note outstanding at the same bank. About two-thirds of the number and amount of bank loans to business had maturities of under one year, that is, were short-term loans, and about half of these short-term loans in number, and a fifth in amount, were loans to small business. The amount of such loans to small business approximated $5 billion.

Credit made available to businesses by manufacturing and wholesale suppliers is in the form of trade receivables. In late 1957, the total of such receivables less the trade payables of all nonfinancial corporations probably approached $25 billion. This was approximately equal to the total volume of short-term business credit outstanding at all commercial banks at the time. Although trade credit is available to businesses of all sizes, large companies extend more of it to smaller enterprises than they receive from such enterprises.

Finance companies and factors had over $3 billion of short-term credit outstanding to small business in late 1957. Such lenders provide short-term credit to small businesses on the basis of their accounts receivable. They also provide warehouse and "on the premises" financing of inventories.

Intermediate-term credit. In recent years, commercial banks, as well as finance companies, have developed further a variety of lending techniques and arrangements to increase the volume of intermediate-term funds available to small businesses. These have included instalment financing of store fixtures, varied equipment, and industrial machinery.

A large volume of intermediate-term funds is currently being made available to small businesses by commercial banks and finance companies. Late in 1957, over a third of the bank loans outstanding to small business concerns, totaling some $2-1/2 billion, had original maturities of over a year. Moreover, such credit had increased about a third since late 1955 and more than threefold since late 1946. In addition, finance companies had outstanding about 3/4 of a billion dollars of intermediate-term, equipment financing to small business in late 1957.

Long-term credit. In the area of long-term financing, the aggregate volume of funds available to small businesses is much smaller. The availability of long-term credit is limited for the most part to real estate mortgage financing. Commercial banks and life insurance companies are the principal sources of such funds. The total of such credit extended by insurance companies to small businesses and outstanding late in 1957 is estimated at little more than $250 million.

Equity capital. A large volume of outside equity capital comes to small businesses from local investor sources and from relatives, business associates, and close friends. An estimate made by one contributor to the System's study indicates that in the neighborhood of $6 billion of outside equity capital has been put into one million new business firms during postwar years. This figure is approximately equal to total outside equity funds obtained through stock issues by larger business corporations over the same period. This is exclusive of existing ownership which is constantly being transferred, often through the medium of newspaper advertising. Little is known about the magnitude of such transfers, but it must be large.

Outside or external equity capital from investors other than friends and relatives is most readily available to small concerns with unusual growth potential--especially those producing or distributing products or services that are based on advanced technological developments, or to mining or oil enterprises with a promise of a rapid recovery of investment as well as a high profit return.

A few investment companies exist which specialize in equity investment in unusually promising small businesses. Individual investors seeking to diversify their investment portfolios constitute the main source of such funds. Because of the expenses and risks involved in making small equity investment, the return expected by these investors is relatively high. In principal financial centers, there are specialists who function by finding small business investment opportunities and, for a fee, bringing them to the attention of investors interested in venture ownership of business.

For small businesses in more routine lines of activity, such as retail distribution and the service trades, outside equity capital for expansion is much less often sought and must less readily available. In this connection, it should be noted that small businesses seeking long-term funds are often much more interested in debt money (borrowed money) than equity funds (+ sale of stock), since they wish to avoid the dilution of their ownership control that the equity funds might entail.

The small business financing study is exploring in detail two sources of equity capital to small businesses, namely, internal financing--that is, retained earnings and depreciation allowances--and funds made available by relatives, business associates, and close friends. Unquestionably, these sources of funds are very important. More information on these sources will be obtained from Part III of the study.

The question of a gap in facilities. These general findings from the study confirm the impression that we conveyed to this Committee in our testimony last June, namely, that there is a gap in the existing structure of financing institutions which lies in the longer term debt and equity capital areas. Although there is clearly an institutional gap, there is still the question as to whether there is an economic gap, that is, whether there is a gap that can be filled on a self-sustaining basis. In other words, can long-term financing be made available on terms that will provide lenders and investors with returns commensurate with the higher risks and other costs involved, as well as enabling small business to avoid an undue burden of fixed charges and inflexible financial structures?

Doubt in this respect arises particularly in the case of long-term debt. Since the profit and loss hazards of small business operations run high, ten-year debt of such enterprises is long term. Also, long-term debt of small businesses is both high in cost to their owners and high in risk and other costs to suppliers of such funds. Accordingly, the financing gap narrows down to one of equity financing or equity-type financing such as has been developed by larger corporations in recent years through the bond instrument convertible into stock.

In specifying a gap in the financing facilities available to small business in these terms, it needs to be remembered that the bulk of the small business population is engaged in routine or repetitive activities that primarily provide a means of support to the owner and perhaps a few other individuals and grow only slowly over the years. These small businesses frequently have enough permanent or long-term investment and are not in the market for more, since the use of more long-term funds would only reduce the rates of return to present owners.

There are some small business enterprises, however, which offer a promising growth potential. They have identifiable financing needs that are not being met.

Main Principles for a Government Program

Although some elements of the Federal Reserve study of small business financing remain to be completed, enough information has been amassed to suggest that there is room for a Government program to foster the flow of private investment funds to small business. A number of proposals are pending before the Congress to achieve this end. In previous testimony and in communications to the Committee, we have commented on various of these proposals. Perhaps the greatest help that we can be at this stage towards the formulation of constructive legislation is to express our views on the main principles that should be considered in its drafting.

Study of the record indicates that an appropriate Governmental program for furthering the investment finance of small business should avoid the pitfalls of (1) building into the private economy undesirable Government subsidy, (2) putting a burden on Government of choosing among applicants for investment financing, and (3) maintaining in the economy uneconomic business units. In our judgment, the most efficient program of Governmental aid for small business will be one that makes maximum use of market incentives and standards in attracting private venture capital to the small business area. The market place is the most efficient allocator of economic resources.

It will be no easy task to design such a program. Our study does not point to any one best approach but rather suggests that emphasis should be put on flexibility, broad private cooperation and participation, and protection of the public interest.

Long-term investment in small business would be a new frontier for Governmental assistance. There is much to be learned about the problems of administering such a program. Accordingly, any new effort should be approached experimentally and on a small scale, with a simple organizational structure that is sufficiently flexible to adapt to the varied situations that will be encountered. The most fruitful contribution to small business finance that can be made would be to stimulate private innovation in filling this gap.

The requirement of flexibility also calls for freedom from arbitrary restrictions that would handicap a program. For example, the development of an economically sound and efficient program would be hampered by restrictions which would (1) limit eligibility for assistance to applicants for funds already turned down by other financing sources, (2) impose unnecessary restrictions on the forms or maturities in which funds are to be made available, (3) fix arbitrary ceilings on interest rates or rates of return, or (4) limit the geographical mobility of funds. Some such restrictions would have to be imposed if the financing were made available predominantly out of public funds. They are not appropriate when, through the use of private funds, main reliance is put on the discipline of the market.

Private financial participation necessarily implies private administration at local levels at which specific loan decisions are made. Private citizens with an intimate knowledge of small business conditions and problems are in the best position to judge creditworthiness of applicants for investment funds, as well as to offer valuable advice in tailoring financing to the particular needs of the applicant.

The ability of local groups to mobilize private capital would be enhanced if they were permitted, in fact encouraged, to seek creditworthy businesses aggressively and without restriction. If they were limited to investment only in enterprises not able to obtain financing elsewhere, or required to bear heavy expenses of investigating and appraising financing situations only to have to surrender the more promising ones to other investors, they could not be expected to operate at a sufficiently profitable level to continue attracting private capital. Neither are they likely to attract private funds unless they are free to earn economic rates of return and to realize gains on successful investments.

Incentives in the form of special tax treatment may be needed to stimulate the flow of capital to small business. Such tax incentives, of course, should not provide a haven for activities other than the supplying of investment funds to smaller business.

To the extent that Government funds are used to supplement private capital, the public's interest must be adequately protected. It would be appropriate for general investment policies to be established by the Federal agency administering the program, and for application of these policies by local instrumentalities to be subject to regular review and examination. The responsible Federal agency should account completely and separately for all Government funds used, so that the public could be fully informed of all economic costs involved.

Whatever Government contribution is provided should serve to stimulate, rather than dominate financing of the program. If the program is based on economically sound principles, private capital will be forthcoming. Therefore, the Federal Government's financial contribution could appropriately be limited to a portion rather than a multiple of the private capital willing to invest in small business.

Small business is a vital sector of a free, competitive enterprise economy, and the existence of a gap in financing facilities which serve it may be inhibiting to the prosperity and growth of the nation. Therefore, the Board believes that Government should foster an experiment in developing new private facilities to meet the investment financing needs of smaller businesses.

CONFIDENTIAL (FR) April 11, 1958

To: Board of Governors Subject: Small Business Investment Administration Act of 1958.

From: Daniel H. Brill

The staff of the Senate Banking and Currency Committee, at the direction of the Committee's Chairman, has prepared a draft bill proposing a new system of financial aid to small business. The proposed bill is entitled the "Small Business Investment Administration Act of 1958." Major provisions of the Committee print are summarized below.

Organization

Administering agency. The Senate Committee staff proposal provides for the creation of a new independent Government agency--the Small Business Investment Administration--to administer a program designed to stimulate and supplement the flow of private equity capital and long-term loan funds to small business.

Chief executive officer of the Small Business Investment Administration (SBIA) would be an administrator appointed by the President with the advice and consent of the Senate. Compensation of the Administrator is fixed at $20,000 per annum (in contrast with the $17,500 paid the Administrator of the SBA). Headquarters of the SBIA would be in Washington, but it would be authorized to establish branch and regional offices as needed. The SBIA is authorized, however, to make use of other governmental facilities, particularly those of the SBA, on a reimbursable basis.

Policy direction. The SBIA would operate under policies promulgated by a Small Business Policy Board (replacing the present SBA Loan Policy Board) to be composed of the Secretaries of Treasury and

Commerce, the Administrator of the Small Business Administration and the Administrator of the proposed SBIA. Chairmanship of the new Policy Board would be rotated each year between the Administrator of the SBA and the Administrator of the SBIA. The Policy Board would coordinate activities of the SBA and the SBIA, establish loan policies of the SBIA, and establish standards and criteria for defining small businesses and their eligibility for financial assistance under the program.

Local instrumentalities. The SBIA would be authorized to issue permits for operation under the Act to small business investment companies, companies organized by private investors to extend long-term credit and equity capital to small businesses. SBIA would advance funds to these companies by investing in their shares or purchasing their obligations. The investment companies would be subject to regular examination by the SBIA, and would be required to make such financial reports as the SBIA might require.

The investment companies would advance funds to small businesses by acquiring convertible debentures of these businesses or by making long-term loans, directly or in participation with other financial institutions. Such loans could have maturities of up to 30 years, with possible extension of up to an additional 10 years to permit orderly liquidation of the loan. State-chartered investment companies could convert into small business investment companies on majority vote of their stockholders, and if approved by the SBIA.

The SBIA would also be authorized to make loans to State and local development companies, if such funds were used to supply equity capital to small businesses.

Financial arrangements and limitations

Small Business Investment Administration. The SBIA would be authorized to borrow up to $250 million from the Treasury, at interest rates not exceeding the current average yields on outstanding marketable United States obligations of comparable maturities. The $250 million ceiling would be approached in steps, however. Maximum outstanding debt to the Treasury in the first year of SBIA's operation would be limited to $50 million, and in the second year of operation the maximum would be $150 million. Not until the third year after enactment of the bill would the full $250 million be available to SBIA. Redemptions, purchases and sales by the Treasury of SBIA notes or other obligations would be treated as public debt transactions of the United States.

Funds borrowed by SBIA from the Treasury would be put into a revolving fund to be used for the investment and loan programs described above. Administrative expenses of the SBIA would be met out of appropriations authorized (but not specified in amount) in the bill. # SBIA could invest up to $250,000 in the shares of any one investment company (or half the minimum capital required to start such an investment company). The SBIA would also be authorized to lend to investment companies through purchasing their obligations, at interest rates and on such other terms as the SBIA determined. SBIA loans to any one investment company would be limited to 50 per cent of the paid-in capital and surplus of the company. Thus, if private investors contributed only the statutory minimum of $250,000, or half the initial required capital, the maximum Government contribution to the investment company could be $500,000 ($250,000 in capital and $250,000 in loans), or two times the minimum capital raised privately.

Shares of stock of these investment companies would be eligible for purchase by Federal Reserve member banks, nonmember insured banks, financial institutions, corporations, partnerships or other persons. Purchases of shares by member and nonmember banks would be limited to 1 per cent of the bank's capital and surplus. Upon application of an eligible purchaser, the Administration would have to sell all or a portion of the shares held.

SBIA loans to State and local development companies would also be made at interest rates and on other terms fixed by the SBIA, and would also be limited in amount to 50 per cent of the development company's paid-in capital and surplus.

Small business investment companies. The "primary function" of the small business investment companies would be that of providing equity capital for small businesses. Such equity capital would be advanced through purchase of convertible debentures, at interest rates fixed by the investment company with the approval of the SBIA, callable at par plus accrued interest on three months' notice, and convertible at the option of the investment company into stock at "sound" book value determined at the time the bond was issued. The investment companies could require recipients of funds to refinance outstanding indebtedness so that the investment company were the only creditor and, subject to regulations issued by the SBIA, require the recipient to obtain the investment company's approval before undertaking additional indebtedness. Small businesses selling debentures to investment companies would be required to invest in stock of the company in amounts equal to from 2 to 5 per cent of the funds received.

Investment companies could also make long-term loans--maturities of up to 30 years--to eligible incorporated and unincorporated small businesses. Maximum interest rates on such loans would be determined by the Administrator of the SBIA. These loans could be made directly, or in participation with other lending institutions. Long-term loans would be of such sound value, or so secured, as reasonably to assure repayment.

Maximum investment or commitment of any investment company in any one small business is limited to 33-1/3 per cent of the combined capital and surplus of the investment company.

Federal Reserve responsibilities

Repeal of Section 13(b) of the Federal Reserve Act is provided for in the bill, and return to the Treasury of the aggregate amounts heretofore paid by the Treasury to Reserve Banks. Amounts so repaid would be covered into miscellaneous receipts of the Treasury. Federal Reserve Banks would be authorized to sell any assets acquired under Section 13(b) to any small business investment company organized under the proposed Act.

Federal Reserve Banks are authorized and directed to act as depositories, custodians and fiscal agents for the SBIA, and to be reimbursed for expenses incurred as fiscal agents. Reserve Banks are also authorized to act as depositories or fiscal agents for investment companies organized under the Act. Investment companies are authorized to make use of the advisory services of the Federal Reserve System which are available for and useful to industrial and commercial businesses.

Tax provisions

Relief from Federal income taxation afforded small business investment companies in the proposed bill appears to be substantially the same as that provided in the Talle bill (H.R.11576). In essence, the provisions would permit investment companies to receive "conduit" treatment on investment income more liberal than present regulations governing taxation of dividend receipts by other corporations, and to charge against income for tax purposes the full amount of any loss on investments not compensated for by insurance or otherwise. (Losses from sales or exchanges of capital assets incurred by business corporations in general are allowed only to the extent of gains from such sales or exchanges.) Taxpayers suffering a loss on stock in a small business investment company would also be permitted to treat the loss as a full deduction from income.

Chairman Martin

May 9, 1958

Memorandum to Board of Governors

From Jerome W. Shay

Subject: Certain excerpts from Chairman Martin's testimony on April 21, 1958 before the Senate Small Business Subcommittee (printed copies of Hearings not yet available).

This morning, I supplied each Board Member with a copy of Chairman Martin's statement on June 20, 1957 before the Subcommittee on Small Business of the Senate Banking and Currency Committee, and attention was invited particularly to the comments on pages 4 and 5 concerning the role of the Federal Reserve in the small business financing problem.

Later, this morning, I re-examined Chairman Martin's testimony on April 21, 1958 before the Senate Subcommittee on Small Business, during which the Chairman summarized the results of the Board's study of small business and also outlined in general a legislative program for small business financing. This program, as you know, is reflected very largely in the new Johnson and Patman bills (S. 3651 and H. R. 12064).

As further background on this matter, set forth below are excerpts from Chairman Martin's testimony on April 21, 1958, which involve possible Federal Reserve participation:

"MR. MARTIN: Mr. Chairman, we have gone over the bills that have been presented; and, I think, the Board was generally unanimous in the view that without any disparagement of the desirability of a small-business financing program, our primary function is in the central banking field, and in these days, particularly, we realize we have our hands full.

"SENATOR CLARK. In other words, you want out?

"MR. MARTIN. We do not want to--we are reluctant to accept the responsibility of individually setting up and organizing and determining this. We have some question as to whether that would be the wisest way to proceed, even if you should say we should, in which event, of course, we would abide by your decision. But that is the general thinking of the Board."

* * * *

"SENATOR BUSH. Thank you, Mr. Chairman, I congratulate Mr. Martin on his statement. I think it is a very constructive one and I am very glad to hear that you are opposed to the Federal Reserve Bank, or any of its banks getting into this problem. I do not think it is necessary and I certainly think it is highly undesirable. I am glad to hear you taking that position."

* * * *

"SENATOR CASE. I have just one question, Mr. Chairman. I will ask Mr. Martin to make any comments he may wish to make on the general question of whether any or all of these proposals would have a marked effect and, if so, what kind of effect, on increasing or reducing the scope or effectiveness of indirect credit or monetary controls over the economy, and any indications that may seem to him in view of his experience to be involved here.

"MR. MARTIN. I would not think the principles we have outlined here, which are incorporated to a large extent in this committee print that I mentioned earlier--I would not think they would have any or make it more difficult for the general controls to operate. Nor would they necessarily insulate small business any more than it is presently insulated from whatever impact there is from a rising tide of demand for credit at a particular time, if the credit pool as a whole is diminished or increased.

"SENATOR CASE. Is that same general comment applicable to all of the bills, or all of the proposals we made?

"MR. MARTIN. I would want to examine the bills again. But I would think that if you went into the Federal Reserve System--set up 12 small business capital banks for example, that there would be more impact on credit policy and more tendency to make it difficult to keep high-powered dollars from getting into the machinery, than by an approach of the type we have outlined.

"SENATOR CASE. I do not have any further questions."

* * * *

"SENATOR FULBRIGHT. .... You are clear you do not want to do it. You do not think the Federal Reserve should be given the responsibility.

"MR. MARTIN. That is our judgment."

* * * *

See p. 2 for S. 2160 - Sparkman
see p. 3 for S. 2286 - Fulbright

Summary of the More Important Bills
Pending in the 85th Congress, Designed to Provide
Equity and Long-term Capital to Small Business

During the 85th Congress, numerous bills have been introduced for the purpose of providing financial relief and assistance to small business concerns. Many of these involve minor amendments to the Small Business Act of 1953, which are designed to solve relatively narrow and limited problems. Others would not involve the actual lending of government funds, but would rely entirely on amendments to the Internal Revenue Code as a means of providing assistance. None of these, however, are being given very active consideration by the Congress.

Certain other bills, some quite comprehensive, have been introduced which, it would appear, are being or will be given considerable study by Congressional committees. Some of these, such as the Johnson Bill - S. 3191, the Patman Bill - H. R. 10345, the Sparkman Bill - S. 2160, and the Multer Bill - H. R. 10980 would create new government agencies or semi-government agencies for the purpose of supplying financial aid to small business. Other bills would give additional authority to the Small Business Administration. These include the Talle Bill - H. R. 11576, the Spence Bill - H. R. 7963, and the Fulbright Bill - S. 2286. The bills mentioned in this paragraph are very briefly summarized below.

Small Business Capital Bank System

The Johnson Bill - S. 3191 and the Patman Bill - H. R. 10345, which are identical, would create a Small Business Capital Bank System consisting of a Small Business Capital Bank Board, 12 Small Business Capital Banks and Small Business Investment Associations. Section 13(b) of the Federal Reserve Act would be repealed and funds authorized under that section, as well as $120 million of the funds in the surplus accounts of the Reserve Banks, would be transferred to the SBC Bank Board. Also, the Reserve Banks would be required to supply quarters and facilities to the Small Business Capital Banks at no cost to them. The banks in turn would provide capital to investment associations organized under State law, and could make long-term loans to business concerns. Such loans would have maturities in general not exceeding 30 years, and would carry an interest rate not in excess of the prevailing rate in the area, but in no event more than 5 per cent per annum.

The investment associations would operate as regulated closed-end investment companies and would provide equity capital to small business. They would secure funds for this purpose by issuing debentures to the capital banks. These debentures could be exempted from the Securities Act of 1933 and the Trust Indenture Act of 1939. For tax purposes the associations would be treated as regulated investment companies but with even more liberal provisions for reserves and for carry-over for losses and some other differences.

(Similar bills, H. R. 10400, H. R. 10401 and H. R. 10683 have been introduced by Representatives Roosevelt, Santangelo, and Evins, respectively.)

National Investment Companies

The Sparkman Bill - S. 2160, provides for the organization of National Investment Companies by private persons or Federal Reserve Banks for the purpose of making loans to and buying stock of small business enterprises. Each company would have a paid-in capital and surplus of $5 million before commencing business and Federal Reserve Bank funds would be used, if necessary, to supply the required capital. Shares of stock would be eligible for purchase by business organizations and financial institutions or individuals, and member banks of the Federal Reserve System could acquire and hold stock in an amount not in excess of 4 per cent of the capital and surplus of the member bank.

Each investment company would have authority to issue its debentures or other obligations under regulations prescribed by the Board of Governors which would have general supervisory authority over the companies.

The companies could be exempted from the Securities Act of 1933 and the Trust Indenture Act of 1939, and in addition would be given considerably more liberal tax exemptions than are now provided in the Revenue Code for regulated investment companies.

Section 13(b) of the Federal Reserve Act would be repealed and the surplus of the Reserve Banks under that section would be transferred to the United States.

Small Business Investment Corporation

The Multer Bill - H. R. 10980 would establish a Small Business Investment Corporation having an initial capitalization of $20 million, one-half which would be subscribed for and paid in by the Secretary of the Treasury. The other half would be offered for sale to the public.

The Corporation would be authorized to issue its obligations in the amount of $500 million, all of which could be sold to private investors and of which not more than $250 million could be issued and purchased by the Secretary of the Treasury.

The Corporation would use funds available to it for investment in the stock of incorporated small business concerns. However, any such small business concern would be required to purchase and pay for stock in the Corporation equal to at least 10 per cent of the amount invested in the small business concern by the Corporation. Thus, the Treasury investment in the Corporation might be gradually retired and the Corporation eventually be privately owned.

Amendments to Small Business Act of 1953

The Talle Bill - H. R. 11576 would authorize the Small Business Administration to make secured loans to local or State Development Credit Corporations with maturities not exceeding 10 years and at an interest rate not to exceed 6 per cent per annum; make loans to State Development Credit Corporations evidenced by debentures and with maturities not to exceed 10 years and carrying a rate of interest not to exceed 6 per cent per annum; and make loans to Small Business Investment Associations chartered by SBA or chartered under State law and approved by SBA. This program would be financed by a $250 million increase in the SBA revolving fund.

Securities issued by private and State Development Corporations, Small Business Investment Associations, and small business concerns could be exempted from the provisions of the Securities Act of 1933 and the Trust Indenture Act of 1939. Special tax treatment for small business concerns would also be provided.

The bill would repeal section 13(b) of the Federal Reserve Act and return to the Treasury amounts paid to the Federal Reserve Banks under section 13(b).

The Spence Bill - H. R. 7963 was introduced in June of 1957 as an amendment to the Small Business Act of 1953. This bill, which passed the House of Representatives on June 25, 1957, would increase the borrowing authority of Small Business Administration to $650 million. These funds could be used to make loans to small business enterprises in an amount to each borrower not in excess of $250,000 carrying a rate of interest of not more than 5 per centum. Larger loans would be permitted to corporations organized by a group of small business concerns (the number of small businesses involved multiplied by $250,000) with maturities not to exceed 10 years, except where construction of facilities is required when maturities of 20 years would be allowed.

Bills containing similar amendments to the Small Business Act have been introduced by Congressmen Multer, Talle, and Hill, by Senators Thye (for himself and 29 other Senators) and Sparkman. Some of these differ in certain important particulars from the Spence bill, For example, under Senator Sparkman's Bill, the borrowing authority of SBA would be increased to $850 million; the maximum loan permitted to individual borrowers would be $500,000; maximum interest rate would be 6 per centum; and separate authority would be given SBA to insure loans made by private lending institutions.

The Fulbright Bill - S. 2286 would authorize the Small Business Administration to purchase obligations of State chartered development credit corporations in the aggregate amount of $27.5 million outstanding at any one time.

Section 13(b) of the Federal Reserve Act would be repealed and the surplus of the Reserve Banks under that section would be transferred to the United States.

Chairman Martin

FOR INFORMATION
PRIOR TO CONSIDERATION AT A
MEETING OF THE BOARD.

APR 18 1958

CONFIDENTIAL (FR)

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The Current Economic Problem

Since the turning point early last autumn, downswing in the economy has now lasted seven months. Declines in broad measures of economic activity, such as gross national product, nonfarm employment and industrial production, have been rapid. Unemployment has shown a disturbingly large increase, especially among younger men formerly employed in producer and consumer durable goods industries. Nondurable goods industries, although less affected, have not been immune from downward readjustment.

This downturn has been sharper and deeper than either of the two preceding postwar recessions. It may be that recession was accentuated in midwinter months by unusually adverse weather conditions. The most recent information suggests some slowing of decline, but these signs relate to quite a brief period.

These are sober facts. We cannot be complacent about them, particularly when the downward phase of this cycle may not yet have run its course. At the same time, however, it is the task of those responsible for decisions in private and public policy to search beyond these facts and explore developments underlying them.

Problem of counter-recession policy

Fluctuation seems to be an inevitable feature of a dynamic economy in which imbalances and the need for adjustment are continually arising; at least, free society has not yet found a formula for eradicating them. These cyclical fluctuations can be and have been very severe.

However, they are not always severe; the two preceding recessions were moderate and short-lived. History does not repeat itself; no one cycle is a close replica of any other. But our history does show that periods of contraction tend to be shorter and less pronounced than periods of expansion. This is another way of saying, of course, that our economy is a growing one.

In view of the unstable aspects of a dynamic and growing economy, economic policy, both public and private, must have its long-run and short-run aspects. From a longer run standpoint, the major task of a competitive economy is to maintain a climate favorable to sustainable high-level growth without inflation.

In the short-run, major tasks for economic policy are to encourage flexible adjustments to changing conditions, to minimize imbalances in market supply and demand, to correct imbalances as they occur, and to avert excesses that are always a danger and that give rise to later problems.

Economic policy directed to shorter run objective can have effects that go beyond those intended and interfere with attainment of longer run objectives. I have always believed, and I continue to believe, that we will have more success in attaining orderly economic growth and in avoiding the hardships of periodic recessions if public policy can work to minimize excesses during recurrent booms. The excesses of booms are our greatest hazard because they later lead to unemployment.

In this modern age of the large corporation and the large labor union with their professional managements, private policy has greater responsibility in these matters of general economic progress and stability than in the past. Responsibility for far-sighted appraisal and policy is in proportion to size and market power. And when excess resources come within the purview of management and labor decision makers, their first task is to do whatever they can to see that these resources are put to work.

It is small comfort to the unemployed wage earner that his union leadership has won another blank cents per hour increase for workers who remain employed. It is small comfort to consumers to find many products continuing in price beyond their willingness or ability to pay--or even rising further. And it is small comfort to investors to see profits and dividends dwindling as plants and manpower become idle. Too often, we seem only to give lip service to a market--supply and demand--economy, and are really afraid to make it work.

Features of current recession

This recession has been accompanied by numerous adjustments. Some of these have been in the nature of corrections of earlier imbalances. Others are responses to new imbalances developing out of recession itself. Many further adjustments may need to take place before a conjuncture of expansive forces predominates in a way as to set in motion, first, recovery and, subsequently, resumed economic growth. A solidly based recovery, that is, one which will ripen into healthy expansion, will not come by postponing essential adjustments; but neither will the beginning of recovery have to await the completion of all of them. We need now to get aggregate demand growing instead of contracting in order to get the redirection of resources that will facilitate many adjustments.

Business inventories. Business inventories, after many years of accumulation, became vulnerable to easier supply positions and declining final demands. Reacting last fall to the emergence of these conditions, businessmen cut their orders drastically and began to run off their inventory holdings. This run-off represented two-thirds of the decline in gross national product from the third quarter of 1957 through the first quarter of this year, and contributed to sharp reductions in output, particularly of durable goods industries.

The process of general inventory reduction may persist for a time. Total stocks, particularly of finished goods, remain large; in absolute amount, the running down of stocks has been moderate. The possibility exists, however, that the rate of inventory liquidation is already close to its maximum and that it has already had much, if not all, of its impact as a contractive influence on output and employment.

Steel industry operations, for example, have recently fallen to less than 50 per cent of capacity. Use of steel by steel consuming industries has not declined nearly as much, so that much excess steel inventory has been worked off.

Business spending for plant and equipment. While inventory liquidation has played an important role in this recession, it is misleading to characterize our downturn as only "inventory recession." Another factor in reduced demand, and possibly a more fundamental one, has been cutback in business spending for fixed investment. In the third quarter of last year, business expenditures for new plant and equipment were at an annual rate of nearly $38 billion, or a fourth higher than two years earlier; plans for the current quarter suggest outlays are down to a rate of about $32.5 billion. Recent surveys indicate a continued decline in business investment spending throughout this year.

The preceding boom was very much a business investment boom, and a margin of excess capacity in many lines became a feature of the economic situation by last autumn. A major problem confronting business as a result of this development and its further aggravation by recession itself is to find the products and prices that will keep this plant and equipment employed. Given an opportunity for market demands to set recovery in motion and given the strong growth forces of our economy, we shall surely later discover inadequacies in our industrial plant that will warrant renewed expansion in business investment.

Industrial capacity, it needs to be remembered, is not only a matter of the stock of fixed capital; it is also a matter of its quality in relation to the state of technology and of the skill and ingenuity of management and workers. The flow of technological advances has been dramatically enlarged in postwar years by rapid expansion in research and development activities, many of which are directed toward the production of new or improved products, as well as towards reducing costs of production. This is the way in which advances in management and worker productivity are developed.

Consumer income and spending. Contraction in consumer money income has been smaller than the decline in the value of total output. Unemployment compensation payments have offset part--about one-fifth--of the sizable decline in wages and salaries. Also, payments under the old-age and survivors insurance program have continued to grow, as have other Government payments. And, recently, farm income has risen. Most consumers still have strong financial positions; in fact, many have reduced their debts and added further to their financial savings.

The purchasing power of consumers has been reduced since autumn not only by declining money income but also by rising prices. Consumer expenditures for goods and services, nevertheless, have been relatively well maintained. Declines in consumer spending have been concentrated in durable goods, particularly for new autos. Along with reducing their purchases of durable goods, consumers have cut back on their use of instalment credit. Meanwhile, repayments on instalment contracts have continued to rise and recently have exceeded the volume of new credit extended. Instalment credit outstanding is now being reduced and has become a contractive factor in the economy.

In the housing area, consumers have been increasing their home mortgage debts more slowly than earlier and have been less active in purchasing houses. With vacancy rates in the residential field continuing relatively low, easier credit conditions have been looked upon as stimulants to residential construction. In recent months, however, the volume of housing starts has declined. In view of the significant decline in the marriage rate since last autumn, it remains to be seen whether easier credit conditions will meet with strong response in the housing field. The economy is indeed fortunate, however, that the inventory of unsold houses was small when recession set in.

Foreign markets. Added to declines in business and consumer investment spending has been a sharp reduction in U. S. exports of merchandise, particularly to industrial countries of Western Europe, to Canada, and to Japan. Meanwhile, over-all imports have been maintained despite the downturn in domestic activity.

The decline in U. S. exports has reflected mainly reduction abroad in demands for steel, fuels, raw cotton and other materials, as well as a leveling out in demand for machinery and equipment. The investment boom of 1954-1956 tapered off in all industrial countries in 1957.

Thus far economic activity in Western Europe has continued to hold up and prospects there now depend in part on developments in world markets for European exports. In Canada, recession, which started somewhat earlier than in this country, now appears to have moderated. A number of nonindustrial countries have been adversely affected by reduced export earnings. The longer recession goes on in this country, the more likely it is that activity in other countries will show contractive tendencies.

The current economic position

In view of the downward adjustments that have already been made and barring further declines in business and consumer demands, there are grounds for hope that output and employment may not be far from the lows of current recession. The economy has many elements of strength for the longer run, and the problems of surmounting the imbalances of the short-run can surely be solved.

Fiscal and monetary policies have both been operating to cushion declines and to set the stage for a regathering of expansion forces.

For instance, monetary action has progressively made credit more readily available and has contributed to a marked lowering of its cost. Fiscal action has included an expansion of Federal spending programs and an easing of Federal underwriting programs in the mortgage field. At State and local government levels, public spending has continued to rise without letup in recent months in response to continued needs for expansion and improvement in community facilities and services.

Thus far, the emergence of recovery forces has been hampered by the tendency of declines in demands to impinge mainly on output, with prices holding at advanced levels or even continuing to rise in some lines. In part, recent price behavior has reflected cost rigidities and in part it has reflected unwillingness on the part of producers to explore markets for their products at lower price levels. Competition, not fear of it, has always been a source of strength of the American economic system.

Let me clarify my views on this topic. No one, so far as I know, advocates a policy of imposed deflation or desires a downward price spiral which would accentuate the business contraction. But there is an area in which reductions in prices would stimulate demand and contribute to an early recovery. Failure to adjust prices in periods of recession delays recovery and means a loss in the purchasing power of the dollar over the long run. It furthers acceptance of creeping inflation psychology and certainly weakens the adaptive abilities of our economy.

Summary

The current status of the economy is one of adjustment, a process which is continuing. Many of the adjustments result from earlier excesses; in short, are consequences of preceding inflation. Recent indications of slow-down in recession are encouraging, but must--as yet--be appraised with caution. The Federal Reserve System by its actions has shown that it views the immediate problem as one of halting recession and paving the way for recovery. I need hardly add that all of us are confident about the long-run growth prospects of the United States as well as of the free world economy.

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TREASURY DEPARTMENT
Washington

STATEMENT OF LAURENCE B. ROBBINS, ASSISTANT SECRETARY OF THE TREASURY, BEFORE THE SUBCOMMITTEE ON SMALL BUSINESS OF THE SENATE COMMITTEE ON BANKING AND CURRENCY
APRIL 24, 1958

MR. CHAIRMAN AND MEMBERS OF THE SUBCOMMITTEE:

I welcome this opportunity to appear before your Subcommittee to submit the comments of the Treasury Department on the financing of small business in connection with the several bills which are before your Committee for consideration. The Treasury is keenly aware that the smaller businesses of our nation have been, and are, a dynamic force in our free competitive economy. Each small enterprise makes its contribution to the development of new ideas, new processes and the maintenance of a continuing broad base of competition. We feel that it is highly important for the Government to try to determine as clearly as possible what the financial and other needs of small business are and, to the extend that it can properly do so, to see that those needs are met.

In our testimony before this Committee last June we urged that any decision as to the method by which further financial assistance should be given to small business by the Government be deferred until the findings of a study, then contemplated by the Federal Reserve Board, would be available. The reports on those parts of the study which have been completed have been submitted to the Committee and, although much more is to be learned from the still unfinished part, it is now possible to draw at least some tentative conclusions which help to place the problem in proper perspective.

The first of these conclusions is that there is no apparent shortage in the availability of short-term or even intermediate-term credit to small business. If there is a gap anywhere in the availability of small business financing, it would appear to be in the area of long-term loans and equity capital. The general acceptance of that conclusion is evidenced by the bills now under consideration.

In trying to find the best way to fill that gap, we believe that there are several basic principles which should govern any assistance or participation on the part of the Government. The first is that since there is no way at the present time to measure the magnitude of the problem, nor even to be certain of just what its elements are, we feel that any program that is adopted should be as simple as possible, but flexible enough to permit modifications, changes or expansion when the results of actual experience can be appraised. We believe that it would be a mistake to create a new governmental agency with its own overhead, personnel and administrative costs. Any new governmental activity in this field should be undertaken by an existing agency in order to avoid a confusion of responsibility and functions and an unnecessary burden on the federal budget, and also to get quicker results.

The second principle which we consider important is that the Government should not put itself in the position of owning directly, or indirectly, an equity in private business. The dangers inherent in such equity ownership seem too obvious to discuss at length. Stock holdings would involve questions of division of profits, participation in and perhaps domination of management, government competition with private business, and in general an invasion into the field of private enterprise. Any advance of federal funds to small business concerns, groups of small business concerns, or investment companies which would own equities in small business concerns should, in our opinion, be rigidly restricted to loans without any purchase of stock.

Third, we believe that Government funds should be used only where private capital is not available so that the Government will not be in the position of either competing directly, or subsidizing competition, with established private business.

Fourth, we believe that federal funds should not be used in such a way as to assist business concerns to move from one area to another. Competition between states and between industrial areas is a desirable factor in our free economy, but the Federal Government should not assist one area at the expense of another.

It should be remembered also that every small business which receives financial assistance from the Government is in competition with some other small business which has financed itself privately and has developed under sound and prudent management without calling on the Government for help. The best contribution the Government can make to the welfare of small business is to encourage by every reasonable means the use of private capital without subsidies.

The bills before your committee all have in general the same objective, which is to make long-term loans and equity capital more readily available to meritorious small business concerns. They differ only in the methods proposed. We are in accord with the objective, and with many of the features of the different bills. With some we do not agree.

Rather than to discuss the provisions of each bill in detail, I think it will save the time of the committee if I simply make some general comments in the light of the principles which I have mentioned previously.

S. 2160 would create national investment companies with minimum capital of $5 million each to be provided by the Federal Reserve Banks to the extent necessary and would permit only one such company to be established in each state. Our feeling is that it would be more desirable to permit investment companies to be organized with much smaller capital, subscribed for by private sources and without geographical limitation. We would favor permission to incorporate with capital as small as $100,000 provided that there must be at least ten stockholders and that no one stockholder could hold a dominant interest. We would favor allowing such companies to be organized wherever a group of individuals would supply the capital, subject only to the approval of the government agency that would administer the program.

S. 3191 would establish what would be tantamount to a new banking system, paralleling the Federal Reserve System, with large capital and high overhead. We believe that this would be an unnecessarily elaborate and extravagant program, extremely costly to the Government and far greater in scope than would be necessary to take care of any need that is now indicated. Moreover it would permit the capital banks to make direct loans in competition with the Small Business Administration and for longer periods of time.

S. 3651. This bill has some very good features but we think its most serious defect is that it would create a new and independent agency with its own regional offices paralleling and, in many respects, duplicating the Small Business Administration. We feel that there are several objections to such a plan. It would pose a difficult question of definition and division of responsibility and functions between the new agency and SBA, not only with respect to financial assistance but also in such areas as management counseling, assistance in procurement and other things outside the strictly financial field. It would almost certainly result in some overlapping, duplication and competition between the two agencies. It would be costly to the Government and, in addition to everything else, it would take so long to recruit and build a competent organization that the benefits of the program would not be available to small business in any substantial degree for a very considerable length of time. We would strongly urge that any program which may be decided upon be placed in the hands of an existing agency which could get the show on the road without delay. The Small Business Administration has been in existence for four and one half years. It has 52 regional and field offices in the Continental United States, Alaska, Hawaii and Puerto Rico. It has an organization of 1,343 people, including financial specialists, engineers, appraisers, management consultants and supervisors. It has well established national and regional advisory boards. We believe it would be very much in the interest of the Government and of small business from every standpoint, economy of operation, experience, clear definition of responsibilities and service to small business to utilize this organization rather than to set up a new one.

S. 2160 would use Federal Reserve funds for the purchase of equity capital in national investment companies and would permit national investment companies to purchase equity capital in small business concerns. S. 3191 would use Federal Reserve funds to provide equity capital in capital banks and would authorize the capital banks to invest in equities of small business investment associations. S. 3651 would authorize the Small Business Investment Administration to supply equity capital for small business investment companies. As previously indicated, we believe that Government funds should be used exclusively for loans and not for the purchase of equities.

Some of the bills provide for loans to small business concerns running as long as 30 years with an additional 10 years for orderly liquidation. We believe that a 10 year loan to a small business is a long-term loan. In setting up a 10 year loan the fixed repayment schedule need not always require evenly distributed amortization nor necessarily complete amortization during the 10 year period because it may be expected that contingent payments from earnings or payments from other sources will supplement the fixed payments and retire the balance within 10 years, or reduce it to an amount which can be refinanced privately. If an additional 10 years is allowed, if necessary for orderly liquidation, we feel that any legitimate needs of a small business concern would be provided for.

It is not clear in some of the bills that the proposed financial assistance shall be available only to small business concerns. We believe that there should be such a requirement and that any investment association should not be permitted to invest more than $250,000 in any one small business enterprise. We also believe that in order to diversify the risk, no investment association should be permitted to invest more than 20% of its capital and surplus in any single business concern.

Most, if not all, of the principles which I have endeavored to express are incorporated in S. 3643.

Mr. Dan Throop Smith will submit a separate statement on the tax provisions of the various bills.

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TREASURY DEPARTMENT
Washington

STATEMENT BY DAN THROOP SMITH, DEPUTY TO THE SECRETARY OF THE TREASURY, BEFORE THE SUBCOMMITTEE ON SMALL BUSINESS OF THE SENATE COMMITTEE ON BANKING AND CURRENCY
APRIL 24, 1958

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(To accompany statement by Assistant Secretary Laurence B. Robbins).

MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE:

The Treasury Department appreciates having this opportunity to comment on the tax provisions of legislative proposals now under consideration by this Committee to provide additional facilities for the financing of small businesses.

S. 2160 and S. 3191 both provide similar special tax treatment for the investment companies or associations to be established under these bills. In general, this would permit these organizations to be treated as regulated investment companies. As such, they would be exempt from tax on the portion of their income or capital gains distributed to shareholders. However, the treatment accorded the proposed companies or associations would be more liberal in significant respects than the usual regulated investment company provisions.

In addition to being exempt on their distributed earnings, these companies or associations would be allowed to retain and accumulate free of tax a substantial fund of earnings in a special tax reserve. The operation and tax treatment of this reserve, termed "national investment company reserve" under S. 2160 and "small business investment association reserve" under S. 3191, would be the same under either bill. The companies or associations would be allowed a tax deduction for certain additions to the reserve and would be allowed a dividends-received deduction on their dividend income which was used to make further additions to the reserve fund. Regulated investment companies under present law are not entitled to the dividends-received deduction and are fully subject to tax on their retained earnings.

The proposed special tax reserve is not to exceed 50 percent of the invested capital of the company or association. It is also provided that the reserve shall not exceed the actual amount of the accumulated earnings and profits of the company or association. Additions to the reserve up to 20 percent of the invested capital are allowed as a tax deduction without regard to the source of such income. Further additions to the reserve up to the over-all maximum of 50 percent of the invested capital qualify for the

85 percent intercorporate dividends-received deduction, provided the company or association has a corresponding amount of dividend income from domestic corporations. These provisions would have the effect of relieving the proposed investment companies or associations of the requirement of distributing 90 percent of their income to shareholders with respect to the amounts of dividend as well as other income deposited in the reserve. Regulated investment companies generally are required to distribute 90 percent of all of their ordinary income in order to qualify for the special method of tax treatment.

Both S. 2160 and S. 3191 also provide that the proposed investment companies or associations, unlike regulated investment companies, would be entitled to the equivalent of net operating loss carryovers, which would be more liberal than those available to corporations generally. In addition, they provide a special treatment of capital losses which under certain conditions would permit the offset of capital losses against ordinary income in the absence of offsetting capital gains. Corporations generally, including regulated investment companies, are not permitted to deduct capital losses from income other than their capital gains, but are allowed a five-year carryforward of capital losses against capital gains. The proposed loss treatment for the investment companies or associations is tied in with the operation of specified charges and additions to the special tax reserve and involves various complex adjustments.

The usual tests for qualifying for regulated investment company treatment are also liberalized in the case of the proposed investment companies or associations. The general requirement that 90 percent of the gross income consist of specific types of investment income (dividends, interest, and gains from sale of securities) is reduced to 75 percent for the proposed companies or associations. This would permit these organizations to receive substantial amounts from service fees and charges and other non-investment sources, and yet qualify for the special tax treatment. Provision is also made for waiving, in the case of the proposed investment companies or associations, the usual requirements applicable to regulated investment companies relating to diversification and liquidity of investments, subject to the approval of the banking authorities having jurisdiction under the respective bills.

These tax provisions would probably relieve the proposed investment companies and associations from Federal income taxes for a considerable if not indefinite period, without actually conferring tax-exempt status on them. They would also have the effect of extending to participating commercial banks and other lending institutions more favorable treatment with respect to earnings arising from loan operations conducted through such an investment company or association as an intermediary than on similar loan operations conducted directly.

The proposed special tax treatment is based on a complex extension and liberalization of the "conduit" or "pass-through" treatment under the regulated investment company provisions. However, since the proposed investment companies or associations would be exempt not only on their distributions to shareholders but also on amounts of retained earnings put into a tax-exempt reserve, they would be substantially tax-exempt even where they did not in fact pass their income on to shareholders. This would be inconsistent with the conduit principle on which the regulated investment company provisions are based. There have been many proposals for special tax-free reserves which the Treasury Department has consistently opposed. The adoption of the proposed tax-free reserve treatment for these investment companies or associations would constitute an undesirable precedent for similar treatment elsewhere.

The proposed legislation under S. 3651 follows a different approach from S. 2160 and S. 3191 in its method of providing special tax treatment for the investment companies which it would sponsor and investors in such companies. Tax features similar to those contained in S. 3651 are also embodied in S. 3643. These tax features include three specific provisions:

1. The proposed investment companies would be allowed an ordinary loss deduction, rather than a capital loss deduction, on losses realized on convertible debentures, including stock received pursuant to the conversion privilege, acquired in connection with the provision of equity-type capital for small business concerns. The loss deduction would include losses due to worthlessness as well as those arising from sale or exchange of the security.

2. Taxpayers investing in the stock of the proposed investment companies would be allowed an ordinary loss deduction rather than a capital loss allowance on losses arising from worthlessness or sale of such stock.

3. The proposed investment companies would be allowed a deduction of 100 percent of dividends received from a taxable domestic corporation rather than the 85 percent deduction allowed corporate taxpayers generally.

These tax provisions contained both in S. 3651 and in S. 3643, are consistent with recommendations which the Administration has made in connection with its small business tax proposals and elsewhere. We endorse this tax approach. The provisions should be helpful in increasing the amount of funds available to the proposed investment companies and they are consistent with other tax recommendations and the general corporate tax law.

In developing its general tax program, the Treasury Department under this Administration has been very much aware of the financial and competitive problems which confront small business owners and investors. Many of the reforms adopted in connection with the general revision of the tax laws in 1954 were of special importance to small business. These include, for example, the liberalized depreciation methods, improved loss carryovers, and clarification of the tax on surplus accumulations.

In 1956 President Eisenhower appointed a Cabinet Committee on Small Business whose members were instructed to investigate the whole range of small business problems, including taxation, and to formulate a constructive program to increase opportunities for small businesses to prosper and grow. A Progress Report of the Cabinet Committee reviewed the problems and existing Federal policies and programs in this area, and submitted recommendations in various fields. Some of these recommendations have already been carried out by administrative policies. Legislative proposals with respect to other recommendations are now before the Congress.

On July 15, 1957, the President sent a letter to the Chairman of the House Ways and Means Committee which discussed in part the tax recommendations of the Cabinet Committee on Small Business, as well as additional suggestions. Specifically those recommendations were:

1. That businesses be given the right to utilize, for purchases of used property not exceeding $50,000 in any one year, the formulas of accelerated depreciation that were made available to purchasers of new property by the Internal Revenue Code of 1954.

2. That corporations with, say, ten or fewer stockholders be given the option of being taxed in a manner similar to partnerships.

3. That the taxpayer be given the option of paying the estate tax over a period of up to ten years in cases where the estate consists largely of investment in closely held business.

4. That original investors in small business be given the right to deduct from their incomes, up to some specified maximum, a loss, if any, realized on a stock investment in such business. At the present time the deduction of such losses from income is subject to the general limitation on net capital losses of $1,000.

As Secretary Anderson indicated to the House Ways and Means Committee earlier this year, we have been glad to recommend this tax relief for small business because of the importance of the new and small businesses in our economy. Specific legislation to carry out these Administration recommendations for small business tax relief was introduced on April 22 by the Chairman and the Ranking Minority Member of the Ways and Means Committee. We believe that the specific proposals for tax changes will give important relief to small businesses for the revenue loss involved.

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STATEMENT BY SENATOR JOSEPH S. CLARK
OPENING SMALL BUSINESS FINANCING HEARINGS
MONDAY, APRIL 21, 1958

These hearings are being held to assist the Committee in its consideration of S. 2160, S. 2185, S. 2286, S. 3191, and a committee print bill which propose to solve some of the long-term credit and equity capital problems of small businesses. In a sense, the Committee is continuing hearings held on this same subject last year when three of these bills -- S. 2160, S. 2185, and S. 2286 -- were then under consideration.

One result of last year's hearings was their contribution to a decision by the Federal Reserve System to study the financing problems of small businesses. The first two parts of this study are complete and have been printed jointly by the Banking and Currency Committees and the Select Committees on Small Business of the Senate and the House of Representatives. I will use this opportunity to express publicly my sincere appreciation to the Chairman of the Federal Reserve Board for expediting this study and to the Federal Reserve System's research staffs and the scholars who have participated in the first two parts of this study. This work will be of great benefit to the Congress as it develops legislation necessary to increase the availability of long-term credit and equity capital for small businesses.

One of the new bills before the Committee, which is labeled a committee print, is a direct result of the Federal Reserve study. This bill was prepared by the staff of this Committee at the direction of Chairman Fulbright. This bill attempts to deal with the problem in ways suggested by an evaluation of the first two parts of the study.

The other new bill before us, S. 3191, introduced by Senator Johnson of Texas, proposes a new and bold approach.

Much of the evidence presented in our hearings last year -- in fact, I think it is fair to say a preponderance of evidence -- and much of the information contained in the new Federal Reserve study support the conclusion that existing financial institutions are not adequately supplying the long-term credit and equity capital needs of small business. We will be taking further evidence on this point. If it is concluded that there is a need for new institutions, the question must be dealt with as to the nature and scope of the new financial institutions to be established. We must determine whether it is an appropriate function of the Federal government to initiate the establishment of such institutions. Accepting the premise that Federal assistance is usually considered to be a last resort, we must weigh whether there is, indeed, any other way of getting the job done.

We have before us the legislative proposals of Senators Sparkman, Fulbright, Johnson, Humphrey, O'Mahoney, Kefauver, Hill and others. I think it is correct to say this Committee is open-minded on all these proposals. Although I myself am a cosponsor of one of these measures, I enter these hearings with no fixed convictions. While we have a bill labeled as a Committee print, the Committee is by no means committed to it.

We already have before us the comprehensive and provocative study by the Federal Reserve Board; and we will receive during these hearings the views and ideas of Federal officials, national organizations, and individuals with expert knowledge of this question.

I am confident that the Committee on Banking and Currency can produce a bill which will help solve the financing problems of small businesses and which will deserve the favorable consideration of the Congress.

(41)

Subcommittee on Housing of the Senate
Committee on Banking & Currency

John J. Sparkman (Ala.) CHAIRMAN

J. W. Fulbright (Ark.)
Paul H. Douglas (Ill.)
A. S. Mike Monroney (Okla.)
Joseph S. Clark, Jr. (Penn.)

Homer E. Capehart (Ind.)
Prescott Bush (Conn.)
J. Glenn Beall (Md.)
Frederick G. Payne (Maine)

February 24, 1959.

Dear Wilfred:

It is thoughtful of you to send me the February 12 issue of the Commercial and Financial Chronicle and gratifying to see the reprint of my statement before the Joint Economic Committee on the President's Economic Report.

With all good wishes,

Sincerely yours,

Wm. McC. Martin, Jr.

Mr. A. Wilfred May,
Executive Editor,
Commercial & Financial Chronicle,
25 Park Place,
New York 7, New York.

May 21, 1958

By Messenger May 22

The Honorable Prescott Bush,
United States Senate,
Washington 25, D. C.

Dear Senator Bush:

Attached is the memorandum which your Administrative Assistant, David Clarke, requested last week. I think it is satisfactorily in line with your questioning at my hearing before the Subcommittee on Housing of the Senate Committee on Banking and Currency on May 13.

Sincerely yours,

(SIGNED) WM. McC. MARTIN, Jr.

Wm. McC. Martin, Jr.

Enclosure
RAY:ac

CONGRESSIONAL COMMISSION FOR THE STUDY OF LONG-RANGE FISCAL PROBLEMS

A commission established by Congress to study the long-run fiscal problems of the United States should consider the following major problems:

1. Potential levels of government expenditures in the foreseeable future and the ability of the economy to sustain such levels.
2. The proportion of total annual output that might be needed to provide public goods and services over the longer run.
3. State and local versus Federal provision of public services and the appropriate role for Federal aid in financing State and local government expenditures.
4. Adequacy of the present tax structure not only for future levels of Government expenditures but also with reference to its impact on long-term growth forces in the economy.
5. A re-examination of other aims of fiscal policy.
   (a) Countercyclical potentials,
   (b) Redistribution of income,
   (c) Promotion of specific economic goals.

1. Future levels of government expenditures. At the present time there is no foreseeable end to the cold war and, consequently, expenditures for national security can be expected to remain at high levels for a long period of time. In addition to national security, the Federal and State and local government has assumed responsibility in many other areas and there is

constant pressure for further expansion of government activities. Therefore, it would be useful to attempt to project on the basis of past trends and current forces, potential ranges of government expenditures for ten years in the future, if not more, in order to estimate the dimensions of the task which government may be asked to assume. The ability of the economy to support high and rising levels of Government activity hinges mainly on growth in the economy's productive capacity. Potential levels of government expenditures must be considered in relation to anticipated levels of total output in order to evaluate the feasibility of expansion of government provision of goods and services. The capacity of the economy to meet the emergency of total war also needs to be explored carefully.

2. Proportion of total annual output appropriately allocated to government. A major question facing the American economy is what proportion of total annual output over the long run is desirable to devote to the public sector. In the absence of a major depression, public goods and services can be provided only by diversion of resources from the private economy. It is a question of how much real income is to be realized in the form of publicly provided goods and services and how much in the form of privately provided goods and services. There are some government functions which must be supplied collectively--defense, police, foreign affairs--because the individual cannot purchase these in the private market place. In the past, the bulk of nonsecurity functions were performed in the private market. In recent years, either for reasons of public safety, health, or general welfare, the role of government has expanded. The governmental share of gross national product over the long run has far-reaching implications for the organization of the rest of the economy.

The longer run goal of government activity should be clarified and the impact of such participation in economic activity on the nongovernmental areas evaluated.

3. State and local versus Federal provision of public services. The Federal Government is only one supplier of public goods and services. The division of labor among Federal, State and local governments in furnishing public services should be examined. Provision of public services can never be divorced from the resources available to the governmental unit. State and local units have limited revenue sources and the revenue base, the income and wealth of the State or city, varies widely. Consequently, the ability of State and local units to provide public services must be considered as well as the type of service. Attention should also be given to a simple, equitable means of establishing satisfactory standards for the most important public services in poorer States and communities. In this connection, the appropriate role for Federal aid in local government activities needs critical review and appraisal.

4. Adequacy of present tax structure. Attainment of a desired level of government activity and the diversion of resources with which to do this is not separable from the use of government fiscal powers to promote economic stability and growth. For purposes of inquiry, however, it would be useful to attempt to measure the adequacy of the present tax structure quite apart from its countercyclical aspects. That is, the present tax structure could be looked at with the purpose of trying: (a) to determine

whether, if maintained, it will yield enough revenue under normal conditions to meet the potential needs of government; (b) to evaluate the equity of the present system; (c) to assess its impact on incentives on business decisions, and on economic growth.

The objective of a study of the tax structure should be to try to develop an equitable system that would interfere least in the operation of the private economy and still provide sufficient revenue to government. Such an ideal solution in reality is unlikely and it may be found that the alternatives to the present tax structure are less satisfactory for meeting long-run objectives. But the alternatives should be carefully weighed against the present system.

5. Re-examination of other aims of fiscal policy.

(a) Countercyclical potentials. In order to keep cyclical fluctuations small, the Federal Government and, to the extent possible, State and local units must use the powers to tax, spend, and borrow to promote economic stability and growth. Recession in economic activity over the past eight months has pointed up some of the problems of countercyclical fiscal policy; others have been made clear by recurrent inflationary pressures since World War II. There is real question whether fiscal policy in postwar years has supplemented other stabilization policies as fully and responsively as it might. Ways should be sought not only to increase the flexibility--the amount of change in fiscal policy--but also to improve the sensitivity--the speed at which change becomes effective.

(b) Redistribution of income. The power to tax, spend and borrow is also the power to redistribute income among individuals in the society. To what extent this is desirable and what the limits to such action may be should also be appraised.

(c) Promotion of specific economic goals. There has been increasing use and increasing pressure to use the fiscal powers to promote specific economic goals. There are sound reasons for excluding normal depreciation and depletion from the tax base, but percentage depletion and rapid amortization are granted primarily as special forms of subsidy. This type of subsidy, through tax exemption, is beginning to spread to other areas such as education and social security. Whether this is an efficient means of achieving specific economic goals should be studied.

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Article Title: A Senate Subcommittee Today Sought the Views of the Federal Reserve Board's Chairman on Whether the Recession May be Leveling Off

Journal Title: Associated Press news wire

Date: May 13, 1958

Article Title: William Mcc. Martin, Federal Reserve Board Chairman, Told Senators Today "There Are Some Hopeful Indicators" That the Recession is Leveling Off

Journal Title: Associated Press news wire

Date: May 13, 1958

For release on delivery

Statement of

William McChesney Martin, Jr.

Chairman, Board of Governors of the Federal Reserve System

before the

Subcommittee on Housing

of the

Senate Committee on Banking and Currency

May 13, 1958

The bills you have asked me to testify about today cover quite a bit of territory. They all deal with activities of the Federal Government relating to real estate, mortgage finance, or urban renewal programs. All of these activities, in their general aspects, are of interest to the Federal Reserve, since they make up part of the institutional framework of our economic system within which monetary policy must be formulated and carried out.

For the most part, however, the bills you have before you are either technical in the sense that they would make changes in authority or procedures that are thought desirable to facilitate carrying out policies already laid down, or make only incidental changes in established policies. I shall not comment on the bills that appear to be strictly technical, for I am not in a position to judge the desirability or suitability of the proposed amendments.

Several of the bills appear to make somewhat more than incidental changes in existing policy. One of these is S. 3064 which would make mortgages ~~in~~ on 2-, 3-, and 4-unit residences eligible for insurance under section 221 of the National Housing Act. Another is S. 3398 which would permit the Federal National Mortgage Association to regard preferred stock dividends paid to the Treasury as deductible expenses in computing the amount to be paid in lieu of corporate income tax under the Secondary Market Operation. Three of the bills would extend the purposes for which educational institutions might borrow from the Federal Government: S. 3281 would make construction of science buildings eligible; S. 3351, construction of science buildings and libraries; and S. 3713, construction of any buildings necessary or appropriate for instruction or administration. Perhaps S. 3484 is also in this group; it permits, and may require, the Secretary of Defense to acquire certain housing situated adjacent to military installations.

S. 3399 is the most voluminous of the bills before you. Like the bills I have just mentioned, it would make a good many technical changes in existing law and some relatively minor changes in policy. It would also make a few changes in policy that might be considered to be major. Among these last are the provisions in sections 305 and 509. As I understand it, the effect of these provisions would be to set up new Federal programs of guaranteeing loans--in the first case to guarantee certain loans for urban renewal projects by having the Government stand ready to make refunding loans, and in the second case to guarantee payment of principal and interest on bonds issued by private educational institutions.

Consideration of all these measures raises the question whether the laws relating to the Federal Government's activities in real estate, mortgage finance, housing, and urban renewal need to be so written as to require amendment so frequently as they have in recent years, or in as great detail as appears in S. 3399. It is possible that more general legislation, flexibly administered, might be more effective, not only in implementing established policy, but also in providing a framework within which the desirability of changes in policy could be judged.

Of all the bills under discussion today, S. 2791 appears to go furthest in writing new public policy. Under this bill, a Home Loan Guarantee Corporation would be established with authority to guarantee, within certain limits, first mortgages on homes designed for single-family occupancy.

We believe that the public interest might be better served if the Federal Government worked toward a single program of insurance of home mortgages--not several programs. To avoid the kind of policy conflicts that are inherent in the duplication of administering bodies operating in the same field, we think that all programs for insurance of home mortgages should be lodged with the Federal Housing Administration rather than with a potentially competitive agency.

The fact that, under the proposed program, only the top 20 per cent of a mortgage is insured rather than the full mortgage, as in the case of the present FHA programs, would not necessarily mean an appreciably smaller risk exposure to the insurer. Short of disaster of the sort that we went through in the 1930's, the bulk of defaulted loans is likely to show losses of less than 20 per cent. In other words, except in an extreme situation, there should be little difference in risk between the two programs, hence little difference between the premiums required to make them self-sustaining. Of course, if the standards for the acceptance of risks were markedly lower under the proposed program, the premiums required for successful operation would be correspondingly higher.

Another aspect of this comparison should be noted. The co-insurance element of the proposed program would increasingly limit the Government's liability as the severity of trouble increased. Sound public policy requires the reverse. Of course, a day-to-day reminder to lenders, by way of some sort of co-insurance feature, that unsound lending is costly is likely to have a good effect on lending practices, and thus minimize the chances of serious trouble. At the same time, however, if serious trouble should come despite the use of sound lending practices, complete insurance would be much more helpful than partial insurance in keeping the trouble within manageable limits.

The bill as drafted raises other questions, also. Contrary to the Federal policy of some years' standing, the Home Loan Guarantee Corporation would be authorized to borrow by issuing obligations with exemptions from Federal, State and local taxes. The Board believes that as a matter of public policy tax exemption favoring particular types of obligations is undesirable. It appears also that the guarantee issued by the Corporation would be available only to mortgagees that had been examined and audited by the Corporation; it should be realized that many financial institutions prominent in mortgage financing, including both banks and insurance companies, are already subject to examination by other supervisory authorities, and might well be reluctant to submit to such additional examinations. While there is much to be said for re-emphasizing the principle of co-insurance in Federal mortgage programs the Board feels that, in view of these shortcomings, enactment of S. 2791 would be undesirable.

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DRAFT
5/9/1958

Questions the Chairman may
be asked in appearance before
Housing Subcommittee of
Senate Committee on Banking and Currency
Tuesday, May 13, 1958

1. In your report to Senator Fulbright of April 2, 1958 on S.3399 you said:

> "On the great majority of the provisions of S.3399, which are technical amendments to existing law, the Board has no specific comment to make, except perhaps to question whether such matters are properly the subject of specific legislation. The frequency with which these laws must be amended gives rise to the question whether more general legislation, flexibly administered, might not be much more effective. As it is, every accretion of experience or change in economic conditions seems to require changes in basic statutes."

You made a similar remark in your testimony today (p.3).

Question: Would you tell us what you have in mind?

Answer: The Committees of Congress and the Bureau of the Budget very thoughtfully and scrupulously ask the Board for its views on bills that look as though they would affect the Federal Reserve's responsibilities and operations. We would not want this changed, and we don't for a moment object to being consulted on these matters. Quite the contrary: we'd object if we were left in the dark about legislation affecting our operations or the problems we have to deal with.

We have been impressed, though, with how often we reply by saying, in effect: This is a technical matter and we have no views on how it ought to be handled.

Sometimes, though, it's hard to tell whether it is really a technical matter or whether it ought to be regarded as a matter of a change in policy. An example in S.3399 is section 103 which would set up a new program to insure mortgages on housing for elderly persons.

Now, whether this amendment is technical--that is, desirable for more effectively carrying out an established policy--or is a proposal to change established policy, I don't know. If it is technical, I'd feel, speaking for myself, that it's up to the Housing Agencies to decide how they can best handle administration of the policy. I'd also feel that if the agencies don't have the administrative discretion to administer the policy they're charged with carrying out, they are working under a severe handicap.

On the other hand, if this amendment represents a change in policy, I'd be inclined to feel that the basic policy ought to be reviewed. A national housing policy, I should think, ought to be a housing policy for all the people. I'm not sure that we get a chance to make a balanced review of housing policy when changes come up piecemeal--this year housing for the elderly, last year cooperative housing, the year before housing for relocation from clearance areas, and so on.

A similar case might be made about Senate Joint Resolution 153, and S.2865 and S.2992, for example. I've classed them as technical amendments in my statement today, but I'd wonder whether, if they really are technical amendments, an administrator ought not to have the authority in the first place to decide the questions involved. If they are really policy changes, on the other hand, would it not be better for Congress to review just what it wants policy to be, rather than make small exceptions here and there?

This may seem like an academic discussion of the role of legislation compared with administration. It's a little more than that for us, though, because in doing our job we have to take account of the Treasury's financial position and transactions--and this means taking account in a very summary way of Federal policies as they are reflected in fiscal and debt management policies. For example, when the Federal National Mortgage Association has to borrow in order to permit a special mortgage insurance program to be carried out this shows up in Federal debt transactions and affects the conditions we have to deal with.

Question: Are you suggesting that Congress should permit administrators to decide to carry out some policies of Congress and to ignore others?

Answer: Sometimes Congress tells agencies they shall do certain things; sometimes Congress tells them they may do other things.

When Congress says it wants a defense establishment of a certain sort, the Treasury has to pay the bills, and if this means it needs to borrow, we know we have to take this into account. In many fields, however, Congress says the President or an agency may do certain things. Here, the Executive Branch can exercise discretion and act or not as seems best, taking account of general economic conditions as well as the fiscal and monetary situation that prevails or is likely to prevail.

Very understandably, enactment of a special program, or exceptions to a general program, even where it is discretionary, seems often to limit discretion. Even when Congress says an agency may make such and such an exception if it wants to, the administrator may very understandably feel that he's been given a rather pointed hint. So I'm inclined to be in favor of discretionary authority, with a minimum of exceptions written in by special act.

2. Question: Governor Balderston some time ago indicated that the Federal Reserve Board disagreed with Congress on what the Government's policy on housing ought to be. He said "housing is postponable," but Congress in its Declaration of National Housing Policy, contained in the Housing Act of 1949 said:

(See attachment)

Are you advocating that we should give Federal Reserve discretion to scuttle this congressional policy?

Answer: Clearly, the function of the Federal Reserve System is to help carry out Federal public policies, and just as clearly, housing policy is one of them.

We also have responsibility for other policies, however. The Federal Reserve Act lays down certain policies, and so does the Employment Act of 1946. We have to work under all of these, and we try to get the balance that seems appropriate from time to time.

Governor Balderston's statement got a lot of controversial attention at the time he made it, but I think it was a perfectly straightforward statement of fact. Housing is postponable for most people just as an automobile is, or a new manufacturing plant. We may wish we lived in a world in which everyone could be decently housed overnight, or have a new car to drive over clear roads and park in a clear space. But providing capital goods or durable goods is not so easy. It takes time, even when people have a disposition to save enough to free the resources needed.

This doesn't mean that Federal Reserve or Governor Balderston is against housing or wants to postpone improving our housing. Far from it. We are quite clear, though, that in an inflationary period people have to forego things they'd like to have, and this is true whether you pursue an anti-inflation policy or let inflation rip. But if we can contain inflation--which is part of the policy of the Employment Act--fewer people will have to forego less for a shorter time than if we permit an inflationary boom to bring on a deflationary bust.

We think the Declaration of National Housing Policy is much more likely to be carried out if we can maintain economic stability than if we have successions of booms and busts.

3. <u>Question:</u>

Federal Reserve policy was very effective in 1956 and 1957 in making mortgage interest rates rise. You don't seem to be very effective in getting them down in 1958.

<u>Answer:</u>

(It wasn't Federal Reserve policy that raised interest rates, but shortage of capital funds relative to demand.)

Of course we don't have as good information on mortgage interest rates as we have on bond yields or loan rates, but mortgage rates do seem to be coming down.

For example, the National Association of Real Estate Boards reported recently that in March, 40 per cent of the places they surveyed had rates on conventional mortgages of 5-1/2 per cent or less. In December only 20 per cent of the places had rates of 5-1/2 per cent or less.

Also, we have reports of financial institutions making FHA loans at ~~4-1/2~~ 4-3/4 per cent, though the permissible rate is 5-1/4, and a short time ago loans were at that rate.

Our staff has charted estimated yields on FHA loans obtained by adjusting for the discounts that are reported to prevail. This is a very rough measure, but it shows that mortgage yields are responsive to money conditions. It is going down now.

4. Question:

Don't you think the Emergency Housing Act the Congress passed in March is having a beneficial effect on housing?

Answer:

We have been quite pleased by the response shown so far in capital and money markets to the System's easier money policy. In quite a few areas, including housing, borrowers who had been holding back earlier seem to be returning to the market.

The April upturn in housing starts, though not dramatic, is encouraging. The lower downpayments permitted for FHA financing by the new act, and for VA financing by administrative action, probably have brought some buyers back into the market. This may make for a further increase in starts in the coming months.

Raising the VA interest rate has also made lenders more interested in VA mortgages, and may have contributed to lowering the yield that lenders are looking for on FHA loans.

The commitment authority given to FNMA by the act has been very useful to builders by providing an assured source of financing, and the Association has been doing quite a bit of business under it. The rise in applications under the FHA and VA programs is probably linked, in part, to this commitment authority.

Developments of the past few months have been encouraging. So far, however, the response has been largely in terms of builders' activity rather than ultimate purchase. Whether home buyers will be prepared to buy an increased number of homes because of more liberal financing arrangements, even though home construction costs and prices are still high, remains to be seen.

Measures before the
Housing Subcommittee of
Senate Committee on Banking
and Currency

Measure	Effect
Senate Joint Resolution 153, to amend Section 101(b) of the Housing Act of 1949.	Require the Housing Administration to encourage utilization of local public agencies established by the States to operate on a State-wide basis in behalf of smaller communities within the States.
S.2791	Create a "Home Loan Guarantee Corporation" to be operated by the Federal Home Loan Bank Board.
S.2865, to amend Title I of the Housing Act of 1949 by adding Section 112.	Permit financial assistance for an reban renewal project to relocate facilities, structures, and other improvements to be flooded as result of building a dam, without regard for present requirements of sec. 103(a) or sec. 102 and 110.
S. 2872 to amend Title IV of National Housing Act and Section 5(i) of Home Owners'Loan Act.	Prevent conversion of an insured mutual institution to a stock institution, or insurance of accounts in a stock institution.
S. 2992 to amend Section 110 (d) of the Housing Act of 1949.	Permit to be counted aslocal assistance under Sec. 110 (d) assistance to projects that were not under contract for capital grant solely because of limitations on the authority of the Housing Administrator to make capital grants or to reserve funds for the purpose.
S. 3064, to amend Sec. 221 (d) (2) of the National Housing Act.	Extend Sec. 221 financing (housing for relocation of displaced families) to 2-, 3-, and 4- unit properties.

S.3213 to amend Sec. 401(d) of the Housing Act of 1950.	Increase the authority of the Housing Administrator to borrow from the Treasury in order to make "college housing" loans from $925 million to $1,175 million.
S.3281 to amend Title IV of the Housing Act of 1950.	(1) Increase the authority of the Housing Administrator to borrow from the Treasury in order to make "college housing" loans from $925 million to $1,250 million, and to add $150 million for loans for construction or rehabilitation of science buildings; and (2) Add construction of science buildings to purposes for which Administrator may lend to colleges.
S.3351 to amend Title IV of the Housing Act of 1950.	(1) Increase the authority of the Housing Administrator to borrow from the Treasury in order to make "college housing" loans from $925 million to $1,125 million, and to add $200 million for loans for construction or rehabilitation of science buildings and libraries; and (2) Add construction of science buildings and libraries to purposes for which Administrator may lend to colleges.
S.3398 to amend Sec. 309(c) of the FNMA Charter Act.	Permit the Federal National Mortgage Association, in computing the amount equivalent to corporate income tax to be paid to Federal Government, to deduct if it were not exempt, and also, amounts paid to the Treasury as dividends on the Treasury's preferred stock in FNMA.
S.3399 to amend various acts.	Cited as "Housing Act of 1958" (see separate memorandum of provisions.)
S.3484 to amend Sec. 404 of the Housing Amendments of 1955.	Permit (and perhaps require) the Secretary of Defense to acquire, in addition to "Wherry Housing", housing adjacent to military installations that was (1) completed before July 1, 1952; (2) certified before construction as necessary to meet a military family housing need; and (3) financed under Section 207 of the National Housing Act.

S. 3548 to amend Sec.103 of the Housing Act of 1949.	Increase the amount of funds immediately available for urban renewal projects by $500 million (This should be considered in conjunction with Sec. 302 (d) of S. 3399 which would make additional funds available more slowly: $200 million on July 1, 1958; $250 million on July 1 of 1959 and 1960; and $200 million on July 1 of 1961, 1962, and 1963.)
S. 3713 to amend Title IV of the Housing Act of 1950.	(1) Make construction or rehabilitation of any structures suitable for use as classrooms, or necessary or appropriate for instruction or for administration of the institution purposes for which the Administrator may make loans to educational institutions; and (2) Authorize the Administrator to borrow $250 million from the Treasury to make such loans.
S. 3717 to amend the Housing Act of 1954.	Authorize planning grants to enable State planning agencies to aid a group of adjacent communities having a total population of less than 25,000, as well as a city or municipality of less than 25,000 population.

1. EXCERPT FROM THE HOUSING ACT OF 1949

[Public Law 171, 81st Congress; 63 Stat. 413; 42 U.S.C. 1441 (1946 ed., Supp. III)]

* * *

DECLARATION OF NATIONAL HOUSING POLICY

SEC. 2. The Congress hereby declares that the general welfare and security of the Nation and the health and living standards of its people require housing production and related community development sufficient to remedy the serious housing shortage, the elimination of substandard and other inadequate housing through the clearance of slums and blighted areas, and the realization as soon as feasible of the goal of a decent home and a suitable living environment for every American family, thus contributing to the development and redevelopment of communities and to the advancement of the growth, wealth, and security of the Nation. The Congress further declares that such production is necessary to enable the housing industry to make its full contribution toward an economy of maximum employment, production, and purchasing power. The policy to be followed in attaining the national housing objective hereby established shall be: (1) private enterprise shall be encouraged to serve as large a part of the total need as it can; (2) governmental assistance shall be utilized where feasible to enable private enterprise to serve more of the total need; (3) appropriate local public bodies shall be encouraged and assisted to undertake positive programs of encouraging and assisting the development of well-planned, integrated residential neighborhoods, the development and redevelopment of communities, and the production, at lower costs, of housing of sound standards of design, construction, livability, and size for adequate family life; (4) governmental assistance to eliminate substandard and other inadequate housing through the clearance of slums and blighted areas, to facilitate community development and redevelopment, and to provide adequate housing for urban and rural nonfarm families with incomes so low that they are not being decently housed in new or existing housing shall be extended to those localities which estimate their own needs and demonstrate that these needs are not being met through reliance solely upon private enterprise, and without such aid; and (5) governmental assistance for decent, safe, and sanitary farm dwellings and related facilities shall be extended where the farm owner demonstrates that he lacks sufficient resources to provide such housing on his own account and is unable to secure necessary credit for such housing from other sources on terms and conditions which he could reasonably be expected to fulfill. The Housing and Home Finance Agency and its constituent agencies, and any other departments or agencies of the Federal Government having powers, functions, or duties with respect to housing, shall exercise their powers, functions, and duties under this or any other law, consistently with the national housing policy declared by this Act and in such manner as will facilitate sustained progress in attaining the national housing objective hereby established, and in such manner as will encourage and assist (1) the production of housing of sound standards of design, construction, livability, and size for adequate family life; (2) the reduction of the costs of housing without sacrifice of such sound standards; (3) the use of new designs, materials, techniques, and methods in residential construction, the use of standardized dimensions and methods of assembly of home-building materials and equipment, and the increase of efficiency in residential construction and maintenance; (4) the development of well-planned, integrated, residential neighborhoods and the development and redevelopment of communities; and (5) the stabilization of the housing industry at a high annual volume of residential construction.[1]

* * *

Approved July 15, 1949.

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1 See also 30-1.1, title III of the Housing Act of 1948, as amended. Title III directs the Housing and Home Finance Administrator to submit to the President and the Congress estimates of national housing needs and reports with respect to the progress being made toward meeting the needs, and to recommend proposals for executive or legislative action which may be necessary for the furtherance of the national housing objective and policy. In addition, the Administrator is directed to encourage localities to make studies of their own housing needs and markets and to provide where needed technical advice and guidance in the making of such studies.

See also sec. 601 of the Housing Act of 1954, 5-2, which declares that it is the policy of Congress to seek the constant improvement of the living conditions of all the people under a strong, free, competitive economy.

Miss Muehlhaus

APR 28 1958

Mr. Jack Carter,
Staff Director,
Subcommittee on Housing,
Senate Banking and Currency
Committee,
Washington 25, D. C.

Dear Mr. Carter:

Your letter of April 22, 1958 advised that your Chairman had requested that I appear during the morning of May 14 as a witness in connection with the general housing hearings scheduled by the Subcommittee on Housing of the Senate Banking and Currency Committee to begin on May 12.

Because of a previous engagement which I have for May 14, it is understood that my appearance before this subcommittee has been rescheduled for May 13, at 10:00 a.m. This letter confirms that date for my appearance.

Sincerely yours,

(Signed) Wm. McC. Martin, Jr.

Wm. McC. Martin, Jr.

JWS:ac
cc: Miss Muehlhaus

COPY

United States Senate
Committee on Banking and Currency
Subcommittee on Housing

April 22, 1958

Mr. William McChesney Martin, Chairman
Federal Reserve Board
Washington 25, D. C.

Dear Mr. Martin:

This is to advise you that the Senate Subcommittee on Housing will begin its 1958 general housing hearings on May 12, 1958, at 10:00 a.m. in Room 301 of the Senate Office Building.

The Chairman has requested that you appear during the morning of May 14, 1958.

The official notice of these hearings, including a list of the bills pending before the Subcommittee, appears on page 6040 of the Congressional Record of April 21, 1958. The Chairman has asked that you also be prepared to discuss such other bills affecting your responsibility as may be referred to the Subcommittee prior to the hearing.

I shall be pleased to discuss with you or members of your staff any questions with respect to the pending hearings.

Sincerely,

(Sgd.) Jack Carter.

Jack Carter

NOTICE OF PUBLIC HEARINGS BY HOUSING SUBCOMMITTEE
OF COMMITTEE ON BANKING AND CURRENCY

Mr. President, the Subcommittee on Housing of the Committee on Banking and Currency plans to begin public hearings at 10 a.m. on May 12, 1958, in room 301, Senate Office Building. Bills to be considered are S. 2791, S. 2865, S. 2872, S. 2992, S. 3064, S. 3213, S. 3281, Senate Joint Resolution 153, S. 3351, S. 3398, S. 3399, S. 3484, S. 3548, and other bills which are referred to the Subcommittee prior to the hearings.

All persons who wish to appear and testify are requested to notify Mr. Jack Carter, Staff Director of the Housing Subcommittee, room 15-A, Senate Office Building, telephone Capitol 4-3121, extension 6348.

I should like to add this note of explanation. It may be recalled it was announced some time ago that those hearings were to commence on April 15. Due to a situation which developed in the Banking and Currency Committee and the pressure of its business, it was found necessary to postpone the hearings in order that consideration might be given to a depressed-areas bill, a bill providing capital banks for small business, and other bills. We regret the delay, but it was unavoidable.

Congressional Record, April 21, 1958, page 6040