William McChesney Martin, Jr., Papers

Box 25/Folder 4

Series V, Subseries D

Hearings, July-August 1959

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(44)

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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

Joint Economic Committee

July 27, 1959

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THE GOVERNMENT SECURITIES MARKET AND ECONOMIC GROWTH

Mr. Chairman:

In this opening statement, I would like to comment first on one aspect of the problem you are considering--the importance of freely competitive markets to maximum economic growth. In so doing, I do not wish to understress the importance of any other conditions necessary to healthy economic growth. Indeed, if there is one essential for sustained growth that stands out above all others, it is the maintenance of a volume of real saving and investment sufficient to support continuous renewal, adjustment, and expansion of our total capital resources. As you know, the maintenance of adequate saving and investment depends upon broadly based and justified confidence in a reasonably stable dollar.

Role of Free Markets

No one here would deny that free markets are essential to the vital and vigorous performance of our economy. No one would urge that we encourage monopolistic practices or administered pricing, and few would advocate Government interference with the market process as a general principle. On the contrary, nearly everyone would agree that such developments are injurious to the best use of our resources, that they distort the equitable distribution of final product, and that they interfere with economic progress.

Differences of viewpoint on free markets arise only when the complexities of specific market situations make it difficult to discern whether markets are, in fact, functioning as efficiently as we might reasonably expect. Well-informed and well-intentioned observers will

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disagree as to whether an appropriate degree of competition exists in particular markets and, if not, as to what corrective steps, if any, it is appropriate for Government to take.

If the policies we follow in the financial field are to be fully effective in promoting growth and stability, they must be able to permeate the economy through the mechanism of efficient markets. This generalization applies to all markets, for all types of goods and services. Naturally, the Treasury and the Federal Reserve are most immediately concerned with financial markets, both because we have some direct responsibility for these markets, and because they represent the main channel through which the Government financial policies to foster growth and stability must pass.

The Market for Government Securities

We are especially concerned with the market for United States Government securities. With a Federal debt of $285 billion, Government securities are a common and important asset in the portfolios of businesses, financial institutions, and individuals. An efficient market for Government securities is obviously needed for the functioning of our financial mechanism. We are fortunate in this country to have such a market. From the standpoint of the Federal Reserve, it is hard to conceive of the effective regulation of the reserve position of the banking system without some such facility through which to conduct open market operations of large magnitude.

The initial results of our study of this market with the Treasury are encouraging in many ways. As was pointed out in the summary of the study made available to you on Friday, huge transactions

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are carried out every day in an orderly fashion and at very small cost to ultimate investors. One cannot fail to be impressed by the fact that there are dealers who stand ready, at their own initiative and at their own risk, to buy or sell large blocks of securities. Frequently, single transactions run into millions of dollars. Despite the absence of any assurance that a given purchase will be followed by an offsetting sale, dealers quote bid and ask prices that typically have a spread of less than 1/4 of 1 per cent on the price of long-term bonds and range down to a few one-hundredths of 1 per cent on Treasury bill yields.

If you have had an opportunity to examine the preliminary study manuscripts, you are aware that they do suggest that some improvements in the Government securities market may be in order. We would hope that these improvements can be made within the framework of existing authority and through voluntary cooperation with various market participants. There is, however, a possibility that further authority might be necessary or desirable. We expect to have a clearer idea about how to accomplish desirable improvements after we have had an opportunity to consider carefully the findings of the staff study just completed last week.

There is one possible change in the organization of the Government securities market that would not, as I view it, lead to improvement. That change would be the enforced conversion of the present over-the-counter dealer market into an organized exchange market. The reasons why this change would not be constructive or even practicable are set forth in the joint statement on the study's

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findings. On the other hand, any efforts on the part of existing organized exchanges to extend or strengthen the facilities now made available to buyers and sellers of Government securities should certainly be encouraged. There is no reason why better exchange facilities would not prove to be a helpful supplement to those provided by the present dealer market.

Another change affecting the Government securities market that has been suggested relates to Federal Reserve participation in it, and pertains in particular to the extension to longer term maturities of Federal Reserve open market operations. Some discussion of this suggested change is appropriate here, for it is not a matter encompassed by the Treasury-Federal Reserve study.

System Operations in Short-Term Government Securities

Since the Treasury-Federal Reserve accord in 1951, the System's day-to-day trading in Government securities has largely been in short-term issues. In 1953, after extensive re-examination of System operations in the open market, the Federal Open Market Committee formally resolved to make this a continuing practice.

I think that nearly everyone who has studied these matters would agree that the bulk of Federal Reserve operations must be conducted in short-term securities; that necessarily means largely in Treasury bills. The short-term sector of the market is where the greater part of the volume of all trading occurs. Dealer positions are characteristically and understandably concentrated in these shorter issues. Differences of view on whether System trading should extend outside the short-term area

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hinge upon whether or not some small part of our regular buying and selling should be done in the longer term area.

To appraise this difference in viewpoint, we need first to consider the basic economics of System open market operations. Federal Reserve operations in Government securities influence prices and yields of outstanding securities in three fundamentally different ways:

(1) They change the volume of reserves otherwise available to member banks for making loans and investments or paying off debts;

(2) They affect the volume of securities available for trading and investment; and

(3) They influence the expectations of professional traders and investors regarding market trends.

Of these effects, the first is by far the most important. Under our fractional reserve banking system, additions to or subtractions from commercial bank reserves have a multiple expansive or contractive effect on bank lending and investing power. Other things being equal, this means that any given change in System holdings of securities will tend to be accompanied by a change in commercial bank portfolios of loans and investments several times as large. Unlike many other institutional investors, commercial banks maintain Government security portfolios with a wide maturity distribution although the largest component will be short-term securities. Hence, the major effect on market prices and interest rates will result from the actions subsequently taken by commercial banks to expand or contract their asset portfolios, and the impact will be distributed throughout the market.

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With regard to the effect on the availability of securities in the market, substantial System purchases or sales of short-term securities exert a minimum influence on the market supply. For example, most of the $35 billion of bills outstanding is in the hands of potential traders. On the other hand, much the largest part of the marketable longer term issues is in the hands of permanent investors. Current trading in them is confined to a very small fraction of the outstanding volume. For this reason, the long-term area of the market shows greater temporary reaction than the short-term area to large purchase or sale orders.

Any attempt to use System operations to influence the maturity pattern of interest rates to help debt management would not produce lasting benefits and would produce real difficulties. If an attempt were made to lower long-term interest rates by System purchases of bonds and to offset the effect on reserves by accompanying sales of short-term issues, market holdings of participants would shift by a corresponding amount from long-term securities to short ones. This process could continue until the System's portfolio consisted largely of long-term securities. Accordingly, the System would have put itself into a frozen portfolio position.

The effect of thus endeavoring to lower long-term yields, without affecting bank reserves, would be to increase the over-all liquidity of the economy. Not only would the supply of short-term issues in the market be increased, but also all Government bonds outstanding would be made more liquid because they could be more readily converted into cash. The problem of excess liquidity in the

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economy, already a serious one, would be intensified. The Treasury now, even with the present interest rate ceiling, would have no difficulty in reaching the same result. It has merely to issue some $20 billion of short-term securities and use the proceeds to retire outstanding long-term debt. Fortunately, it is not contemplating any such action.

The effect of System open market operations on the expectations of market professionals, can be of critical importance depending upon the market area in which the operations are conducted. In the longer term area of the market, dealers, traders and portfolio managers are particularly sensitive to unusual changes in supply and demand. One important reason is that long-term securities are subject to wider price fluctuation relative to given changes in interest rates than are short-term issues. Therefore, trading or portfolio positions in them incur a greater price risk.

These traders and investors in long-term securities are aware that the System holds the economy's largest single portfolio of Government securities. They also know that the System is the only investor of virtually unlimited means. Consequently, if the System regularly engaged in open market operations in longer term securities with uncertain price effects, the professionals would either withdraw from active trading or endeavor to operate on the same side of the market as they believed, rightly or wrongly, that the System was operating.

If the professionals in the market did the former, the Federal Reserve would become in fact the price and yield administrator of the long-term Government securities market. If they did the latter, the total effect might be to encourage artificially bullish or bearish expectations

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as to prices and yields on long-term securities. This could lead to unsustainable price and yield levels which would not reflect basic supply and demand forces. The dangerous potentialities of such a development is illustrated by the speculative build-up and liquidation of mid-1958, described in detail in the Treasury-Federal Reserve study.

Either of these effects would permeate, and tend to be disturbing to, the whole capital market. Accordingly, instead of working as a stabilizing force for the economy, such open market operations in long-term securities could have the opposite result. In other words, if the Federal Reserve were to intrude in the adjustment of supply and demand in order directly to influence prices and yields on long-term securities or in a way that resulted in unsustainable prices and yields, it would impair the functioning of a vitally important market process.

Some public discussion of the Federal Reserve's present practice of conducting open market operations in short-term securities implies, it seems to me, that the System has assumed an intractable and doctrinaire position on this matter. This is not a correct interpretation of what we have done. We adopted this practice after a careful study of experience and of the effects of our operations upon the market and the banking system. In this review, we were naturally mindful of the specific tasks of the System, namely, to regulate the growth of the money supply in accordance with the economy's needs and to help maintain a stable value for the dollar.

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The practice or technique was adopted, not as an iron rule, but as a general procedure for the conduct of current operations. It is subject to change at any time and is formally reconsidered once each year by the Federal Open Market Committee in the light of recent experience. Exceptions can be, and have been, authorized by the Committee in situations where either Treasury financing needs, conditions in the money market, or the requirements of monetary policy call for such variations. The System, at times has been a subscriber to longer term issues in Treasury exchange offerings when appropriate, and at other times has purchased such securities in the market.

In other words, we endeavor to apply this practice flexibly as we do all of our practices in the administration of monetary policy. As I have stated to this Committee on other occasions, flexibility is an essential ingredient of our entire reserve banking operation. When reserve banking loses flexibility, it will no longer be able to do the job that is required of the central bank in the market economies of the free world.

Measurement of Economic Growth

Before concluding my statement, I want to mention one entirely different matter that has special relevance to the broad scope of this Committee's interest. That is the measurement of growth. As you know, one of the frequently used indicators of growth in the industrial sector has been the Board's index of industrial production. One of the great

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lessons we learn from the compilation of this index, which we try to do as carefully and competently as we know how, is that the mere matter of measuring growth is a very tricky thing.

As the structure of the economy keeps changing, the job of combining measures of its many parts into a single index cannot be done, despite our best efforts, without having to make major revisions every few years. We again have underway a basic revision, the final results of which will be available soon. The nub of what this revision shows is that the growth rate in the sectors covered by the Board's index has been materially greater over the past decade than has appeared from the unrevised index.

The statistical data that we have to use from month to month, can only be cross-checked in a comprehensive way when we have available the results of a full census. Congress authorized the Department of Commerce to conduct one of these in 1947, and another as of 1954. The immense task of digesting and reappraising the results of these censuses, and then refitting all of the monthly data into these basic benchmarks, has now progressed far enough to indicate that the revised index, with the 1947-49 period as the starting point at 100, will show a level of around 165 at mid-1959. That is 10 points higher than the figure shown by our unrevised index for June.

Some of this difference results because we are now able to include, with appropriate proportional weight alongside other items, more of the fuel and energy production that has been going on all the time without being represented in the index. More than half of the difference, however, results from improvements in measurement of presently included industries. The monthly movements of the revised and present indexes

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are quite similar, so that main effect of the revision in the total is to tilt upward this measure of industrial growth over the past decade. For example, it now appears that industrial output of consumer goods on a revised basis has risen at an average annual rate of 3.8 per cent as compared with 3.2 per cent shown by the unrevised index for the consumer goods sector. Population growth has been at a rate of 1.7 per cent per year.

Industrial production, to be sure, is only one of the ways that growth might be measured, but it is a measure in real terms and so is free of price influences. Crude measurements of growth in aggregate dollar terms can be seriously misleading, not only with respect to what the economy has done but also in marking out guidelines as to how we may reasonably expect the economy to grow in the years ahead. It is no achievement to have a rise of 10 per cent in the general price level such as occurred in the months after the Korean outbreak--even though that does puff up the figures on gross national product quite handsomely. The increase of 15 per cent in the current dollar value of gross national product from 1955 to 1957 was only half of what it seemed to be because it was inflated by a general price increase of 7 per cent.

Throughout its entire history, this economy has grown by staggering magnitudes. It is because I, for one, want to do everything I can to keep it growing that I urge the maintenance of free markets and reasonably stable prices as primary objectives of public policy.

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M·ss Muehlhaus

March 29, 1960

The Honorable Wright Patman,
House of Representatives,
Washington 25, D. C.

Dear Mr. Patman:

Your attention is invited to the table at page 288 of the attached copy of the Federal Reserve Bulletin for March 1960. You will note that under the heading "Investments" there has been restored the column entitled "Obligations of States and political subdivisions."

You will recall that this matter came up during my testimony before the Joint Economic Committee on February 2.

Sincerely yours,

(Signed) Wm. McC. Martin, Jr.
Wm. McC. Martin, Jr.

JWS:ac

Attachment

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LOANS AND INVESTMENTS OF COMMERCIAL BANKS, BY CLASSES[1]

[In millions of dollars]

Class of commercial bank and call date	Total loans and investments	Loans[2]										Investments						
		Total[2]	Commercial including open market paper	Agricultural	Loans for purchasing or carrying securities		Loans to financial institutions		Real estate loans	Other loans to individuals	Other loans	U. S. Government obligations					Obligations of States and political subdivisions	Other securities
					To brokers and dealers	To others	To banks	To others				Total	Bills	Certificates	Notes	Bonds		
Total:[3]																		
1947—Dec. 31...	116,284	38,057	18,167	1,660	830	1,220	......	......	9,393	5,723	1,063	69,221	2,193	7,789	6,034	53,205	5,276	3,729
1958—Dec. 31...	185,165	98,214	40,425	4,973	2,832	1,829	......	......	25,255	20,698	4,156	66,376	6,294	7,399	13,396	39,287	16,505	4,070
1959—June 10...	186,151	103,406	41,613	5,098	2,333	1,903	......	......	26,669	22,382	5,419	62,035	5,149	4,722	14,037	38,127	16,984	3,725
June 10*e.	186,151	103,406	37,158	5,098	2,333	1,903	1,850	5,569	26,669	22,382	2,455	......	......	......	......	......	......	......
All insured:																		
1941—Dec. 31...	49,290	21,259	9,214	1,450	614	662	......	......	4,773	4,545		21,046	988	......	3,159	16,899	3,651	3,333
1945—Dec. 31...	121,809	25,765	9,461	1,314	3,164	3,606	......	......	4,677	2,361	1,181	88,912	2,455	19,071	16,045	51,342	3,873	3,258
1947—Dec. 31...	114,274	37,583	18,012	1,610	823	1,190	......	......	9,266	5,654	1,028	67,941	2,124	7,552	5,918	52,347	5,129	3,621
1958—Dec. 31...	183,596	97,730	40,289	4,913	2,797	1,810	......	......	25,148	20,589	4,134	65,669	6,159	7,362	13,240	38,908	16,266	3,932
1959—June 10...	184,632	102,902	41,459	5,046	2,312	1,884	......	......	26,550	22,264	5,396	61,396	5,025	4,690	13,928	37,754	16,743	3,591
June 10*..	184,632	102,902	37,013	5,046	2,312	1,884	1,846	5,553	26,550	22,264	2,444	......	......	......	......	......	......	......
Member, total:																		
1941—Dec. 31...	43,521	18,021	8,671	972	594	598	......	......	3,494	3,692		19,539	971	......	3,007	15,561	3,090	2,871
1945—Dec. 31...	107,183	22,775	8,949	855	3,133	3,378	......	......	3,455	1,900	1,104	78,338	2,275	16,985	14,271	44,807	3,254	2,815
1947—Dec. 31...	97,846	32,628	16,962	1,046	811	1,065	......	......	7,130	4,662	952	57,914	1,987	5,816	4,815	45,295	4,199	3,105
1958—Dec. 31...	154,865	84,061	37,444	3,052	2,730	1,599	......	......	20,013	17,028	3,920	54,299	4,644	6,143	11,117	32,396	13,405	3,100
1959—June 10...	155,289	88,431	38,469	3,132	2,260	1,669	......	......	21,180	18,397	5,098	50,225	3,854	3,688	11,410	31,273	13,820	2,813
June 10*..	155,289	88,431	34,172	3,132	2,260	1,669	1,820	5,277	21,180	18,397	2,298	......	......	......	......	......	......	......
Dec. 31...	157,879	94,779	36,826	3,116	2,885	1,587	811	6,801	22,185	19,877	2,603	46,813	4,612	1,812	11,604	28,785	13,677	2,610
New York City:[4]																		
1941—Dec. 31...	12,896	4,072	2,807	8	412	169	......	......	123	554		7,265	311	......	1,623	5,331	729	830
1945—Dec. 31...	26,143	7,334	3,044	......	2,453	1,172	......	......	80	287	298	17,574	477	3,433	3,325	10,339	606	629
1947—Dec. 31...	20,393	7,179	5,361	......	545	267	......	......	111	564	330	11,972	1,002	640	558	9,772	638	604
1958—Dec. 31...	25,966	16,165	10,928	1	1,652	382	......	......	641	1,502	1,424	7,486	643	1,106	1,602	4,135	1,869	446
1959—June 10...	25,648	16,514	10,731	1	1,556	409	......	......	746	1,625	1,819	6,745	1,165	350	1,717	3,513	1,978	411
June 10*..	25,648	16,514	9,523	1	1,556	409	966	1,344	746	1,625	717	......	......	......	......	......	......	......
Dec. 31...	25,291	18,121	10,549	9	1,740	403	531	1,788	936	1,739	833	5,002	639	227	1,277	2,859	1,833	335
Chicago:[4]																		
1941—Dec. 31...	2,760	954	732	6	48	52	......	......	22	95		1,430	256	......	153	1,022	182	193
1945—Dec. 31...	5,931	1,333	760	2	211	233	......	......	36	51	40	4,213	133	1,467	749	1,864	181	204
1947—Dec. 31...	5,088	1,801	1,418	3	73	87	......	......	46	149	26	2,890	132	235	248	2,274	213	185
1958—Dec. 31...	6,830	3,637	2,628	15	266	97	......	......	161	357	220	2,562	232	361	522	1,446	491	140
1959—June 10...	6,581	3,643	2,678	16	146	107	......	......	181	386	241	2,235	178	205	439	1,414	564	139
June 10*..	6,581	3,643	2,308	16	146	107	38	418	181	386	155	......	......	......	......	......	......	......
Dec. 31...	6,885	4,206	2,527	21	268	124	33	588	183	435	148	1,985	108	78	467	1,332	562	133
Reserve city:																		
1941—Dec. 31...	15,347	7,105	3,456	300	114	194	......	......	1,527	1,512		6,467	295	......	751	5,421	956	820
1945—Dec. 31...	40,108	8,514	3,661	205	427	1,503	......	......	1,459	855	404	29,552	1,034	6,982	5,653	15,883	1,126	916
1947—Dec. 31...	36,040	13,449	7,088	225	170	484	......	......	3,147	1,969	366	20,196	373	2,358	1,901	15,563	1,342	1,053
1958—Dec. 31...	60,558	34,003	15,808	669	518	851	......	......	8,405	6,930	1,492	20,645	1,293	2,370	4,497	12,484	4,864	1,047
1959—June 10...	60,812	36,315	16,410	753	404	860	......	......	8,986	7,513	2,073	18,663	870	1,512	4,230	12,051	4,885	949
June 10*..	60,812	36,315	14,285	753	404	860	714	2,635	8,986	7,513	848	......	......	......	......	......	......	......
Dec. 31...	61,621	38,686	15,252	765	580	776	235	3,369	9,251	8,211	980	17,292	1,484	645	4,109	11,054	4,830	813
Country:																		
1941—Dec. 31...	12,518	5,890	1,676	659	20	183	......	......	1,823	1,530		4,377	110	......	481	3,787	1,222	1,028
1945—Dec. 31...	35,002	5,596	1,484	648	42	471	......	......	1,881	707	363	26,999	630	5,102	4,544	16,722	1,342	1,067
1947—Dec. 31...	36,324	10,199	3,096	818	23	227	......	......	3,827	1,979	229	22,857	480	2,583	2,108	17,687	2,006	1,262
1958—Dec. 31...	61,511	30,257	8,080	2,368	294	268	......	......	10,806	8,239	784	23,606	2,475	2,306	4,495	14,330	6,181	1,467
1959—June 10...	62,248	31,960	8,650	2,362	154	293	......	......	11,267	8,872	965	22,581	1,642	1,622	5,023	14,295	6,392	1,315
June 10*..	62,248	31,960	8,057	2,362	154	293	101	879	11,267	8,872	578	......	......	......	......	......	......	......
Dec. 31...	64,082	33,766	8,498	2,321	298	284	11	1,056	11,816	9,491	643	22,535	2,381	863	5,751	13,540	6,452	1,330
Nonmember:[3]																		
1947—Dec. 31...	18,454	5,432	1,205	614	20	156	......	......	2,266	1,061	111	11,318	206	1,973	1,219	7,920	1,078	625
1958—Dec. 31...	30,327	14,165	2,981	1,921	102	230	......	......	5,256	3,671	235	12,088	1,651	1,255	2,280	6,901	3,102	971
1959—June 10...	30,889	14,988	3,144	1,967	73	234	......	......	5,502	3,985	321	11,821	1,295	1,034	2,629	6,864	3,166	913

[e] Estimated.

* For a discussion of revision in loan schedule, see the BULLETIN for January 1960, p. 12.

[1] All commercial banks in the United States. These figures exclude data for banks in U. S. territories and possessions except for member banks. During 1941 three mutual savings banks became members of the Federal Reserve System; these banks are included in member banks but are *not* included in all insured or total banks. Comparability of figures for classes of banks is affected somewhat by changes in Federal Reserve membership, insurance status, and the reserve classifications of cities and individual banks, and by mergers, etc.

For other notes see opposite page.

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January 28, 1960.

Mr. John H. Karaken,
Economist,
Study of Employment, Growth
and Price Levels,
Joint Economic Committee,
Congress of the United States,
Washington 25, D.C.

Dear Mr. Kareken:

Thank you for your nice letter of January 27 and it is indeed thoughtful of you to write. I am pleased to have your kind comments about our staff, and particularly Mr. Shay, and want to send you my best wishes on your return to the University of Minnesota.

Sincerely yours,

(Signed) Wm. McC. Martin, Jr.

Wm. McC. Martin, Jr.

mnm

FOR FILES
M. Muehlhaus

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Miss Muehehaus

DEC 9 1959

The Honorable Paul H. Douglas,
United States Senate,
Washington 25, D. C.

Dear Senator Douglas:

Thank you for your letter of November 5, expressing your appreciation for the Board's contribution to your Committee's study of Employment, Growth, and Price Levels.

For our part, we have been most impressed with the fine work that your Committee and its staff have been doing in bringing together the thinking of qualified persons, in formulating questions to be addressed to us and to other agencies, and in the studies thus far published.

In reading over the material that has been presented to your Committee, it occurs to me that there are two aspects of the problems under study that may deserve more explicit consideration than has been given to them so far. For this reason, I am taking the liberty of bringing them to your attention in this letter.

The first point that I have in mind relates to imperfections in our price system--variously referred to as cost-pushes, ratchet effects and administered prices--and perhaps it can best be phrased in the form of a question. Granting that there are these imperfections as regards the behavior of individual prices and that they create inflationary pressures or biases in economic processes that cannot be effectively dealt with by monetary policy, does it follow from this that monetary policy should be less (or more) restrictive than if such phenomena did not exist? I am sure that all serious students of economic policy are concerned with this question, and to some extent, their views are implied in their responses to other questions. I know this is true, for example, in the case of much of the material which the Federal Reserve has furnished to your Committee.

As I understand it, the argument presented by those who advocate acceptance of creeping inflation is that institutional factors which are not dealt with directly by Government action

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are likely to cause money wages and administered money prices in certain basic industries, to increase more rapidly than is consistent with full employment of the labor force and the growth of other productive resources. Therefore, unless these wages and prices are, in effect, reduced by inflating the price of everything else, we will suffer from chronic underemployment. In other words, these advocates suggest that monetary and, indeed, fiscal policy as well, should be used openly to frustrate the bargaining efforts of organized labor and the pricing policies of certain industries. Only in this way, they imply, can a workable equilibrium be achieved between the marginal productivity of labor and real wages and between the relative prices of competitively marketed and administered price goods.

The objections to a policy of deliberately engineered creeping inflation seem to me to be manifold. I hope the problems generated by such a policy, with respect to the whole process of saving and investment and for the balance of payments, have been adequately treated in my responses, and those of others, to the questions asked by your Committee. If this is the case, all that needs to be said here is that these problems would be greatly intensified by any effort to absorb wage increases and administered prices through calculated inflation.

Beyond this, I think there is a very serious question as to whether such a policy could possibly succeed in the accomplishment of its primary objective. Would those who are in a position to administer prices or extract wage settlements in excess of productivity gains be content to maintain the same pace when they discovered that their efforts to capture a larger share of the real income stream were being frustrated by calculated inflation? Would they not increase their demands further to improve their relative position?

Thus, it seems probable that, far from encouraging a high level of employment and growth in the economy, a policy of calculated creeping inflation would not make any contribution--and certainly not a lasting one--toward the correction of the difficulties toward which it was directed. On the contrary, it would involve all of the social injustices that economists universally agree accompany inflation, and it would also disrupt the saving and investment process, which must function efficiently if vigorous growth and high level employment are to be sustained.

If we reject a policy of deliberate inflation, what should be the role of monetary policy in a situation in which the

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over-all price level or average of prices is being pushed up by administered costs and prices? Increases in the general level of prices, and the expectation of further increases, regardless of their origin, diminish the incentive to save and increase the incentive to borrow. Hence, unless credit expansion is limited to a rate of growth consonant with the increase in the physical output of goods and services a cost-push inflation will automatically become a demand-pull inflation as well. This point is spelled out in one of the papers I referred to in my replies to your Committee, but I would like to quote it in this context.

"It is the fact of rising prices or anticipation of rising prices that provides the incentive to borrow to finance overaccumulation of inventories and the construction of plant capacity in advance of need. It is the fact of rising prices or the anticipation of rising prices that leads to misallocations of investment and miscalculation of investment decisions. It is rising prices or the anticipation of rising prices that diverts savings into equities, and that dissipates their ability to finance growth, in short, that diminishes the supply of loanable funds and accentuates the demand in such a way as to force high and rising interest rates. Finally, it is the fact that a country's prices have risen above those of its competitors that prices a country out of world markets and initiates a deficit in the balance of payments. All of these reactions, which place great strains on the monetary and fiscal mechanism, ensue irrespective of whether an inflation may be described as cost-push or demand-pull.

"In the credit market, these situations increase the profitability of operating on borrowed funds even at very high interest costs. They increase, therefore, the demand for borrowed funds far above the amounts made available by savings and unless they are resisted by appropriate fiscal and monetary policies, i.e., by balanced budgets and by restraints on the availability of reserves, they result inevitably in an expansion of bank-created money.

"Because borrowing to anticipate inflation appears very profitable, the pressure of customers on their banks to borrow is very heavy and this in turn brings pressure on the Federal Reserve Banks to expand reserves. If this pressure is resisted, interest rates may have to rise quite sharply before the force toward overexpansion is contained. If the pressure is not contained and bank-created money is used to finance these hedges against inflation, the inflation, even if it started as a cost-push type, will by that very fact be converted into one of the demand-pull variety."

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This indicates how the pressure of cost-pushes on price levels leads to conditions in which monetary policy tends to be forced into a more restrictive position than would otherwise be the case and the level of interest rates tends to be higher than would otherwise be required to maintain the balance between savings and investment. On the one hand, it gives strong support to the desirability of direct and vigorous attack on cost-push elements themselves. On the other hand, it suggests to me that the adoption of a "stable plus cost-push" goal for prices could not lead to anything but trouble. It would both encourage the proliferation of cost-pushes and, at the same time, provide the demand-pull to match them. We come back to what appears to me the inescapable conclusion that deviation from the objective of reasonable price stability for all arms of public economic policy would multiply our difficulties, not reduce them.

The second, and related question which I think deserves more examination and probing, might be stated as follows: Does the demand for credit from consumers and for private investment sometimes converge on the market with such vigor that it defies any reasonable application of general monetary and fiscal measures, producing either uncontainable inflationary forces or the impoverishment of certain socially desirable programs which are unable to compete for loanable funds, and perhaps having both effects? If this happens, should an attempt be made to expand bank credit sufficiently to satisfy all creditworthy borrowers at a lower rate of interest than the demand and supply relationship between real savings and investment would establish? This sort of a surge in the demand for credit in the private sector, it is argued, presents a problem not unlike that to be faced should the Federal Government be required to expand its expenditures and borrowing rapidly in a defense emergency. The implication is that bank credit expansion--a form of forced saving through inflation--is the only way to meet this problem so as to prevent socially undesirable distortions in the economic system.

To me, this line of reasoning is indefensible, on both moral and economic grounds. To the extent that such a program could succeed, even temporarily, it could do so only because the public was deceived as to the nature of the policy and its effects. The moral objection to any national policy based on public deception seems to me overwhelming. On economic grounds, this kind of monetary policy could not possibly succeed for more than a very short period. Even before the economic effects became fully apparent, they would be anticipated by those who would seek to protect themselves from the ravages of inflation, or to profit from it. The inevitable result would be a rapid decline in the volume of savings and an even more rapid rise in the rate of interest than would otherwise have occurred.

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Rather than inflation, the first approach to a solution to this problem lies in a sound general monetary and fiscal policy. Of equal importance is the elimination of those imperfections in the operation of the price and wage mechanism mentioned in connection with my first point. If we do these things I believe there is a strong likelihood that we will avoid the kind of surges of credit demand that are postulated. If they still occur then we should certainly consider the application of selective controls on credit use by consumers and businesses. I would like to hope that these can be avoided because I am sure that they are bound to interfere with the process by which resources are directed to their most efficient uses in a free enterprise economy. When one weighs the alternatives, it seems clear that such controls would be preferable to either calculated or uncontrolled inflation, but we should recognize that they involve a degree of regimentation never before accepted in this country except in time of war.

I have addressed myself to these questions at some length because I think there may have been some real misunderstanding of my position. My interest in a monetary policy directed toward a dollar of stable value is not based on the feeling that price stability is a more important national objective than either maximum sustainable growth or a high level of employment, but rather on the reasoned conclusion that the objective of price stability is an essential prerequisite to their achievement.

I want to emphasize that I am most concerned with the preservation of freely competitive markets and the correction of any institutional imperfections which exist in the working of the price mechanism. While such imperfections cannot be corrected simply by a sound monetary and fiscal policy; they surely cannot be corrected by an unsound financial policy.

Nor does a sound general monetary policy necessarily, in itself, accomplish the optimum distribution of loanable funds among various sectors of the economy. It is not only the right but the duty of Government to assure that socially necessary programs are adequately financed. But, again, this objective can never be well served by unsound general monetary or fiscal policies. If, as a matter of public policy, the financing of school construction, for example, should have an over-riding priority in the allocation of resources, this can be accomplished in a number of ways, but we can be sure that it would not be accomplished by the general expansion of bank credit and money.

I trust that these additional comments will be helpful to your Committee in its work of clarifying for the Congress and

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the nation the basic issues involved in attaining and maintaining optimum levels of employment and vigorous growth, as well as a structure and level of prices conducive to both.

Sincerely yours,

(Signed) Wm. McC. Martin, Jr.

Wm. McC. Martin, Jr.

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JAMES W. KNOWLES,
SPECIAL ECONOMIC COUNSEL

Congress of the United States

JOINT ECONOMIC COMMITTEE
(CREATED PURSUANT TO SEC. 5 (A) OF PUBLIC LAW 304, 79TH CONGRESS)
STUDY OF EMPLOYMENT, GROWTH, AND PRICE LEVELS
(PURSUANT TO S. CON. RES. 13, 86TH CONG., 1ST SESS.)

November 5, 1959

Honorable William McChesney Martin, Jr.
Chairman
Board of Governors of the Federal Reserve System
Washington 25, D. C.

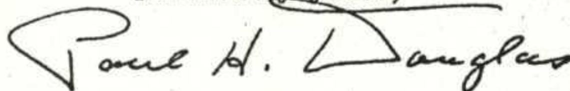
Dear Mr. Martin:

The Joint Economic Committee has just completed its ninth and final set of hearings in connection with its study of Employment, Growth, and Price Levels.

The completion of the schedule of public hearings provides an appropriate occasion for me to express for myself, the other members of the Committee, and the members of the staff, sincere appreciation for your cooperation and valued contribution to the series of hearings which we have held during the past six months. We have attempted in these hearings to afford an opportunity for qualified representatives of all major segments of the nation's economy to present their views and we thank you for helping to make the hearings a successful part of the committee's program to conduct the most comprehensive and objective factual and analytical study possible within the limits of time imposed by the resolution authorizing the study.

As a small additional expression of our appreciation we have arranged to send you copies of all hearings, study papers, and reports coming out of this project.

Faithfully yours,



Paul H. Douglas
Chairman

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BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

OFFICE OF THE CHAIRMAN

DEC 9 1959

The Honorable Paul H. Douglas,
United States Senate,
Washington 25, D. C.

Dear Senator Douglas:

Thank you for your letter of November 5, expressing your appreciation for the Board's contribution to your Committee's study of Employment, Growth, and Price Levels.

For our part, we have been most impressed with the fine work that your Committee and its staff have been doing in bringing together the thinking of qualified persons, in formulating questions to be addressed to us and to other agencies, and in the studies thus far published.

In reading over the material that has been presented to your Committee, it occurs to me that there are two aspects of the problems under study that may deserve more explicit consideration than has been given to them so far. For this reason, I am taking the liberty of bringing them to your attention in this letter.

The first point that I have in mind relates to imperfections in our price system--variously referred to as cost-pushes, ratchet effects and administered prices--and perhaps it can best be phrased in the form of a question. Granting that there are these imperfections as regards the behavior of individual prices and that they create inflationary pressures or biases in economic processes that cannot be effectively dealt with by monetary policy, does it follow from this that monetary policy should be less (or more) restrictive than if such phenomena did not exist? I am sure that all serious students of economic policy are concerned with this question, and to some extent, their views are implied in their responses to other questions. I know this is true, for example, in the case of much of the material which the Federal Reserve has furnished to your Committee.

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The objections to a policy of deliberately engineered creeping inflation seem to me to be manifold. I hope the problems generated by such a policy, with respect to the whole process of saving and investment and for the balance of payments, have been adequately treated in my responses, and those of others, to the questions asked by your Committee. If this is the case, all that needs to be said here is that these problems would be greatly intensified by any effort to absorb wage increases and administered prices through calculated inflation.

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Thus, it seems probable that, far from encouraging a high level of employment and growth in the economy, a policy of calculated creeping inflation would not make any contribution--and certainly not a lasting one--toward the correction of the difficulties toward which it was directed. On the contrary, it would involve all of the social injustices that economists universally agree accompany inflation, and it would also disrupt the saving and investment process, which must function efficiently if vigorous growth and high level employment are to be sustained.

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"In the credit market, these situations increase the profitability of operating on borrowed funds even at very high interest costs. They increase, therefore, the demand for borrowed funds far above the amounts made available by savings and unless they are resisted by appropriate fiscal and monetary policies, i.e., by balanced budgets and by restraints on the availability of reserves, they result inevitably in an expansion of bank-created money.

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The second, and related question which I think deserves more examination and probing, might be stated as follows: Does the demand for credit from consumers and for private investment sometimes converge on the market with such vigor that it defies any reasonable application of general monetary and fiscal measures, producing either uncontainable inflationary forces or the impoverishment of certain socially desirable programs which are unable to compete for loanable funds, and perhaps having both effects? If this happens, should an attempt be made to expand bank credit sufficiently to satisfy all creditworthy borrowers at a lower rate of interest than the demand and supply relationship between real savings and investment would establish? This sort of a surge in the demand for credit in the private sector, it is argued, presents a problem not unlike that to be faced should the Federal Government be required to expand its expenditures and borrowing rapidly in a defense emergency. The implication is that bank credit expansion--a form of forced saving through inflation--is the only way to meet this problem so as to prevent socially undesirable distortions in the economic system.

To me, this line of reasoning is indefensible, on both moral and economic grounds. To the extent that such a program could succeed, even temporarily, it could do so only because the public was deceived as to the nature of the policy and its effects. The moral objection to any national policy based on public deception seems to me overwhelming. On economic grounds, this kind of monetary policy could not possibly succeed for more than a very short period. Even before the economic effects became fully apparent, they would be anticipated by those who would seek to protect themselves from the ravages of inflation, or to profit from it. The inevitable result would be a rapid decline in the volume of savings and an even more rapid rise in the rate of interest than would otherwise have occurred.

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Rather than inflation, the first approach to a solution to this problem lies in a sound general monetary and fiscal policy. Of equal importance is the elimination of those imperfections in the operation of the price and wage mechanism mentioned in connection with my first point. If we do these things I believe there is a strong likelihood that we will avoid the kind of surges of credit demand that are postulated. If they still occur then we should certainly consider the application of selective controls on credit use by consumers and businesses. I would like to hope that these can be avoided because I am sure that they are bound to interfere with the process by which resources are directed to their most efficient uses in a free enterprise economy. When one weighs the alternatives, it seems clear that such controls would be preferable to either calculated or uncontrolled inflation, but we should recognize that they involve a degree of regimentation never before accepted in this country except in time of war.

I have addressed myself to these questions at some length because I think there may have been some real misunderstanding of my position. My interest in a monetary policy directed toward a dollar of stable value is not based on the feeling that price stability is a more important national objective than either maximum sustainable growth or a high level of employment, but rather on the reasoned conclusion that the objective of price stability is an essential prerequisite to their achievement.

I want to emphasize that I am most concerned with the preservation of freely competitive markets and the correction of any institutional imperfections which exist in the working of the price mechanism. While such imperfections cannot be corrected simply by a sound monetary and fiscal policy; they surely cannot be corrected by an unsound financial policy.

Nor does a sound general monetary policy necessarily, in itself, accomplish the optimum distribution of loanable funds among various sectors of the economy. It is not only the right but the duty of Government to assure that socially necessary programs are adequately financed. But, again, this objective can never be well served by unsound general monetary or fiscal policies. If, as a matter of public policy, the financing of school construction, for example, should have an over-riding priority in the allocation of resources, this can be accomplished in a number of ways, but we can be sure that it would not be accomplished by the general expansion of bank credit and money.

I trust that these additional comments will be helpful to your Committee in its work of clarifying for the Congress and

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the nation the basic issues involved in attaining and maintaining optimum levels of employment and vigorous growth, as well as a structure and level of prices conducive to both.

Sincerely yours,

(Signed) Wm. McC. Martin, Jr.

Wm. McC. Martin, Jr.

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Miss Muehlhaus

November 18, 1959

The Honorable Wright Patman,
Vice Chairman,
Joint Economic Committee,
1201 House Office Building,
Washington 25, D. C.

Dear Mr. Patman:

I am transmitting herewith copies of answers to your 48 supplementary questions to my testimony before the Joint Economic Committee on July 27, submitted with your letter of August 17. In preparing the answers, we have tried to accommodate your request that replies be brief. In every case, however, I am afraid we have not succeeded, although we have endeavored to avoid repetition by combining answers to related questions.

Even though you suggested that quick and short answers to the questions should be possible, the preparation of adequate responses has taken a good deal of time. In part this has resulted from the range of subjects covered. I trust that the time required to complete answers to your questionnaire has not impeded unduly your Committee's work.

Sincerely yours,

(Signed) Wm. McC. Martin, Jr.

Wm. McC. Martin, Jr.

Enclosures

RAY:ajm

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Mis Muehlhaus

NOV 12 1959

The Honorable Paul H. Douglas,
Chairman,
Joint Economic Committee,
Congress of the United States,
Washington 25, D. C.

Dear Mr. Chairman:

The Board of Governors is grateful to the Joint Economic Committee for transmitting with your letter of October 30 a copy of Professor Robert Triffin's statement before the Committee and the transcript of the Hearings for the day when Professor Triffin's suggestion was considered by the Committee.

The Board's Staff has had under continuous study the problems with which Professor Triffin's suggestion is intended to deal, and of course will continue its studies in this field. We appreciate your making this material available to us so promptly.

Sincerely yours,

(Signed) Wm. McC. Martin, Jr.

Wm. McC. Martin, Jr.

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OTTO ECKSTEIN,
TECHNICAL DIRECTOR

Congress of the United States

JOINT ECONOMIC COMMITTEE

(CREATED PURSUANT TO SEC. 5 (A) OF PUBLIC LAW 304, 79TH CONGRESS)

STUDY OF EMPLOYMENT, GROWTH, AND PRICE LEVELS
(PURSUANT TO S. CON. RES. 13, 86TH CONG., 1ST SESS.)

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WILLIAM B. WIDNALL, N.J.

JOHN W. LEHMAN,
ADMINISTRATIVE OFFICER

JAMES W. KNOWLES,
SPECIAL ECONOMIC COUNSEL

October 30, 1959

Hon. William McChesney Martin, Jr.
Chairman
Board of Governors of the Federal Reserve System
Washington 25, D. C.

Dear Mr. Chairman:

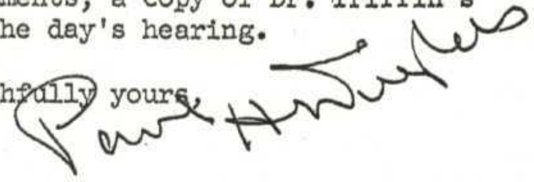
The Joint Economic Committee wishes to bring to your attention a most interesting and stimulating suggestion presented to the Committee in its public hearings Wednesday afternoon by Professor Robert Triffin of Yale University.

Professor Triffin, an internationally known authority on international monetary problems, has suggested the revision of the International Monetary Fund or the creation of a new organization to replace the present one, which, if successful, would in our judgment help to solve problems both of the United States and of other countries in maintaining liquidity reserves required by international financial transactions.

The Committee, of course, has not had an opportunity to consider Professor Triffin's suggestion in detail and as a committee is not prepared at this time to endorse his recommendations. The Committee does believe, however, that his suggestion is of such outstanding merit and originality that it deserves the most serious and intensive study on the part of responsible officials.

In view of these facts, the Committee is taking the somewhat unusual course of transmitting to you for your consideration and, we hope, your comments, a copy of Dr. Triffin's statement and the transcript of the day's hearing.

Faithfully yours,



Paul H. Douglas
Chairman

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COPY

October 27, 1959.

The Honorable Paul H. Douglas,
Chairman,
Joint Economic Committee,
Congress of the United States,
Washington 25, D.C.

Dear Mr. Chairman:

In Chairman Martin's absence, I am transmitting herewith copies of the answers of the Board of Governors to the questions submitted under date of August 17, in connection with your Committee's general survey of the marketing of Treasury securities. It is our hope that these answers will help achieve the purpose for which the questionnaire was designed.

We want to thank your Committee and its staff for their patience in awaiting the completion of our replies.

Sincerely yours,

C. Canby Balderston,
Vice Chairman.

Enclosure

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September 30, 1959.

The Honorable Paul H. Douglas,
Chairman,
Joint Economic Committee,
Congress of the United States,
Washington 25, D.C.

Dear Mr. Chairman:

The questions on monetary policy and debt management which you addressed to me on August 13 on behalf of the Joint Economic Committee have been receiving intensive study and consideration by the Board's staff. The staff has sought to make my answers as responsive and helpful as possible and the written material has become quite voluminous. This has necessitated more review, checking, revision and time than we had initially provided for in our planning.

While I am unable to forward the replies today as you had requested, we are giving every priority to completion of the staff work and are hopeful that the replies can be transmitted no later than the middle of October.

Sincerely yours,

Wm. McC. Martin, Jr.

RAY:mmm

cc: Mr. Shay
Mr. Young
Mr. Martin

FILE COPY

FOR FILES
Mary [illegible]

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September 30, 1959.

Mr. James W. Knowles,
Special Economic Counsel,
Joint Economic Committee,
Congress of the United States,
Washington 25, D.C.

Dear Mr. Knowles:

Thank you for your letter of September 24 enclosing four papers presented to the Joint Economic Committee in connection with its study of Employment, Growth, and Price Levels.

Please tell Senator Douglas I appreciate his thinking of me in this connection, and I will study the papers carefully at the first opportunity.

With all good wishes,

Sincerely yours,

(SIGNED) WM. McC. MARTIN, Jr.

Wm. McC. Martin, Jr.

WMM:mnm

Note: Mr. Martin kept papers enclosed by Mr. Knowles (Study Paper No. 1, Recent Inflation in the United States by Charles L. Schultze; A Summary Analysis of above by Mr. Schultze; Arthur M. Okun statement before Committee; Statement prepared for Committee by Hyman P. Minsky; and paper presented by Dr. Theodore A. Anderson, "Price Inflation in the Major Manufacturing Industries, 1955-59."

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OTTO ECKSTEIN,
TECHNICAL DIRECTOR

Congress of the United States

JOINT ECONOMIC COMMITTEE
(CREATED PURSUANT TO SEC. 5 (A) OF PUBLIC LAW 304, 79TH CONGRESS)

STUDY OF EMPLOYMENT, GROWTH, AND PRICE LEVELS
(PURSUANT TO S. CON. RES. 13, 85TH CONG., 1ST SESS.)

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JOHN W. LEHMAN,
ADMINISTRATIVE OFFICER

JAMES W. KNOWLES,
SPECIAL ECONOMIC COUNSEL

September 24, 1959

Honorable William McChesney Martin
Chairman
Board of Governors of the Federal Reserve System
Washington 25, D. C.

Dear Mr. Chairman:

At hearings held yesterday before the Joint Economic Committee in connection with our study of Employment, Growth, and Price Levels, four papers were presented on the analysis of inflation which so impressed the Chairman, Senator Paul H. Douglas, and other members of the Committee, that he requested me to be sure to send you copies of the statements for your consideration as well as that of your associates and staff. He thought these statements might be of particular value to you as they bear upon some of the important aspects of the analysis of inflation in which you are most seriously concerned.

I am also sending a copy of Study Paper No. 1, "Recent Inflation of the United States," which was prepared by Charles L. Schultze, one of yesterday's participants, and upon which his statement was based.

Sincerely yours,

James W. Knowles
Special Economic Counsel

Encl. (5)

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Miss Muehlhaus

AUG 25 1959

The Honorable Wright Patman,
House of Representatives,
Washington 25, D. C.

Dear Mr. Patman:

This will acknowledge your letter of August 17, 1959, which referred to Chairman Martin's appearance on July 27 and 30 at hearings of the Joint Economic Committee and submitted a list of 48 questions. You indicated that you desired to have the answers for inclusion in the record of the hearings.

A list of comprehensive questions also was enclosed with a letter of August 17, 1959, from the Committee, which asked that answers be supplied no later than September 30, 1959.

Answers to your questions will be furnished as promptly as circumstances permit.

Sincerely yours,

(Signed) A. L. MILLS, JR.

A. L. Mills, Jr.

JWS:ac

cc: Miss Muehlhaus
Miss Wolcott
Mrs. Cotten
Miss Benton

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BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

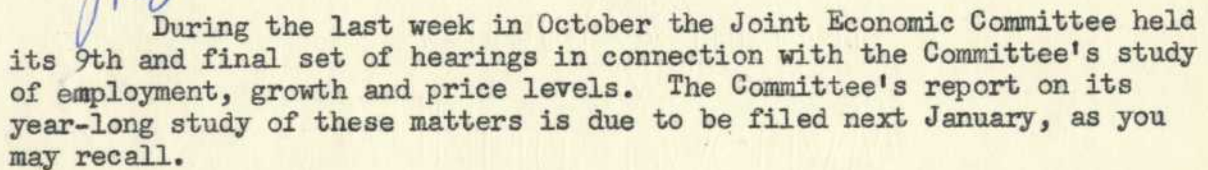
Office Correspondence

Date November 2, 1959

To Chairman Martin

Subject: Joint Economic Committee Hearings

From Jerome W. Shay



During the last week in October the Joint Economic Committee held its 9th and final set of hearings in connection with the Committee's study of employment, growth and price levels. The Committee's report on its year-long study of these matters is due to be filed next January, as you may recall.

Considering that Congress is in adjournment, the recent hearings were relatively well attended by the Committee members. Chairman Douglas and Congressmen Reuss and Curtis were regularly present and were joined from time to time by Senator Bush and Congressmen Bolling and Widnall. The questioning of witnesses was not extensive, however. Nor did any of the Committee members develop any new, significant lines of questioning.

Attached is the statement made to the Committee by Professor Fritz Machlup of Johns Hopkins University. As you will note, this statement was highly regarded by Mr. Thomas, who sent copies to the Federal Reserve Banks. Your attention is invited particularly to the portions of Professor Machlup's statement that I have marked at pages 5, 7-8, 22-23, 25, and 27. At the close of his oral testimony Professor Machlup emphasized that, in his judgment, the fear that monetary stringency would lead to unemployment (especially in a cost-push inflation) is not justified, since he strongly doubts that wage costs would continue to rise. As you know, this does not agree with the conclusions of several economists.

The last of the eight witnesses appearing before the Committee was Professor Milton Friedman, whose testimony was substantially the same as that which he presented to the Committee earlier this year and reiterated the now rather well-known "Friedman line" that it would be better if the monetary authorities were restricted to open market operations designed to increase the money supply at a fixed rate somewhere between, three and five per cent a year, so as to "avoid the monetary uncertainties that have plagued us in the past." A copy of Professor Friedman's statement before the Committee is attached in the event you may wish to examine his specific recommendations on monetary policy and debt management, beginning at page 6.

During his oral testimony, Professor Friedman denied that we now have a "tight money policy" in view of the rate of increase in the money supply which he found to be in progress. He also, in effect, defended the so-called "bills only" policy. He said that none of our present difficulties is attributable to that "policy" which, in his judgment, effects a fairly good division of responsibility between the Board and the Treasury.

A principal point in the testimony of Professor Richard A. Musgrave of Johns Hopkins University and Professor Walter W. Heller of the University of Minnesota was that fiscal policy as a tool for stabilization should receive

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greater use and emphasis; that, while monetary and fiscal policy are both necessary, too much dependence has been placed on monetary policy. This also seemed to be implicit in the testimony of Professor William J. Baumol of Princeton.

Professors Musgrave and Heller and also Professor R. A. Gordon of the University of California seemed to think that the so-called "general" monetary controls are in fact selective and discriminatory in their impact on certain groups, and that there is a real need for truly "selective" controls to help equalize the impact of monetary policy, i.e., consumer credit control.

On the whole, I would say that the Committee's last set of hearings did not add significantly to the materials and information previously obtained by the Committee.

Attachments

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BOARD OF GOVERNORS
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WASHINGTON

October 29, 1959.

Dear Sir:

Attached is a copy of a statement presented on October 27 to the Joint Economic Committee of Congress by Dr. Fritz Machlup, Professor of Political Economy, Johns Hopkins University. This presents a comprehensive and well reasoned analysis of the problems of unemployment, growth and price stability, together with some comments on monetary and fiscal policies, and is well worth reading and study.

Very truly yours,

Woodlief Thomas

Woodlief Thomas,
Economic Adviser.

TO THE PRESIDENTS OF ALL FEDERAL RESERVE BANKS

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STATEMENT BY PROFESSOR FRITZ MACHLUP, THE JOHNS HOPKINS UNIVERSITY

Prepared for presentation before the Joint Economic Committee, United States Congress, in the Hearings on Employment, Growth, and Price Levels, on Tuesday, October 27, 1959, at 10 A.M.

Maximum employment, a record-breaking growth rate, and a stable price level are generally regarded as three important goals of economic policy. Our question is whether they conflict with one another and, if so, whether we can establish priorities or preferences in the sense that we should be unwilling to strive as hard as possible for one of them if this were to impede us much in our attempts to attain the others. The answer is not just a matter of personal tastes - about which one could not fruitfully argue. For none of the three goals is ultimate; they all are instrumental to higher values on which there might be agreement. In order to make good sense, a discussion of the comparative importance of the three goals must first establish which higher values they are supposed to serve.

Fast Growth

Many of us say modestly that we want an "adequate" rate of growth. But this does not commit us to anything. What most people mean is a dazzling growth rate, a record-breaking growth, or at least a growth faster than the growth of most other economies. Some want the fastest possible growth.

Why does anybody want fastest possible growth? Why is it that so many of us get excited about whether the annual rate of growth is 3.5 per cent or 4.1 or only 2.9 per cent - when most of the growth-rate fans are not even clear just what it is that is growing at these rates? Assuming, provisionally, that they mean the annual rate of increase of total national product, measured at constant prices, I can see several very different reasons for which people may want that rate to be as high as possible:

(1) To make sure that our children will be better off than we are.

(2) To do for the next generation as much as, or more than, the previous generation has done for us.

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(3) To make it possible that what we now regard as poverty will eventually be eliminated in our society.

(4) To make it possible for us to help other nations more generously in future years.

(5) To help other nations, not through direct aid, but through the normal emanations of growth, which benefit the less advanced by way of trade, investment, and the flow of information.

(6) To be stronger in a possible military contest with an enemy of our nation.

(7) To impress other nations with the fine performance of our economic system.

(8) To win an economic race as if it were a sports contest, and to be able to smile condescendingly at the outdistanced rival.

(9) To please our ego and become increasingly self-satisfied.

Of these reasons those that seem to motivate most growth-rate fans most strongly happen to be least valid from an economic or from an ethical point of view. I find it hard to approve of the last two reasons, satisfying the propensity to boast. Regarding Point Six, military preparedness is not a function of an increase in total income, since more TV sets, better houses, more and better washing machines, etc., do little or nothing to strengthen our capacity to win a war or to avoid destruction in a war. If the growth rate refers to total income rather than per capita income or per capita consumption, that is, if it disregards the increase in the number of people who have to share in the income increase, it is not directly relevant to Points One and Three, the improvement of the living standard of the next generation and, still less, the elimination of poverty. On Point Seven, I am afraid, we shall not be doing so well, compared with some communist countries which have only recently started to develop their industry. The strongest reasons are probably in Point Four and in Point Five, but those have the smallest support from the people.

Perhaps it will not be considered academic pedantry if I draw more attention to the multiplicity of meanings of economic growth. One may mean,

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to mention only a few such meanings, the continuing increase in

(a) total net national product,

(b) net national product per head,

(c) net national product per worker,

(d) net national product per labor hour,

(e) net national product per unit of factor (labor and capital),

(f) total consumption

(g) consumption per head,

(h) consumption per head of the poorest third (or quarter, half, etc.) of the population.

The annual rate of growth of each of these magnitudes is interesting, and the various rates may differ substantially from one another. Apart from these distinctions the different causes of growth are also worth distinguishing. Total net national product may increase as a result of:

1. an increase in labor input

   (a) because the population (of working age) has increased, that is, there are more people who need jobs,

   (b) because the labor force has increased relative to the working-age population, that is, a larger percentage of the people want jobs.

   (c) because employment has increased relative to the labor force, that is, a larger percentage of those who want to work have found jobs, unemployment being reduced, or,

   (d) because average weekly hours have increased, that is, people work more hours;

2. an increase in capital input,

   (a) because thrifty people have saved some of their income and financed new investment, - without being forced to do so and without any government measures restricting consumption,

   (b) because income was redistributed from people who would have liked to consume it to others who saved some of it, for example, when real income is switched from the poor to the rich, by means of certain kinds of credit inflation,

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(c) because income that would have been consumed has been taken away by taxation and used for constructing productive facilities,

(d) because, in a centrally planned economy, the authorities have reduced the part of total product made available for consumption and have increased plant and equipment;

3. an improvement in the use of productive resources,

(a) because better production methods previously known but not yet utilized have now been introduced.

(b) because better production methods have been discovered without cost and have been introduced,

(c) because better production methods have been derived from costly research and development work and have been introduced,

(d) because inefficient ways of allocating productive resources to different uses have been eliminated, e.g., certain monopolistic distortions of the cost structure have been removed or reduced, which has permitted the shift of labor and capital from less valuable to more valuable lines of production.

Some of these "growth factors" work only for relatively brief periods, others work steadily; some yield an income increase without cost, others presuppose a sacrifice. It would, therefore, be rather naive to wish for the "maximum rate of growth" that might be achieved now no matter what it costs and regardless of whether it is a steady growth or only one for a few years followed by a necessary retardation that would make the long-run rate of growth less than it would be without the "fillip". Especially distasteful to many of us is a demand for faster growth even if it could be had only by means of authoritarian dictation.

The greatest "advantage" which a communistic economy has over a free society - if it is regarded as an advantage - is the ease with which, under the plan, consumption can be held down for the sake of capital accumulation. A large part of the potential savings of a free economy cannot go into capital formation because the investible funds have to be used for higher wages and thus go into increased consumption. (This is the so-called "Wicksell effect": an increased supply of capital funds raises the marginal productivity of labor and thus bids up

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wages with the result that a large part of the funds is diverted into consumption, leaving less for the formation of real capital.) In an authoritarian economy the increase in wages and in consumption per worker can be prevented and accumulation can therefore proceed at a faster pace. I for one prefer the slower accumulation of a free society to the faster accumulation of a communist society.

I reject the "maximum rate of growth" as a goal of economic policy unless it means something other than the fastest possible growth regardless of cost. I can accept it if it means fastest possible long-term growth compatible with the institutions of a free society and consistent with the free choices of income recipients concerning their consumption and their saving, and without confiscatory taxation. By confining my acceptance to long-term growth I have also rejected the forcing-up of investment and employment by means of monetary inflation - because such forcing-up is apt to be of relatively short duration and not conducive to a high rate of continuing growth.

Maximum Employment

Similar difficulties exist with regard to the employment goal of economic policy. If maximum employment is to mean the highest possible number of jobs no matter for how long and regardless of social cost, then I doubt that many of us would want it.

Few advocates of the maximum-employment goal want it as an end in itself. Most of them take it for granted that the national product will be the higher the larger the number of employed; and perhaps also that the rate of growth will be the greater. This assumption is often not justified, for there may be a range within which employment and output vary inversely. This range may be rather wide in economies that are poorly endowed with natural resources and capital. In such economies maximum output may be obtained with a labor input far below the actual labor supply. (In cases of this sort, disguised unemployment usually is preferred to the lower output that would go with larger employment.) In economies richly endowed with resources, natural and man-made, the critical range may be quite

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narrow, extending perhaps only over the last one or two per cent of the labor force. (This "perverse" range may be due partly to the limit set by plant capacities under the law of factor proportions, partly to such things as reduced labor mobility and the "hoarding" of labor, and possibly also to reduced effort, in times of labor scarcity.) Thus, it is possible that with the employment of, say, 98 per cent of the labor force total national product in real terms may be greater than with 99 per cent employment.

To produce the highest possible output that can be produced in a single year may not guarantee the fastest growth of output (given the stock of capital and its accumulation); indeed, growth may be faster with even more unemployment than is consistent with maximum output. Growth usually implies change in the composition of output, the "structure" of industry. Such change requires transfers of labor between industries, regions, and occupations; the existence of some pools of unemployed may facilitate the movements of labor. (One may also express this by saying that frictional unemployment will be greater in a progressing than in a stationary economy.) Thus, while 98 per cent employment may yield maximum output in a given year, 95 per cent employment may yield a faster growth of output and, hence, maximum output over a period of several years. These figures are, of course, merely illustrative, to help explain possible relationships between employment, annual output, and growth, and to show that in the range of the highest percentage figures of employment the relations may well vary inversely.

Of course, one may prefer higher employment for other reasons, for example, in order to avoid the hardship and suffering of the unemployed and their families. This is a very important reason. Much depends, however, on the rate of turnover in the pools of unemployed. Three million unemployed most of whom are jobless for only a few weeks is, in my opinion, less disconcerting than chronic unemployment of only two million.

Some measures widely prescribed for achieving "full employment" may secure higher employment for a time, but not in the long run. Indeed, average employment

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over several years may be lower when employment is forced up by inflationary policies than if such policies are eschewed. I submit that the label "full-employment policy" for expansions of effective money demand by means of monetary and fiscal methods is deceptive. I believe that better results in terms of long-run growth of employment have been achieved by countries that have rejected the so-called "full-employment policies" and have allowed higher levels of employment to be achieved in the more orthodox way through capital formation based on thrift and through the establishment of cost-price relations based on competitive supply and demand.

Full-employment prescriptions of money injections are especially ineffective, or even harmful, when unemployment is not general but is concentrated in declining industries and "distressed areas". If in such circumstances the demand for goods and services in general is increased through the finance of additional spending by government, industry, and consumers, prices will be pulled up and wage rates will be both pulled up and pushed up, while the pockets of unemployment will not be removed. To prescribe increased doses of effective demand to cure all sorts of unemployment is like prescribing the same strong medicine for all sorts of illness; in some instances this can be very dangerous.

Monetary and fiscal policies to bolster effective demand may be perfectly sound if they are designed to offset genuine deflation, that is, to avoid a decrease in aggregate demand. They may also be justified as means of providing the additional money supply needed to avoid reductions in the price level when productive resources and total real output increase. But, while it is true that deflation may cause unemployment, it is surely not true that all unemployment is due to deflation. There is, especially, one kind of unemployment that raises one of the most serious problems of our time: the unemployment that would arise if wage rates were pushed up too fast without a simultaneous demand inflation supporting an increase in the general price level. Thus we come to the third of the three policy objectives; a stable price level.

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Stable Price Level

To consider stability of the price level as an end in itself is no more justifiable than to take full employment and fast growth as ultimate ends - or even less so. Some economic puritans treasure a stable price index "as a matter of principle" just as they treasure an A for good behavior or deportment in the report cards of their offspring. But this is not a reasonable position. To be worth striving for, price-level stability must be a means toward some important social objectives. And this it can be shown to be, at least in my judgment.

One of these objectives is justice or fairness to large groups of people, especially pensioners, holders of savings accounts and government bonds, and all other recipients of money incomes in fixed amounts, who are being deprived of some of their real incomes when the price level rises; but also recipients of incomes that are not easily adjusted to inflated price levels, such as the salaries of teachers and civil servants. But justice in economic life is often rated below prosperity and I doubt that one could successfully defend price-level stability on the ground of justice alone if such stability interfered with greater prosperity.

The main issue is how price-level stability is related to the size and growth of national product. One contention is - and I support it - that a stable price level will secure a better performance of the economic system and thus promote the attainment of a larger product in the long run; and consequently that we must maintain a stable price level in order to obtain and sustain as large a product and as fast a growth as is compatible with the institutions of a free society and the sovereignty of the consumer. But this contention is denied by others, who hold that stability of the price level will depress productive activity and retard economic growth; that only a policy of demand expansion will secure high employment and fast growth; and that we should accept creeping inflation of prices as a small price to pay for greater prosperity.

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Can historical evidence decide the argument? Historical evidence is rarely convincing, because one can always hold that circumstances have changed so much that the experience in one country or at one time would not apply to another country or another time. Otherwise one could quickly and decisively dispose of the assertion that growth involves, requires or engenders a rising price level. Measured by the index of wholesale prices, the United States between 1800 to 1940 had more years of falling prices than years of rising prices, and the price index was about the same in 1940 as in 1840, and lower than in any year between 1800 and 1819. Yet the growth rate during the 140 years was remarkable. The national product of the United States has never again grown as fast as it did between 1875 and 1890, when the price level not only failed to rise but actually declined by almost 30 per cent. In other words, a "price deflation" accompanied the fastest long-period growth this country has had in the last hundred years. In recent times, Western Germany is the country in which employment and production has had the highest growth rate of all industrial nations in the free world, while at the same time its record regarding price-level stability was one of the best in the world. But if my colleagues tell me that the United States today is not like it used to be 75 years ago, and not like present-day Germany either, I cannot contradict them.

If crucial differences exist between these economies, they lie probably in the size and strength of trade unions, in the size of corporations that bargain with them, and in the acceptance of monetary and fiscal policies to force up employment when it flags. A constant wage push, boosting money wage rates by more than two or three per cent a year, is in fact not compatible with high employment at a stable price level. If the wage push persists, you can either have price-level stability with more unemployment than you like, or high-level employment with more price inflation than you like. If both high-level employment and price-level stability are wanted, then the constant upward pressure of money wage rates has got to be stopped.

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There is a question whether the wage push would persist if society resolved to avoid inflation at all cost, that is, face the unemployment that would follow the overdose of wage increases. But to try this might be an expensive experiment, and not many would be prepared to propose it. Is there any other way to alleviate inflationary wage pressures? If we could find a way and thus maintain stability of the price level, the benefits for the economy would be great. Much waste and inefficiency would be avoided and also a higher rate of voluntary saving and productive investment would be attained by a people able to count on a stable dollar. One of the greatest economies of price-level stability would consist in the redirection of effort from purely speculative activities and risk-reducing hedging policies to actions designed to increase the productivity of resources.

The Causes of Inflation

What I have said or implied concerning our recent failure to maintain a stable price level seems to contradict the opinions of many who have testified here about the causes of our inflation. I believe, however, that some of the differences of opinion are more apparent than real.

There are probably two dozen different meanings of the word "inflation". Let us agree that this morning "inflation" shall mean "continuing increase in the general price level", especially the level of consumer prices. Then let us understand what may be meant when some economists distinguish cost-push inflation from demand-pull inflation, and other economists deny that such a distinction is workable or meaningful.

In our economy many wage rates and many prices are "administered" in the sense that an increase or decrease presupposes some administrative actions - decisions, agreements, announcements. All of these wage rates and many of these prices are cost elements. One may conclude that there can hardly be a price inflation without administered wage and price push.

In our economy most prices and wages involve payments to be made by somebody who has the money or can get the money and is prepared to spend it. One

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may conclude that there can never be a price inflation without expansion of demand and rarely one without expansion of the money supply.

Thus both cost boosts and demand expansions must be present. But it is possible for one of these to start the procession and the other to follow and catch up. For purposes of analysis it is necessary to distinguish between stimuli and responses, causes and effects, disequilibrating and equilibrating changes. Let us thus speak of an "autonomous" wage or price increase when the increase is independent of demand, that is, when it would also be made in the absence of an increase in demand. Likewise, let us call "autonomous" a demand expansion that is independent of costs, that is, one that would occur also if costs were not raised.

By sheer coincidence it could happen that autonomous cost boosts and autonomous demand expansions occur at the same time. Then both could be regarded as prime causes of the price inflation. More likely, however, one or the other would initiate the process.

An autonomous demand expansion may take the form of increased government spending, increased business spending, or increased consumer spending. At given wage rates and prices, an excess demand for goods and services would arise and prices and wages would rise in response to it. In some markets the "responsive" wage or price increases will be attributable only to anonymous market forces, in others they will be "administered". Thus, even an "administered" increase can be regarded as "responsive" or "competitive" if it would also have occurred in the absence of any price-making powers of the sellers or wage-setting powers of labor unions. A test for the responsive or competitive nature of an increase might be seen in the existence of an excess demand, i.e., a shortage of the goods or services in question. As long as there is idle excess capacity or unemployment, increases of prices or wage rates cannot well be regarded as responsive, i.e., as the result of a competitive bidding-up on the part of buyers and employers. (But one may reject this test because there can be "induced-administered" increases even in the

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face of excess capacity and unemployment, increases which might not have been made if demand had not expanded.)

Autonomous wage or price increases may have three possible effects: (a) reductions in production and employment, (b) "induced" expansions of private demand, and (c) "supportive" expansions of demand by means of fiscal and monetary measures. Any one or two of these effects, or all three, may eventuate. Supportive demand expansions are designed to prevent the reduction in employment that would tend to result from the wage and price increases: Under some sort of full-employment commitment, the fiscal and monetary authorities take measures to compensate for the employment-reducing effects of increased costs and to support a higher level of product prices that permits industries to maintain or restore employment despite the higher costs. If the authorities play their instruments well, they will resort to this compensatory or supportive expansion of effective demand only to the extent that the induced expansion of demand is insufficient to absorb the excess supply of labor created by the wage and price increases. I call "induced" the demand expansions that are direct consequences of a cost increase, as either those who receive the increased cost-prices or those who pay them make larger disbursements than they would have made otherwise. For example, industrial firms yielding to union pressure for a wage increase may borrow from banks (or dig into cash reserves) in order to pay the higher wage bill; or individuals receiving bigger pay checks go into more ambitious installment purchases of durable consumer goods.

The proposed concepts help in a simple description of the two basic "model sequences" of inflation.

Demand-pull inflation: An autonomous demand increase is followed by responsive (competitive) wage and price increases.

Cost-push inflation: Autonomous wage or price increases are followed by induced and/or supportive (compensatory) demand increases.

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Perhaps I should mention that these two are not the only models of price inflation; there can be price inflation which is neither of the demand-pull type nor of the cost-push type. I had much fun constructing a model to demonstrate that in an economy where wage rates are never reduced and where prices can only go up but never go down, and where technological unemployment is treated with remedial demand expansion, every cost-reducing technological innovation will lead to price inflation, even in the absence of wage rate increases. And another model has recently been presented to demonstrate that, in an economy as just described, a shift in consumer demand from some products to other products will lead to price inflation, likewise in the absence of wage rate increases. Both these models are quite ingenuous and they may even become applicable, but I doubt that they do explain our experience of past years. While it is surely interesting to know that there _can_ be price inflations without autonomous expansions of demand and without autonomous increases in wages or prices, and even without _any_ increases in wages, we know that the picture presented by the real world has contained a great deal of demand expansion and a great deal of wage increase.

The trouble with the real world is that things do not happen in the neat order in which we describe them in our theoretical models. For example, an autonomous demand expansion may in actual fact be followed by administered wage and price increases more drastic than merely competitive increases would be; thus, the increases would be partly responsive, but partly autonomous, requiring further demand expansions, induced or supportive, if unemployment is to be avoided. Or, autonomous wage and price increases may be followed by excessive demand expansions, perhaps because an excessively nervous government rushes in with overdoses of supportive injections of buying power; some of the effective demand thus created would then be in the nature of an autonomous expansion, resulting in further (responsive) upward adjustments of costs. Complications of this sort make it difficult to arrive at interpretations of an observed course of events that are acceptable to all observers, even impartial ones. That the real world is

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too messy to fit our neat theories more closely does not vitiate the theories. They must bring some imaginary order into the real mess if they are to do their job of explaining a perplexing jumble of events.

The "Postwar Inflation"

Another source of differences of opinion among your past witnesses lies in the failure to identify precisely the phenomena to be interpreted. A reference to "postwar inflation" as the subject of inquiry is much too vague. Some may have been thinking of the period 1946-52, others of 1955-59. If some tried to give one explanation for the entire period, 1946-59, they could only deal in the most general of generalities.

It is my impression that the price increases from 1946 to 1952 should be interpreted chiefly as a demand-pull inflation. The increases in wage rates and material prices during that period can be explained as the effect of the derived demand for labor and materials. These increases were of the responsive type; they would have come about also if there had been no trade unions and no big corporations in the country.

On the other hand, I believe one should interpret the price increases from 1955 to 1959 largely as a cost-push inflation, especially a wage-push inflation. The expansions of demand that occurred in these years were partly induced (borrowing by business and consumers in consequence of wage increases) and partly supportive, though the expansions were not sufficient to absorb all the unemployment created by increasing wage rates. A more generous creation of supportive demand would probably have produced more employment, but would surely have produced more price inflation.

Let me propose another distinction which may be helpful in interpreting the inflationary process, a distinction regarding the magnitude of autonomous (disequilibrating) wage or price increases. If such an increase is designed merely to restore real earnings which the group in question had long been enjoying, I call it "defensive"; if it is designed to raise real earnings above that level, I call it

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"aggressive". The specification of a "long time" is necessary in the distinction, so that one avoids calling "defensive" what really is a battle to defend the ground just gained in an aggressive action. For example, aggressive wage rate increases by ten per cent are likely to be partially eroded within less than a year through the resulting cost-push inflation (financed by induced and supportive expansions of demand). If the <u>same</u> trade unions then demand "cost-of-living raises" to restore their real wages, it would be somewhat ironic to call these new wage adjustments "defensive".

A defensive wage rate increase is different from a responsive one in that the exercise of bargaining power is needed to bring it about; that is, it is not just a response to an excess demand for the type of labor that obtains the raise. Thus, it is an autonomous increase; but the increase is just enough to compensate for a rise in the cost of living which has reduced the wage rates these workers had been enjoying for years. Defensive increases play a role in the inflationary process - in the notorious "wage-price spiral" - in controlling its speed. But the initiating causes of the cost-push inflation must be found in the aggressive increases.

Much discussion has been devoted to the role of administered prices in the cost-push inflation. Prices of materials and other intermediate products are cost items in the production of other goods, and autonomous increases in these prices may be either of an aggressive or of a merely defensive nature. Partisans of organized labor have argued that the price policies of business have been responsible for most or all of the inflation, a view which in a sense was forced upon them by the positions they had to take for rather obvious reasons. They must reject the wage-push diagnosis because, understandably, they do not wish to take the blame for the inflation. But they also must reject the demand-pull diagnosis, because this diagnosis would militate against the use of fiscal and monetary policies to bolster employment. They want effective demand to be increased at a rate fast enough to permit full employment at rapidly increasing

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wage rates; but they do not want to attribute the increase in prices either to the increase in demand or to the increase in wage rates. The only way out of this logical squeeze is to blame the consumer price increase on the increases of prices "administered" by big business.

Representatives of industry have denied that their price increases were responsible for the inflation, and insisted that they merely adjusted for increases in their cost. One might think that statistical evidence could settle this issue in a hurry. This is, however, made difficult by conceptual complications, especially regarding the choice of the relevant data from among several possibilities: (a) the absolute profit margin in dollars per physical unit of output, (b) the same in constant dollars, (c) profits per sales dollar, (d) profit rates per investment dollar, (e) profit rates on the replacement cost of total assets, (f) profit rates on the replacement cost of the assets required for the production volume actually produced. An industry that could show that none of these six profit indices had increased over the four years of cost-push inflation could hardly be accused of aggressive price increases. But if some of the indices had increased, the controversy would not be settled.

The logic of the situation, as I see it, would support the contention that the autonomous price increases for industrial products were of the defensive, not of the aggressive type. A businessman who attempts to maximize his profits but, in the absence of increased demand (since we are talking about cost-push inflation) and in the absence of increased cost (or beyond the amount needed to cover increased cost), decided to raise his prices and expected thereby to increase his profits, either was a fool in doing so or had been a fool in not having done so long before. If we assume that most businessmen are no fools, we must at least provisionally conclude that they have not resorted to aggressive increases of their prices. (The same reasoning does not apply to trade union leaders, who do not try to maximize either the total wage bill, or the total wage bill net of any sort of cost, or total employment, but just try to get increased wage rates and/fringe benefits.)

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One may point to exceptional instances where businessmen for some reasons had been charging lower prices than was good for their profits and then corrected this situation by raising prices, or took the occasion of a wage rate increase to raise prices more than would be necessary to cover the increased cost. Or one may point to the possibility that businessmen do make errors and may raise prices higher than is good for them, so that their action, though taken in the quest for increased profits, actually results in reduced profits. Neither of these hypotheses is good enough to support the contention that the series of increases of administered prices in industry were aggressive in the sense that every increase was designed to raise profit rates higher than the year before. I am prepared to argue that steel prices were too high from many points of view, and that a reduction of steel prices would have been a wise and beneficial move; but I cannot argue that the increases in steel prices were initiating a cost-push inflation. The theory of cost-push inflation based on "administered pricing with periodically raised profit targets" is, I believe, untenable.

To avoid misunderstandings let me repeat that I should expect profit rates and margins to increase in the course of a demand-pull inflation, for there prices are pulled up by excess demand before costs have increased. But in a cost-push inflation, it seems to me, increases in administered prices of strategic materials are typically of the defensive type - "defending" profit rates and margins against encroachment, not pushing them up to new record levels. A successful strategy of government policy aiming at price-level stability will have to be centered on avoiding autonomous expansions of demand and on avoiding or mitigating aggressive increases of wage rates.

The Strategy of Inflation Control

To avoid autonomous demand expansions is a responsibility of our fiscal and monetary authorities. Our present knowledge of these matters is sufficient to carry out this task satisfactorily, provided unwholesome political pressures can be neutralized or withstood. If I do not say more about this, it is not because

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I underrate the importance of fiscal and monetary sobriety. Almost all inflations in the history of this and other countries were demand expansions, chiefly through government spending, and I expect that most inflations in the future will be of the same sort. But there is no need to discuss here this familiar story. Let us assume that demand-pull inflations will be avoided by sound fiscal and monetary policies. And let us note that fiscal and monetary controls can be exercised without resort to prohibitions, commands, sanctions, or coercive actions of any sort, that is, without direct controls.

Are direct controls perhaps indispensable if we want to avoid autonomous increases of wage rates of the aggressive type? If so, I am not ready to recommend such a policy of control, for, much as I fear the consequences of inflation, I fear even more the consequences of direct controls of wages and prices. Let us then think of other methods of avoiding aggressive increases, not by prohibiting them but merely by discouraging them. Either the trade unions can be made more self-conscious and squeamish about demanding aggressive raises, or employers can be made more reluctant to grant them.

For the government to refuse supportive demand expansions would be the simplest method from an economic point of view, but the hardest from a political point of view. In the absence of supportive fiscal and monetary policies, businessmen would find it impossible to sell their output at increased prices and they would quickly learn that granting higher wages would be economic suicide. Unions do not strike for higher wages when they are certain that there is no money to pay them. But it would probably be political suicide for a government to adopt such a course. Business and labor leaders would not believe that the government would remain unyielding when loud cries are raised about unemployment being "wantonly created" by the "hirelings of Wall Street" working for "banking interests" and other "enemies of the poor people".

An alternative policy for discouraging businessmen from raising prices and granting higher wages would be to reduce or abolish protective tariffs. This would,

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of course, be effective chiefly in industries now protected. Competition through imports from abroad has in several countries been the most effective safeguard against price inflation and, Congress willing, it could become so in this country. I am afraid, however, Congress is not willing; it will not use this simple, efficient and economic safeguard against inflation.

If neither supportive nor protective policies are abandoned, exhortation and the pressure of public opinion remain as the only possible courses of action short of direct controls. Exhortation alone, without strong public opinion behind it, can be written off as worthless. Public opinion cannot be aroused against aggressive wage increases as long as the people do not clearly understand the issues. And they will not understand them as long as we go on confusing them with the ability-to-pay argument for wage increases. You, the members of Congress, and we, professional economists, have obscured the issue by careless talk about the ways of distributing the fruits of increased productivity. It is our paramount duty to clear up the confusion on this matter.

Real National Product per worker may increase either because more capital becomes available per worker or because improved technology and organization allow more output to be produced with given capital and given amounts of labor. Apart from a few modifying influences, such as a whittling down of the real claims of recipients of contractual incomes or a lucky improvement in the terms of trade, real wages per worker cannot increase faster than product per worker. If <u>money</u> wage rates are raised faster than productivity and if the monetary authorities supply the money needed to pay the increased wages without unemployment, prices will rise enough to keep <u>real</u> wage rates from rising faster than productivity. To say that the price inflation has the "function" of keeping the increase in real wages down to the rate at which productivity increases may help some to understand the mechanism. But it is not really an appropriate expression, for nothing has to "function" to prevent from occurring what cannot occur anyway. Either prices rise (with the help of a supportive expansion of demand) and cut the

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real wage rates to the level made possible by the productivity increase, or unemployment occurs (if inflation is prevented or restrained) and cuts total real wages even lower.

If money wages were not increased at all and all increments to the net national product that are due to technological progress were distributed to consumers in the form of lower prices, all income recipients - wage earners, owners of businesses, and fixed-income recipients - would share in the increased product. If money wages all over the economy are increased approximately by the rate at which average productivity has increased, prices on the average will neither fall nor rise and hence the fixed-income recipients (bondholders, landlords, pensioners, perhaps also civil servants, teachers, etc.) will be cut out of their share in the increment. Thus, aggressive money wage increases which, on the average, equal the average increase in productivity in the economy will improve the income share of labor at the expense of the receivers of contractual incomes.

It is now an almost universally accepted "rule" that both price stability and full employment can be maintained if all money wage rates are increased by the same percentage by which average productivity has increased in the economy as a whole. This "rule" is frequently misunderstood and mistakenly applied to advocate increases in money wage rates in individual firms or industries by the same percentage by which productivity has increased in these firms or industries. In other words, the rule is perverted to the proposal that the benefits of advancing productivity should accrue to the workers in the industries in which the advances take place. It is twisted into a proposition justifying

> "union demands in those industries, which, because of improved technology and consequent cost reductions, can afford to pay higher wages without charging higher prices for their products. This proposition is thoroughly unsound. It misses completely the economic function of prices and wages; its realization would sabotage the economic allocation of resources without serving any purpose that could be justified from any ehtical or political point of view."[1]

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1 Fritz Machlup, The Political Economy of Monopoly (Baltimore: Johns Hopkins Press, 1952), p.403.

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A sensible allocation of resources requires that the same factors of production are offered at the same prices to all industries. It causes misallocations if industries in which technology has improved are forced to pay higher wages for the same type of labor that rates lower pay in industries where technology has not changed. Wage rates should be temporarily higher in fields into which labor is to be attracted, not in fields where labor is released by labor-saving techniques. It is economic foolishness to advocate that wage rates should be forced up precisely where labor becomes relatively abundant.

> "One might accept an economically unsound arrangement if it were ethically much superior. But no one could claim that the proposition in question satisfied any ethical norm. If five industries, let us call them A, B, C, D, and E, employ the same type of labor; if any of them, say Industry A, develops a new production process and is now able to make the same product as before with half the amount of labor; then this Industry A could afford to raise its wage rates without raising its selling prices. Should now workers in Industry A get a wage increase of 100 per cent while their fellow workers in Industries B, C, D, and E get nothing? Should the coincidence that the technological advance took place in A give the workers there the windfall of the entire benefit, raising them above the rest of the people? I can see no ethical argument that could be made in favor of such a scheme."
>
> "But as a matter of practical fact, apart from economics and ethics, the scheme could never be consistently applied, because the workers in other industries would not stand for it...similar wage increases would have to be given in all...firms and industries regardless of their ability to pay, regardless of whether their selling prices would remain stable or go up slightly or a great deal. It simply would not be fair if a favored group were to be the sole beneficiary of progress while the rest of the population would have to sit back and wait for better luck."[2]

No fair-minded person would ask them to sit back and wait; every labor union with any power at all would go to bat for its members, and where no unions exist workers would eventually appeal to their employers and to the public to end the injustice. Yet, any "equalizing" wage increases would be clearly of the cost-push type and would, if unemployment is prevented, lead to consumer price increases which take away from the originally privileged worker groups some of the real gains they were first awarded with the approval of short-sighted politicians.

2 Ibid., pp. 404-405.

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This spill-over of money wage increases and the cost-push inflation which it produces (with the help of a supportive demand inflation) serves to redistribute the productivity gains first captured by the workers in the industries where the gains occurred. This redistribution by means of consumer-price inflation cuts back the real wages of the first-successful labor groups, whose unions will then complain about the corrosion of their incomes and will call for seemingly defensive wage increases to regain the ground lost through inflation.

In short, a policy that condones wage increases in industries which thanks to increased productivity can afford to pay increased wages without charging increased prices, is actually a policy that accepts a rising cost-price spiral without end. It is not significant in this respect how big are the profits of the industries that are the first to be forced to grant the increased wages; it is irrelevant how well they can afford to pay these wages; and it is not essential whether these firms shift the incidence of the increased wages onto the consumers by raising the prices of their products or whether they absorb the wage increase. For obviously the spill-over wage increases will hit industries which could not possibly absorb the increased labor cost; in addition, the spending of increased wages, financed by induced and supportive demand expansions, will pull up prices all over the economy.

When a labor union demands annual wage rate increases of four per cent or more and points to substantial increases in productivity and profits in their industry, it is unsound to ask for a fact-finding board to establish by just how much productivity has increased in the industry in question and how large are its profits. It is unsound because these facts are not essential and we are apt to confuse the public about their relevance. The relevant fact is whether or not the demanded increase in wage rates (or employment cost) is in excess of the average increase in productivity in the economy as a whole, which has been something like two or two and one-half per cent a year.

This is then what the public should learn to understand: whenever any group in the economy wants to raise its real earnings faster than the rest of society,

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there will be other groups who will insist on similar raises; since they exceed the increase in total output, these claims can be satisfied only at the expense of the rest of the people, who will be deprived of parts of their real incomes by means of price inflation. Whether the profits of the industries where wages are raised first have been exorbitant or moderate does not make much difference to the outcome. An immoderate wage increase - immoderate in that it exceeds the average increase in productivity in the economy as a whole - will result in inflation and will take income away from those who have no bargaining power or are not equally aggressive in its exercise.

If most people understood this, public opinion would be aroused whenever a labor group, already having secured special advantages in previous years and earning much more than others of similar training, skill and industry, should come forward with additional demands for pay increases. They would have little sympathy with these demands if they understood that not the profits of rich corporations but their own modest real incomes would be reduced as a result of the ambitions of the aggressive group. Conversely, if every group demanding a raise of more than the average improvement rate felt that public opinion is solidly against it and that people considered the move a selfish attempt to gain at their expense, aggressiveness would probably be diminished. Past experience seems to indicate that public opinion is an important factor in wage settlements.

This hope of mine, that improved understanding will eventually lead to an alleviation of the aggressiveness in wage demands and will thus act as a check on cost-push inflations, does not make me sanguine about monetary restraints becoming dispensable. The monetary brakes on credit and demand expansion cannot be relaxed, they remain the only reliable instrument of inflation control. They are especially indispensable as long as public opinion still condones substantial increases in money wage rates and large parts of the public still believe that higher and higher money wage rates are good for the national economy.

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Creeping Inflation and Employment

The conclusion that it would be well to avoid aggressive wage increases exceeding the average increase of productivity in the entire economy does not yet dispose of the questions whether there is a conflict between the goals of full employment and stable price level, whether one of them should be given priority, and how much of one should be sacrificed to approach the other more closely.

The thesis that a creeping inflation will permit higher levels of employment than could be secured under a stable price level must be rejected, at least in the form stated. A creeping wage-push inflation, surely, does not increase employment, but can at best help avoid a reduction of employment; that is to say, it may prevent some or all of the unemployment that would be brought about by immoderate increases of wage rates. Assume that, at an employment level of 95 per cent of the labor force, some labor groups secure increases in money wage rates which spill over to other labor groups and cause average money wage rates in the economy to rise by some 6 per cent. If productivity has increased on the average by only 2 per cent, unemployment would be substantially increased unless induced and supportive demand expansions permitted a rise of the price level by roughly 4 per cent. Assume now that a mild restraint of the monetary expansion holds the price inflation down to 3 per cent. As a result, the employment level would be reduced. In other words, the 3 per cent creep of the price inflation would be associated with a fall, not a rise, in employment.

A creeping demand-pull inflation may succeed in raising the level of employment as long as responsive wage increases are delayed. The power of an autonomous expansion of demand to create employment depends strictly on the existence of a lag of costs, and hence also a "wage lag", behind the new spending. The length of the wage lag is apt to diminish as trade unions become familiar with the working of price inflation and insist on re-negotiations of wage contracts to adjust to increased costs of living, or even on escalator clauses linking wage adjustments automatically to increases in the consumer price index. As the wage

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lag diminishes or disappears, the effectiveness of a demand expansion in raising employment diminishes or disappears.

Some economists have spoken of the "money illusion" in this context. A demand expansion that leads to increased prices will promote employment only as long as the money illusion works. If the illusion is gone and wage rates catch up and keep pace with product prices, demand expansion will not do anything for employment.

Hence, one cannot say correctly that there is a conflict between a stable price level and full employment. The maintenance of full employment does not require a rising price level, nor is it, in the long run, aided by a rising price level. This statement must be qualified by the "long run" clause in order to allow for the possibility that brief spurts of demand-pull inflation raise employment temporarily to a level sometimes called "over-full employment". "Maximum employment", mentioned earlier in this statement, is such a level of employment, reached temporarily under the impact of a lead of "demand prices" over costs. If institutional arrangements facilitate faster adjustment of cost-prices, chiefly by reducing the intervals between successive wage increases and between successive increases of administered prices, only a further speed-up of the demand expansion can keep employment at the "maximum level". The day of reckoning comes sooner or later and, as the price inflation is slowed down or stopped, the employment level falls back - usually below the full-employment level, however defined, and leaves us with considerable unemployment.

At that point the monetary authorities are usually criticized for "creating" unemployment or for "allowing" employment to fall. It is true that perhaps another acceleration of the demand-pull inflation might have postponed the recession of employment, but probably only at the expense of more serious consequences, especially a more drastic depression of employment at a later time.

On the basis of these considerations I conclude that, while there is a conflict between "short-run maximum" employment and price-level stability, there

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is no conflict between the latter and a high level of employment in the long run, usually referred to as full employment.

Creeping Inflation and Growth

What has been said about demand-pull inflation and employment level can be carried over to a discussion of accelerated growth, but only in part because there is more to the relation between inflation and growth than just the temporary fillip to employment and output. I believe three possible effects have to be mentioned, of which the employment effect is the first:

1. The lead of demand expansion and of increases in demand-prices over increases in cost will, as long as it can be maintained, stimulate employment and output, and an increase in output will imply a higher annual "growth rate", though not a continuing one, regardless of whether the demand expansion is in government spending, business spending, or consumer spending.

2. To the extent that the demand expansion is concentrated on investment, which will be the case chiefly if most of the newly created funds are first spent by business for newly built plant and equipment, the ratio of investment to consumption is increased. This involves capital accumulation and, if the choice of investment projects is sound, this may contribute to a lasting growth of productive capacity.

3. To the extent that the demand-pull inflation of consumer prices deprives some consumers of parts of their real incomes and to the extent that this is not offset by increases in the incomes of other consumers, the resulting squeeze on consumption may give an extra opportunity to the production of capital goods.

Of these factors forcing up either total production or the capacity to produce or both, none is likely to last for anything but a brief period if cost increases follow quickly the demand expansions and if the price inflation has to be slowed down eventually or stopped entirely as is likely to be the case in many developed countries. In addition, it is very unlikely that the choice of

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investment projects will be a sound one, contributing to a lasting increase in the productive capacity of the nation, if it is made in anticipation of rising prices, partly as a "hedge" against inflation. In any case, the whole thing will not last long and the temporary acceleration of growth achieved through demand-pull inflation will have to be paid for, in due time, by a retardation of growth. The long-term rate of growth will hardly be aided by the inflation, and may even be lowered.

When some of the critics of an anti-inflationary monetary policy point to a poor growth rate and recommend a more active, expansionary policy, they usually do not consider the possibility that the poor growth rate may be a consequence of an earlier artificial speed-up of growth. There are some who believe that it is always possible to create a little more "effective demand" and thereby give another push to economic growth. This looks to me, forgive the analogy, as if someone thought you could always "energize" a man into greater activity by giving him another shot of whiskey and, when the stimulus wears off, recommend more of the same medicine. Unfortunately the stimulant, continually administered, will reduce his activity and perhaps debilitate him for a long time. If I find a man drowsy after prolonged stimulation, I shall not prescribe to revitalize him with more stimulants. I recommend sobering him up for steady work.

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Introductory Statement
Hearings on Employment, Growth, and Price Levels
before
Joint Economic Committee
on October 30, 1959

Milton Friedman
University of Chicago
and
National Bureau of Economic Research

Goals stated in terms of employment, growth, and price levels are necessarily intermediate goals deriving their significance and indeed, their very meaning, from the ultimate ends they serve. In a free society, these are the ends of the individuals who together compose the society.

The appropriate goal for employment is the fullest opportunity for each individual to use his own resources in accordance with his own aspirations and to develop his capacities to the fullest, subject only to the condition that he not interfere with the opportunity for others to do likewise. This is vastly more difficult to achieve and to describe than "full employment" defined in terms of the number of people having something called a "job" regardless of its adaptation to the capacities and aspirations of the job holder. There is little problem of achieving "full employment" in a prison or a slave state.

The appropriate goal for growth is the fullest opportunity for each individual to devote whatever fraction of his income he wishes to providing for the future, the opportunity to accumulate capital that will enable him to raise the future standard of life of himself and his children and to promote whatever social causes and activities he holds dear. The strivings of countless individuals for a better world will produce some rate of change in the statistical aggregate we call national income or output, but there is no way in a free society to say in advance that one or another numerical rate of change is "needed" or "desirable," or that a higher rate of change is "better" than a lower. And there is no

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way to compare validly the rate of change in output that occurs in response to the demands and needs of free men with the rate of change in output that occurs in response to the orders of dictators. Whatever rate of change in the statistical aggregate results from the effort of free men to promote their own aspirations is the "right" rate.

Of course, these are ideals. Their attainment is inevitably limited by human imperfections. Unfortunately, their attainment is currently limited even more by exigencies of the cold war which threaten the very existence of our free society and which require us to devote all too much of our resources to maintaining the means of national survival rather than to satisfying the aspirations of individual citizens. This very necessity enhances the importance of shaping governmental policy wisely to promote our basic ideals. Mistakes that by themselves might be easily overcome by the strength and vigor of a free society may be the final straw if added to the departures we must make to survive.

The free societies of the Western world have come closer than any others to enabling individuals to use their own resources in accordance with their own aspirations. They have done so by relying predominantly on voluntary cooperation organized through private enterprise in a free market. This is the only alternative to coordination of economic activities through the coercive power of the state that has so far been discovered. Economic freedom has produced an unprecedented development of the capacity and the productivity of individuals. It has enabled the masses for the first time in recorded history to be freed from drudging toil and backbreaking labor.

The state has played an essential role in this process by providing a legal framework, preventing physical coercion of one man by another, and helping to keep markets free. At the same time, the state has been kept in check by the market. The market has protected political freedom by enabling economic power to offset rather than reinforce political power.

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Wars aside, the chief economic threats to the preservation of a free society have come from the sharp fluctuations that have occurred from time to time in economic activity and in prices and that have threatened to tear the social fabric asunder. These partly account, of course, for this committee s concern with employment, growth, and price levels, and for the present hearings. In devising means to prevent such fluctuations, it is well to be clear about their source.

One view, which the Great Depression did more perhaps than any other single event to instill and reinforce is that a private market economy is inherently unstable and has been the source of the major periods of economic instability in our history. On this view, only a vigilant government, offsetting continuously the vagaries of the private economy,has prevented or can prevent such periods of instability. This view seems to me fundamentally mistaken. As I read the historical record, including the record of the Great Depression I reach almost the opposite conclusion. The major inflations and depressions in the United States have in almost every instance been produced, or at the very least, strongly reinforced, by the failure of government to discharge properly the tasks assigned to it, in particular the task of providing a stable monetary framework. Perhaps the most remarkable feature of the record is the adaptability and flexibility that the private economy has shown under such extreme provocation.

This conclusion is almost self-evident for the major inflations of our history. These have all been associated with war and were quite clearly produced by use of the printing press or its equivalent to finance governmental expenditures. But it can also, I believe be shown to be in accord with the major contractractions in the history of our country--from the contraction of 1839 to 1843 which was greatly exacerbated by the aftermath of the Bank War; to the contraction of 1873 to 1879, which was intensified by the deflation incidental to creating the monetary conditions for resumption of gold payments at pre-Civil-War

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parity; to the unsettled conditions of the 1890's, which owed much to agitation for free silver and uncertainty whether the government could maintain the gold standard; to the major price contraction after the post-World War I inflation, resulting from the inexperience of the Federal Reserve System in handling its new tools; to the Great Depression, in which a System established in large measure to prevent a banking panic permitted the most severe and widespread panic in our history to occur and by its actions helped to produce a decline of one-third in the stock of money although it had ample power to prevent either development; to the severe contraction of 1937 to 1938, when a collapse in investment in reaction to unwise and erratic governmental policies was reinforced by deflationary action by the monetary authorities.

Our monetary performance has been far better in the postwar period. But even in that period it has probably on balance contributed to instability. And this is almost surely true of the government's fiscal performance. The most unstable major sector of the national income has in the postwar period been government expenditures. Fluctuations in expenditures have arisen partly from the changing needs of defense. But they have also arisen from the response to recurrent recessions. Increases in governmental expenditures designed to offset the recessions have taken so much time that they have come into play in important measure only after the economic tide has turned and recovery has been resumed, thus reinforcing rather than offsetting cyclical fluctuations.

What is true about economic fluctuations is true also, I believe, about growth. While a stable legal framework and preservation of free markets are essential prerequisites for healthy economic growth, and while government has done much in these respects to promote and facilitate growth, it has taken other measures that have tended to inhibit growth. These include not only the promotion of instability just considered, but also such

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interferences with the effective operation of the free market as price fixing, subsidies to particular activities, tariffs and quotas affecting foreign trade, and taxes seriously distorting economic incentives.

I cannot hope to demonstrate these propositions in the time available. I have stated them in order to make clear the point of view that underlies the constructive suggestions I shall offer. If my reading of history is right, it means that the central task for government at the present time is not to construct a highly sensitive set of instruments that can continuously offset instability introduced by other factors or that can facilitate economic growth, but rather to mend its own ways, to cease from being itself a primary source of instability and a primary obstacle to the effective utilization of resources by individuals. What we urgently "need is not a skilled [governmental] driver of the economic vehicle continuously turning the steering wheel to adjust to the unexpected irregularities of the route but some means of keeping the [governmental] passenger who is in the back seat as ballast from occasionally leaning over and giving the steering wheel a jerk that threatens to send the car off the road."[1]

I have tried to make my suggestions specific and to keep my comments on them brief in order to reserve as much time as possible for points that may be of special interest to the Committee. My suggestions range over a wide area including monetary policy, debt management, fiscal policy, and certain aspects of international trade policy. I have omitted other areas, in particular, labor policy and anti-trust policy, not because I regard them as unimportant but because I am not

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[1]Quoted from my forthcoming "Agenda for Monetary Reform," the Moorehouse F.X. Millar Lectures given at Fordham University to be published by Fordham University Press. The words "governmental" in brackets replace the word "monetary" in the original.

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competent to discuss them in detail. With respect to monetary policy and debt management, a fuller exposition of my suggestions is contained in a series of lectures I have just completed at Fordham University and that will be available in printed form in the near future. I turn to my concrete suggestions.

A. Monetary policy

1. Replace the present vague guides to the monetary authorities by the instruction that they increase the stock of money in the hands of the public at a fixed rate specified in advance and that they not alter the rate in response to changes in business conditions. The rate of growth chosen should be designed to produce an approximately constant level of prices over the long run. Evidence to date suggests that this would require a rate of increase somewhere between 3 and 5 per cent per year, if the money stock is defined as including currency in the hands of the public and demand and time deposits in commercial banks. This rule would avoid the monetary uncertainties that have plagued us in the past, provide a stable monetary background for short-run adjustments, and assure long-run stability in the purchasing power of the dollar.

2. Streamline present Federal Reserve powers by eliminating obsolete and unnecessary powers that interfere with the ability of the System to control the stock of money and that introduce unnecessary instability. The major changes required are the elimination of rediscounting and of the power to vary reserve requirements. These are highly defective tools of monetary management. Their elimination would leave open-market operations as the major tool of monetary management.

3. Alter our gold policy by abandoning the fiction that gold has an essential monetary role. A thoroughgoing 100 per cent gold standard would have much to recommend it. Our present gold standard, or any gold standard currently within the realm of possibility, offers few of the advantages while exaggerating the

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disadvantages of a full gold standard. Elimination of disturbances arising from gold requires repeal of the present 25% gold reserve requirement for Federal Reserve Notes and Deposits; and elimination of the present commitment on the part of the Treasury to buy and sell gold at $35 an ounce. The subsequent treatment of the existing gold stock is a matter of subsidiary importance.

At present, the fixed price of gold also fixes the rate of exchange between the dollar and other currencies. No substitute means of fixing rates of exchange should be adopted. Rather, the rates of exchange should be permitted to be determined on free markets by private transactions, as rates of exchange for the Canadian dollar are now determined.[1]

4. Reform our present banking arrangements. The most satisfactory reform would be to separate the depositary from the lending and investing activities of banks by requiring depositary institutions to have reserves of 100% in the form of Federal Reserve notes and deposits. If this were done it would be desirable to pay interest on the reserves, to remove any limitations on the interest rates commercial banks may pay to depositors, to permit free entry into the depositary banking business, and to eliminate present government controls over lending and investing activities. This reform would eliminate instability arising out of shifts in the fraction of its money the public wishes to hold in the form of currency and in the fraction of their assets banks want to hold in the form of cash or Federal Reserve deposits. It would establish a closer link between Federal Reserve action and the money supply.

A less far reaching yet desirable reform would be to make member bank reserve requirements uniform for all classes of banks and all deposits, whether demand or time; to put into effect the

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[1]I have examined "The Case for Flexible Exchange Rates," in some detail in an article by that title which appears in my Essays in Positive Economics (Chicago: University of Chicago Press, 1953), pp. 157-203.

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recently enacted power to treat vault cash as satisfying reserve requirements; to pay interest on reserves held in the form of Federal Reserve deposits; to remove the present prohibition of the payment of interest on demand deposits; and to repeal the present power of monetary authorities to limit the interest payable on time deposits. The change in reserve requirements should be made in such a way that the net effect is neither expansionary nor contractionary.

B. Debt Management

1. Debt management and open market operations are essentially the same monetary tool, differentiated now only by the agency that wields it. The technically most efficient arrangement to coordinate debt management and open market operations would be to assign responsibility for debt management to the Federal Reserve. Whether this is done or not, there remains the question of substance. For simplicity, the following substantive recommendations assume present administrative arrangements.

2. Restrict marketable issues to at most two kinds, say a 90-day bill or its equivalent for seasonal needs, and an intermediate or long-term security, say an 8 or 10-year maturity when issued. Float such securities at regular and close intervals, preferably weekly, if not bi-weekly or monthly, in amounts announced long in advance and varying from date to date as smoothly as possible. These two steps would eliminate the present bewildering array of securities differing in maturity and terms and the present bunching of refinancing and issuance of securities at a few dates which render debt management operations a potent source of instability.

3. Sell all securities exclusively by auction so the market can set the price. The method of auction should however differ from the method now used for bills under which purchasers submit a single bid for a specified quantity and pay the amount bid if their offer is accepted. The present method involves

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payment of different prices by different purchasers, which tends to limit the market to specialists and to establish a strong incentive for collusion among bidders. A preferable alternative is to ask purchasers to specify the amounts they are willing to buy at a schedule of prices, determine a single price so as to clear the market, and charge all purchasers that single price.[1] So far as I can see, the adoption of this alternative technique would meet every objection to the sale of long term securities at auction that was offered by the Treasury department to this committee at the Hearings on July 24, 1959. Every one of the objections derived from the assumption that the particular method of auctioning now used for bills would also be used for long-term securities.

Adoption of this recommendation would require elimination of the present legal ceiling on the rate of interest that the Treasury may pay on longer-term securities. This limitation should be removed in any event.

C. Fiscal Arrangements

1. To promote economic stability, it is desirable to avoid erratic and sudden changes in governmental expenditure programs so far as possible, and in particular, in response to changes in economic conditions. With a stable program of expenditures and a stable tax structure, changes in economic conditions automatically produce shifts in the governmental budget toward a surplus in time of expansion and a deficit in time of contraction. This built-in flexibility is all to the good. Attempts to go still farther have in practice had the effect of fostering rather than curing instability.

2. To promote ecnnomic productivity and growth, a

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[1]An equivalent alternative, of course, would be to fix the price and conduct the auction in terms of the coupon rate, again settling on a single coupon for all purchasers.

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thorough reform of our tax structure is required. The present structure distorts incentives and discourages effort, and thereby leads to much waste, and it does so in ways that produce glaring inequities. The major reforms that seem to me desirable are:

a) The ultimate elimination of the corporation income tax. Instead, corporations should be required to attribut their undistributed income to stockholders and stockholders should be required to include their pro-rata share of undistributed income in income subject to the individual income tax.

b) Reform of the individual income tax to reduce drastically the nominal rates imposed in the high brackets and to widen greatly the tax base. These high nominal rates have been responsible for the proliferation of provisions reducing the amount of income subjected to them. This has mitigated the adverse effect of the rates on incentive but only at the cost of producing a misdirection of resources to take advantage of the provisions, and a largely arbitrary distribution of the tax burden, with persons in essentially the same economic position paying vastly different taxes, depending on their accidental capacity to take advantage of special provisions. Taxes finally paid would be both more equitably levied and less disturbing to efficiency if rates were drastically lowered and the base expanded and changed. The most important changes required in the base are the elimination of percentage depletion on oil and other raw materials; the elimination of tax exemption of interest on state and local securities; the coordination of income, estate, and gift taxes; and provision for averaging income over a period, which would also permit a more satisfactory treatment of capital gains.

D. International Trade Policy

1. To permit a more efficient utilization of our resources, and thereby to promote economic growth in accordance with the preferences of our citizens, we should move toward the complete elimination of restrictions on international trade. Recent years

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have seen a growing use of direct physical limitations on trade, such as import quotas. Such physical limitations are even worse than tariff barriers, since they are equivalent to prohibitive tariffs on any additional amounts, involve arbitrary subsidies to persons or enterprises assigned quotas, and have generally been imposed or removed by administrative discretion rather than legislative action. A recent important example is the imposition of restrictions on oil imports. The most urgently needed step currently is to erect effective legislative barriers against the use of such direct physical impediments to trade.

2. One major factor that accounts for the use of direct limitations is our agricultural policy, which has been perhaps the single most important source of increased impediments to international trade. The attempt to maintain domestic prices at a level above world prices has enforced segregation of markets, and has led to quotas on imports and the sale of exports at prices below internal prices--a process widely called "dumping" when done by private parties. In my view, no governmental policy has done so much to undermine our attempt to promote a wider use of the market mechanism in conducting the economic activities of the world as our agricultural policy. In the long run, this external effect may turn out to be even more harmful than the waste of our domestic resources produced by our agricultural policies. The best way to resolve this problem would be to eliminate agricultural price supports entirely and to sell off government stocks at a steady rate over, say, the next five years.

3. With respect to tariffs, we should unilaterally move toward their reduction and eventual elimination by providing in advance for a series of regular annual reductions spread over, say, the next 10 years. There are few measures we could take that would do so much at one and the same time to expand the effective freedom of our own citizens and to stimulate foreign countries, particularly the less developed, to rely more heavily on free market techniques in organizing their own economies.

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I recognize that these suggestions will appear at once drastic and negative. They would require far-reaching changes in present arrangements and seriously disturb important vested interests. Yet they offer no easy answers to hard problems, no devices for government to adopt that can guarantee either perfect stability or rapid growth. Drastic measures are certainly not politically feasible. But a clear sense of the direction in which we want to move is necessary to guide the small steps that are feasible. If the suggestions appear negative, it is because I have been concentrating on the role of government. In a free society, the positive source of economic prosperity is to be found not in the plans of the few but in the voluntary strivings of the many. Government serves best when it fosters those strivings.

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Congress of the United States
House of Representatives
Washington, D. C.

COMMITTEES:
BANKING AND CURRENCY
CHAIRMAN, SMALL BUSINESS OF THE HOUSE
VICE CHAIRMAN, JOINT ECONOMIC COMMITTEE
JOINT COMMITTEE ON DEFENSE PRODUCTION

SECRETARY:
MRS. LUCILLE SPAIN

August 17, 1959

Hon. William McC. Martin, Jr.
Chairman, Board of Governors
Federal Reserve System
Washington 25, D. C.

Dear Chairman Martin:

During the course of your recent appearance before the Joint Economic Committee, it was agreed that in order to save your time and the time of the Committee, individual members who cared to do so would submit additional questions to you in writing and have the answers returned in writing for inclusion in the record of the Committee's hearings. Accordingly I am attaching herewith 48 questions for which I would like to have the answers appear in the Committee's record.

While these questions appear lengthy, running to some seven typed pages, I believe they can be answered briefly and readily. In fact, the reason for the rather lengthy way in which the questions are stated is to explain the questions in detail and make clear the particular interest with which the question is asked, so as to make quick and short answers possible.

In some instances the questions ask about studies or statistical analyses which you may have made, but original studies or compilations are not called for.

Sincerely,

Wright Patman

cc. Hon. Paul Douglas, Chairman

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1. Is it the Federal Reserve's position that its monetary policies have had their practical effects principally through interest rates, or principally through money supply?

2. Is there any factual evidence that, over the past decade, price changes have been correlated with changes in the money supply? If so, please present the evidence.

3. Is there any factual evidence that people have saved a larger percentage of their incomes in periods when interest rates were high than in periods when interest rates were low? If so, please present the evidence.

4. Is it the Board's position that the principal effect of the change in interest rates is upon the demand for funds, or upon the supply of loanable funds?

5. Has it been the Federal Reserve's experience that it can, or cannot, significantly influence the level of interest rates without making corresponding changes in the money supply?

6. Has the Federal Reserve had occasion to be concerned with any significant tendency for interest rates to be "sticky" - that is, any failure of interest rates to come down promptly when increases in the lending capacity of the banks were made or, conversely, any tendency for interest rates to rise when the supply of money has not been tightened? If so, please describe these occasions and the steps that were taken to bring about the desired responses.

7. What are the major factors which have been found, if any, which have caused interest rates to fail to come down when the money supply was increased, or which have caused interest rates to rise when no corresponding change in the supply and demand for money had occurred?

8. What steps has the Federal Reserve taken, if any, in an effort to influence the level of interest rates other than that of changing the supply of member banks' reserves?

9. On the basis of past considerations, what steps does the Federal Reserve think it could take, within its present authority, that might influence interest rates independently of the supply of credit?

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10. Has the Federal Reserve noted any occasion when interest rates were influenced by speeches, public pronouncements, and so on, by members of the Board? If so, please describe.

11. What interest rates, if any, are most effective in dampening an investment boom - short-term rates, intermediate-term rates, or long-term rates?

12. At about the beginning of its anti-recessionary program in late 1957, the discount rate was reduced from 3-1/2% to 3% on November 15 and the several days immediately following. Yet it was not until January 22 of 1958 that a reduction in the prime rate was announced (from 4-1/2% to 4%). Did the Federal Reserve expect or hope to attain a reduction in the prime rate by an earlier date? (If some rate other than the prime rate is considered to be a more significant measure of bank lending rates, please answer also in terms of that rate.)

13. Following the reduction in the prime rate to 4% on January 22, there were 3 reductions in the discount rate (beginning at 3% and ending at 1-3/4%), and 3 reductions in required reserves. Yet it was not until April 21, approximately 3 months after the first reduction in the discount rate, that the prime rate was reduced again (to 3-1/2%). Please state whether the Board had expected or hoped to attain (a) a reduction in bank lending rates with substantially less addition to bank lending capacity than was made, and (b) a reduction in bank lending rates at a substantially early date. Please state also what was expected or hoped for in each case. If so, please state also what efforts were made (other than those directed at increasing bank lending capacity) to obtain either an earlier or a more substantial reduction in the prime rate.

14. With reference to those periods when the Federal Reserve was attempting to restrain an investment boom, such as in the 1956-57 period, is there any factual evidence that monetary restraint had any direct effect (other than through eventual curtailment of consumer demand) on the investment plans of corporations above the $100 million asset size? If so, please describe the evidence and indicate particularly what the effects of the credit restraint were as to the following: (a) investment expenditures from retained earnings; (b) corporate cost schedules, and (c) temporary shifts from long-term financing to short-term financing for expansion funds.

15. With reference to the tight-money period of 1956-57, has the Board made an analysis of the effects of high interest and tight money upon: (a) the rate of economic growth, (b) small business expansion and failures, (c) farm income, (d) consumer prices, (e) home building, and (f) expansion of State and local facilities? If so, please outline what the principal immediate effects upon each have been.

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16. With reference to the tight money period of 1956-57, please describe what effects the System's methods of monetary restraint had upon lending by the insurance companies, the mutual savings banks, and other so-called "intermediaries," indicating particularly the time lags before the System's policies were transmitted to these "intermediaries," as well as the volume of lending and changes in interest rates brought about.

17. It has previously been indicated that the principal maladjustment which the Federal Reserve saw in the 1956-57 period was a faster increase in productive capacity than in consumer demand. Did the Federal Reserve take any steps then, or since, to stimulate consumer demand? If so, please describe what steps were taken.

18. Has the Board had occasion to be concerned about noncompetitive factors in the money and securities markets, such as might hamper the effectiveness of its monetary controls? If so, please describe the general nature of the problems encountered.

19. Have fears of inflation caused a significant increase in interest rates?

20. Is it the Board's conclusion that fears of inflation have caused a significant change in the rate of savings during the past 7 years?

21. Is there any factual evidence that there has been a change in the rate of savings in this period? If so, describe.

22. With reference to its monetary policies for the present and for the period immediately ahead, what are the main problems in the economy which are the objects of this policy? Has the Federal Reserve established any quantitative targets or criteria to be accomplished? If so, please state what they are?

23. With reference to the System's present policy of monetary restraint, and the objectives which the System hopes to achieve in the months ahead, have any tentative estimates been made, or any outside limitations established, as to (a) the degree of unemployment, (b) the rate of economic growth, or (c) the level of consumer spending, which the System is willing to accept, if necessary, to achieve its objectives? If so, please state what these estimates or limitations are.

24. With reference to the reductions in required reserves of the member banks in 1953, 1954, and on 4 occasions in 1958, was the decision that credit should be eased on each of these occasions first made by the Board of Governors or by the Federal Reserve Open Market Committee?

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25. With reference to the reductions in required reserves in 1953, 1954, and 1958, please state in each case whether the conclusion that the desired ease of credit should be accomplished by reductions in required reserves, rather than by purchase of securities in the open market, was first reached by the Federal Reserve Board or by the Federal Open Market Committee?

26. Has there been any occasion when there was a difference in view as between a majority of the Board and a majority of the Open Market Committee as to what monetary policy was currently most appropriate? If so, please describe the occasion, the nature of the issue, which side of the issue the two groups were on, and how the issue was resolved?

27. Has there been any occasion when there was a difference in view as between the majority of the Board and a majority of the Open Market Committee as to the question whether current monetary policy should be effectuated through open market operations or through reduction in required reserves? If so, please describe the occasion, indicating which side of the issue the two groups were on, and how the issue was resolved?

28. Has there been any occasion when members of the Board have protested, informally or otherwise, that monetary policy as decided by the Open Market Committee was not being carried out according to the members' understanding of the policy decision?

29. Has it been the Board's position, over the past 5 years, that the discount rate should be the same in all 12 Federal Reserve Districts, or has the Board attempted to maintain different discount rates when there may have been marked differences in the levels of economic activity as between the different regions?

30. Please indicate, as a practical matter, the genesis of changes in discount rates over the past 5 years, indicating particularly whether the impetus for the change has come from the Board of Governors or from the Reserve Banks.

31. Has there been any occasion when the Board failed to adopt the discount rate recommendation made by a Reserve Bank or, conversely, when the Board or the Chairman suggested to a Reserve Bank what discount rate the bank should recommend?

32. Who determines lending policies of the Federal Reserve Banks, the Board, the Open Market Committee, or the individual Reserve Bank?

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33. When either the Open Market Committee or the Board is effecting a change in credit policy, are there also associated changes in policies of the Reserve Banks as to the volume of bank credit which may be extended through the discount window? If so, how is such policy concerning discount window activity coordinated with the general monetary policy?

34. How are differences in economic conditions among the different regions provided for in Federal Reserve policy-making?

35. Please describe the circumstances which have led the Board to recommend or approve more lenient lending by the Federal Reserve Banks to member banks in areas of high unemployment.

36. Please describe the role of the Federal Advisory Council, its part in determining discount rates, and the functions which the Board has found to be of most service.

37. Have Federal Reserve authorities ever investigated the possibility of a "leak" of information from inside the System concerning a prospective change in credit policy? If so, has evidence been obtained that such a "leak" has occurred?

38. Has the Federal Reserve made, or had made, any study to determine with how many different member banks, or in how many different cities and towns, the Government securities dealers trade and what the frequency or regularity of such trading is? In other words, one of the justifications which has been given for the dealer market, for the Federal Reserve "open market" trading with the 17 dealers, and for the Federal Reserve making repurchase agreements with these dealers is that the dealers serve the needs of the banking system by distributing bank reserves and thus balancing the supply of loanable funds with local demands for credit; so the question here goes to the point whether or not the Federal Reserve has collected information which would indicate how extensively the 17 dealers do in fact perform this function for the various member banks.

39. With reference to S.1120, a bill to amend the Federal Reserve Act with respect to reserves required to be maintained by member banks, did the Federal Open Market Committee approve this legislation? If so, please state the following: (a) The date of approval, (b) whether or not there were any dissenting votes, (c) which members dissented, if any, and (d), please also submit any statement which the Federal Open Market Committee may have acted upon relative to the purpose for recommending the legislation or relative to any limitations which the System would be expected to observe in using its authority to reduce required reserves of member banks.

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40. With reference to S.1120, a bill to amend the Federal Reserve Act with respect to reserves required to be maintained by member banks, did the Board of Governoss approve this legislation? If so, please state the following: (a) The date of approval, (b) whether or not there were any dissenting votes, (c) which members dissented, if any, and (d), please also submit any statement which the Board of Governors may have acted upon relative to the purpose for recommendigg the legislation or relative to any limitations which the System would be expected to observe in using its authority to reduce required reserves of member banks.

41. Mr. Martin has indicated in his testimony to the Committee that it was at his request that the American Bankers Association initiated the study and recommendations which were made for reducing required reserves in its report of February 1957. Did this request to the American Bankers Association have prior approval, or concurrence, of (a) The Federal Open Market Committee, (b) the Board of Governors? If so, please give the date or dates when these bodies acted to approve this request.

42. When the Treasury purchases gold from a foreign central bank, does this gold flow through member banks?

43. Please indicate the nature of each transaction, in sequence, taking place between the Treasury and the member banks and the Federal Reserve System and the member banks which is involved in the acquisition by the Treasury of gold from a foreign central bank.

44. Recognizing that several different statistical measures of the money supply are available and that at different times for different purposes one or the other of these measures has been considered the most appropriate, which of the definitions of money supply do you consider most appropriate for the purpose of determining whether or not the money supply is being increased too much or too little in relation to the amount of economic activity taking place?

45. Please supply data comparing the relative increase in the money supply with the relative increase in the real Gross National Product in the 4 peacetime years just prior to the Federal Reserve-Treasury "accord" early in 1951 and in each of the three 4-year periods beginning with 1951.

46. In its oonsiderations of the question of what the appropriate money supply should be, please indicate the nature of the consideration given to the rate of use, or the velocity, of money and supply also a comparison of the velocity of money in each of the 3 4-year periods specified in question #45.

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47. How does Chairman Martin define (a) "printing-press" money, and (b) "fiat" money? Please name the two kinds of money which are in use in the largest volume in the United States today, indicating the relative volume of use, and stating also how these two types of money differ from (a) "printing-press" money and (b) "fiat" money.

48. In the Board's annual report for 1957, under the digest of principal policy actions, at page 32, action for the period January-June 1957 is described as follows: "Reduced holding of U.S. Government securities by about $1.8 billion. Member bank borrowings increased from an average of $400 million in January to $1 billion in June."

Then under "Purpose of Action" the reason given for reducing holdings of U.S. Government securities is to offset seasonal factors and offset the acquisition of $600 million of gold by the Treasury while simultaneously, the reason given for increasing loans to member banks is "to exert pressure on bank reserve positions by bringing about a higher level of member bank borrowings."

Please explain more fully how objectives of monetary controls were improved by (a) reducing the Federal Reserve's holdings of Government securities to reduce bank reserves, and conversely, increasing Federal Reserve loans to member banks and thus increasing the amount of their loanable funds.

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AUG 7 1959

The Honorable Henry S. Reuss,
House of Representatives,
Washington 25, D. C.

Dear Mr. Reuss:

In connection with my testimony before the Joint Economic Committee last Thursday, you asked me about forces affecting wholesale prices. It was not clear to me at the time exactly what aspects of this matter you had in mind and wanted me to discuss. As you are no doubt aware, it is an extremely complex question, because any index of wholesale prices necessarily includes many different items which are subject to a host of different influences.

It so happens that one of the members of our staff has recently completed a very interesting analysis of basic commodity price movements in the recent period and, in view of your expressed interest in the subject, it occurred to me that you would like to have a copy. I am, therefore, enclosing, for your information, the paper prepared by Mr. Murray Altmann of our Division of Research and Statistics.

A copy of this letter and its enclosure is being sent to Chairman Douglas.

Sincerely yours,

(Signed) Wm. McC. Martin, Jr.

Wm. McC. Martin, Jr.

Enclosure.

GEN:

JWS:cd

cc: Chairman Paul H. Douglas.

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AUG 7 1959

The Honorable Paul H. Douglas,
Chairman,
Joint Economic Committee,
Washington 25, D. C.

Dear Mr. Chairman:

Enclosed is a copy of a letter which I am sending today to Congressman Reuss, together with a paper dealing with basic commodity price indexes in relation to price analysis.

It occurred to me that the paper might be of interest to you and probably to the other members of the Committee.

Sincerely yours,

(Signed) Wm. McC. Martin, Jr.

Wm. McC. Martin, Jr.

Enclosures.

JWS:cd

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July 31, 1959

Basic Commodity Price Indexes in Relation to Price Analysis

by Murray Altmann

Since recovery from the 1957-58 recession began in the spring of 1958, prices of basic industrial commodities have generally advanced. Prices of basic foodstuffs, meanwhile, have generally declined. In consequence, most regularly compiled indexes of "basic commodities" have shown only small changes. This behavior very closely resembles developments in the first year of recovery from the 1953-54 recession.

Study of commodity-price developments can be very useful in cyclical analysis. As indicators of demand trends or of prospects for more comprehensive measures of prices, however, the basic commodity indexes are of questionable value. Furthermore, they make little if any contribution to an understanding of price-level changes over longer periods. A rationale of changes in price levels between two points widely separated in time requires study of the process of change in the intervening period--a study of the interaction of demand, cost, productivity, and price developments.

Most of the basic commodity indexes were developed many years ago when agriculture was a relatively larger part of the economy than now and when, prior to the modern type of Federal price support programs, prices of some agricultural commodities fluctuated more widely. Consequently agricultural commodities, mainly foodstuffs, have weights in these indexes which far exceed their current importance in commodity production and trade.

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The emphasis on agricultural commodities, and the omission of such important industrial materials as lumber and fuels, also results partly from the requirement that the indexes be calculated daily. It would be accidental if a list of commodities chosen on this basis were representative of general commodity-price developments. The approach is indicated in the following quotation from a description of Moody's index, contained in "Commodity Price Indices," published in 1937 by the National Association of Purchasing Agents. "The number of commodities in the index was limited to 15 leading staples, to enable its prompt compilation daily, soon after the close of the various markets. Yet this limitation did not prevent the inclusion of practically all those raw products, dealt in on recognized central exchanges for futures and actuals, in which general day-to-day business and speculative interest is centered and which are commonly referred to in daily market reviews as 'commodities.'"

Recent changes in basic commodity prices and price indexes

The attached table shows price changes for commodities which, in various combinations, are generally included in basic commodity indexes, and for a few commodities, such as lumber and leather, which usually are not included. Of the 15 industrials, all but 3 have risen since the spring of last year, and 10 have increased 10 per cent or more. On the other hand, every one of the 9 foodstuffs in the table has declined, and decreases for 5 have exceeded 10 per cent.

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As a generalization, it might be said that short-run analysis of demand trends--of requirements of materials for use and inventory in manufacturing--focuses on the industrial items. The foodstuffs as a group are more often subject to sharp changes in supply which are not directly related to current trends in demands and economic activity; the expansion in hog production and marketings taking place this year is an example. Moreover, changes in prices of some of the foodstuffs (and cotton as well) in recent years have been largely in response to changes in Federal price support programs. These programs tend to limit advances in prices when demands expand or production declines as well as to limit price declines; the stocks accumulated in the process of supporting prices in years of large output become available at around support levels should demands expand sufficiently or should production be curtailed.

The table also shows changes for a few of the more familiar published indexes of basic commodities. The BLS daily index of 22 commodities has risen only 1 per cent since the spring of last year when recovery began in the United States. This index is divided into raw industrials and foodstuffs, with the former having an influence in the total of somewhat more than half by virtue of the fact that it includes 13 of the 22 commodities. The rise of only 1 per cent in the total occurred despite an average increase of 14 per cent in the industrials as foodstuffs declined 14 per cent.

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Reuter's index has declined 1 per cent since the spring of last year, and the recent level is the lowest since 1946. This index, which is often used as a measure of changes in "world commodity" prices, is a weighted average of 21 foodstuffs and industrial materials, but the weights are such that its movement is disproportionately influenced by wheat, sugar, and other foodstuffs. Among the nonfood commodities, cotton has the heaviest weight.

The Dow-Jones indexes have also declined since the spring of 1958. These are very like the Reuter's index in that cotton, wheat, and sugar have the heaveist weights of the 12 commodities included.

Moody's daily index has declined 4 per cent in the same period. Eight of the 15 commodities included in this index are industrial, but among these are silver and silk--two commodities of much less importance currently than in prewar days. As in the Reuter's and Dow-Jones indexes, furthermore, wheat and cotton are heavily weighted. So also are hogs and sugar.

Recent changes in special groupings of wholesale prices

Special groupings of foods and foodstuffs and industrial commodities, within the framework of the BLS wholesale price index, have been calculated at the Federal Reserve since the 1930's. Further breakdowns of these groups have also been provided--the industrial into materials and finished products, and the foods and foodstuffs into livestock and products and crops and products. This year, a further breakdown of the industrial materials has been developed,

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based primarily on the responsiveness of prices to short-run shifts in demands; they are called sensitive materials and, for want of a better title, other materials. These two groups, shown in the middle panel of the accompanying chart, together with the two groups of finished products shown in the bottom panel, comprise all the industrial commodities in the wholesale price index.

The index of sensitive materials is broader in its coverage of industrial commodities than most basic commodity indexes. It includes ferrous and nonferrous scrap; refined nonferrous metals and mill products; rubber; hides and leather; textile fibers and intermediate products; lumber and plywood; wastepaper; and residual fuel oil. These items account for one-fourth of the weight of all industrial materials in the wholesale index. Monthly, rather than daily or weekly, calculation of the index made it possible to include many of these commodities. Since prices of many of the items are available weekly or daily, however, it is possible to make reasonably good current estimates when they are desired.

The fairly smooth cyclical pattern of the sensitive materials index is apparent on the chart. So also is the tendency of the other industrial materials group to lag during the last two expansions in activity and to show downward inflexibility in the last two recessions. Furthermore, while these indexes should not be used in any strict stage-of-manufacturing analysis, in combination with measures of capacity and output of materials they are useful for analysis of price pressures and prospects.

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In 1954, for example, recovery in output of materials was preceded by an upturn in average prices of sensitive materials. Prices of steel scrap and nonferrous metals began to rise rapidly early in the second quarter, and rubber and lumber began to advance soon thereafter. After midyear, fuel oils turned up. Hides and leather declined further through 1954 but then turned up at the beginning of 1955. Textiles were generally stable through the period. By mid-1955, the price index for sensitive materials had increased 8 per cent from the early 1954 low. By then also, total industrial output of materials had increased about one-sixth from the low in the spring of 1954, to a level slightly above the previous high in mid-1953. Output of major materials averaged 90 per cent of capacity, with the steel, aluminum, and cement industries even closer to capacity operations.

After mid-1955, as the chart shows, advances in prices became more widespread among industrial materials, prices of consumer goods began to rise, and what had been a moderate rate of increase in prices of producers' equipment became a very rapid rate. These developments followed midyear increases in wages and prices in the steel industry. Whether any of these developments can be singled out as causes and others as effects is questionable. Strong demands, rising costs, and advancing prices were influencing one another in an inflationary spiral.

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Since recovery in economic activity began in the spring of last year, the broad outline of price developments has been similar to 1954 and early 1955. Average prices of sensitive materials have advanced 9 per cent. Metals, lumber, and rubber again turned up promptly. Nondurables have been much more prominent in the rise than in 1954-55, however, with hides and leather rising sharply through the period and textiles generally turning up this year. Average prices of "other materials" have been nearly stable, as during the comparable portion of the earlier expansion. The wholesale price behavior of consumer goods and of producers' equipment has also been similar to the earlier period. At midyear, furthermore, industrial output of materials was up more than one-fourth from early 1954 and was about 7 per cent above peak levels in 1956 and 1957. Output of major materials was (prior to the steel strike) nearly 90 per cent of January 1, 1959 capacity.

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Prices of Basic Commodities

	Per cent change	
	Mid-July 1959 from mid-May 1958	Mid-May 1955 from mid-March 1954
Industrial		
Hides	99	- 2
Wastepaper	65	10
Rubber	37	55
Leather	32	- 2
Copper	20	20
Steel scrap	20	47
Print cloths	19	4
Wool tops	16	- 5
Lumber	11	7
Zinc	10	23
Tin	8	- 3
Lead	3	-16
Cotton	- 3	- 1
Burlap	- 4	4
Tallow	-20	- 7
Foodstuffs		
Corn	- 2	- 4
Cottonseed oil	- 4	2
Steers	- 6	- 4
Cows	- 9	- 2
Wheat	-17	2
Cocoa	-23	-37
Sugar	-23	4
Coffee	-26	-37
Hogs	-38	-30
* * * * *		
Indexes		
BLS Daily	1	0
Raw industrials	14	10
Foodstuffs	-14	-14
Reuter's	- 1	0
Dow-Jones - Spot	- 6	-10
Futures	- 4	-14
Moody's	- 4	- 6

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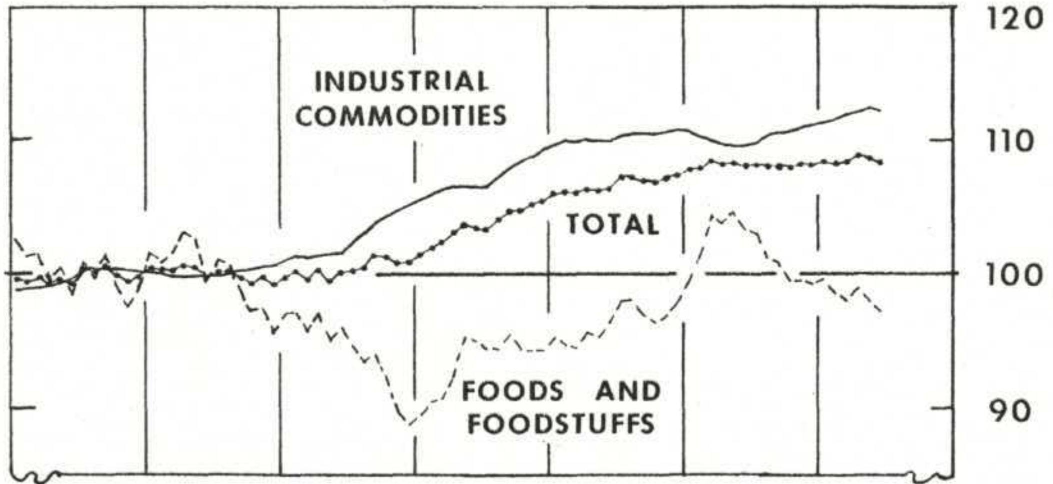
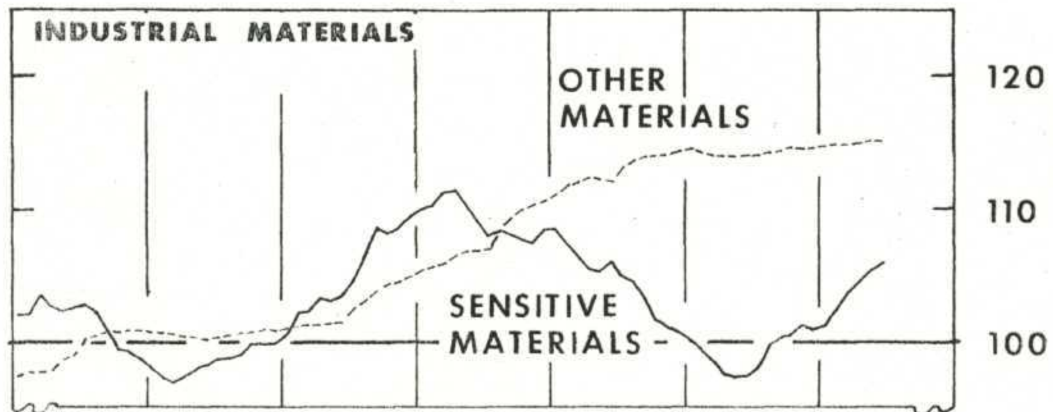
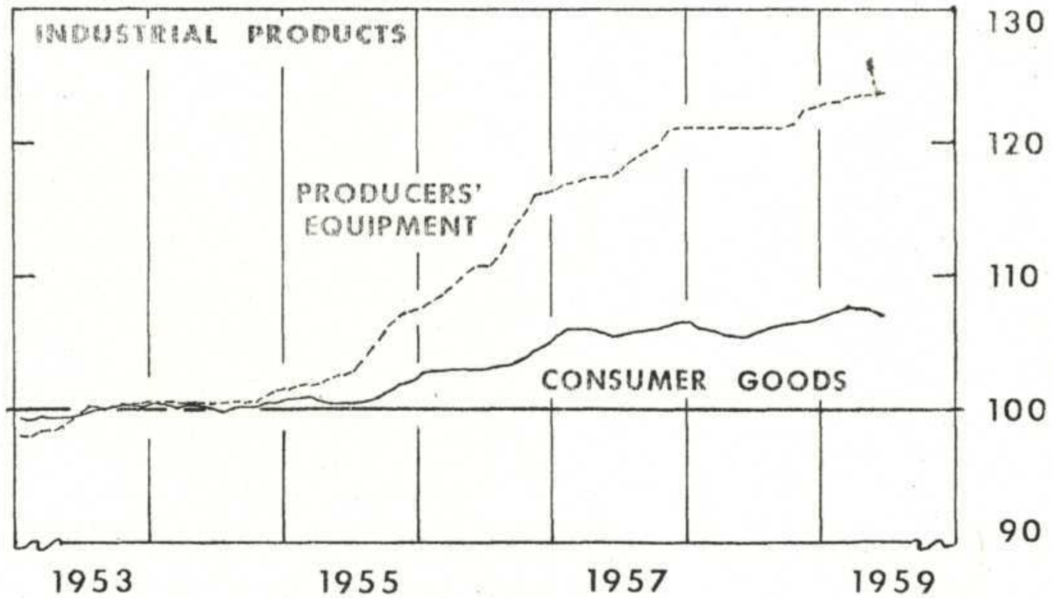
WHOLESALE COMMODITY PRICES

1953 – 54 = 100







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Friday P. M.

Chairman Martin:

In the hope that we could get some light on what was behind Abbot's memo, Jack and I spent a half hour in chat with him this afternoon. What he wants is a statement about the current economic situation, credit restraint and its role, and (while I am sure he would say it was the opposite of his intention) pontification about facilitating healthy stable growth. He thought bills only should be handled off the cuff and treated as mere procedure, not raised to policy or pedestal stature. He felt that, in any case, it couldn't be made clear, so why try; better to leave it in a cloud of mystery.

Since time then was pressing, we resolved this statement dilemma in the only way we could -- having the same statement set up in a long form with "bills only" in and in a short form with "bills only" out.

In view of statements made to us and to the Treasury staff by Committee staff as to what's on the minds of members, and also in view of the Simpson statement, my hunch is that the longer statement is the more appropriate one for the occasion. Jack shares this view and from my conversations with him I'm sure Bob Roosa would also. However, it is a matter for you to decide from your view of the whole situation.

We are having an adequate supply of both the longer and shorter statements prepared so that you can feel completely free to arm yourself with either on Monday morning.

Ray

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BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM

Office Correspondence

Chairman Martin
I don't know what
we do about this. It
calls for another type
of statement.
RAY

Date July 24, 1959

To Mr. R. A. Young

From Governor Mills

Subject: Statement of Chairman Martin before the Joint Economic Committee, July 27, 1959.

In my opinion the proposed statement that has been prepared for the Chairman is off on the wrong foot. Considering his appearance is before the Joint Economic Committee, there is singularly little comment in the statement on general economic conditions or reference to the Federal Reserve System's role as a public instrument for economic stabilization at the present time by way of exerting its influence to restrain the expansion of credit to limits that will promote rather than unsettle economic stability.

Instead of being confined to broad subjects affecting economic conditions and their relationship to monetary policy, the statement is a long dissertation in defense of the so-called "bills only" policy. Inasmuch as this is an admittedly controversial issue, the attention that it receives in the statement might suggest some lack of confidence in the very principle for which support is sought. Where there are differences of opinion on the "bills only" policy within the System and outside of the System in reputable economic and financial circles, the statement reads to me as being clothed with the kind of doctrinary inflexibility that it is attempting to dispel. This is unfortunate and will only aggravate criticism in that the argument at one time indicates that "bills only" is a continuing policy but subsequently comments that it is subject to change thereby leaving readers to question what position has really been taken. In effect, I am fearful that the statement instead of bringing support to the Board will needlessly arouse antagonism.

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August 14, 1959

TO: Board of Governors

FROM: Guy E. Noyes

Attached are clean drafts of the replies to the questions asked by members of the Joint Economic Committee, prepared in accordance with the decisions at the Board meeting of August 13. The table to be inserted in the record as agreed with Senator Douglas is not included, since no further decision with respect to it is needed.

Attachments

NOTE: The attached "draft", with some corrections made, was submitted to the Joint Economic Committee for the "record". (A typed, corrected copy is in the Board's files.)

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REVISED DRAFT
August 14, 1959

FIRST QUESTION BY SENATOR DOUGLAS

The overriding aim of Federal Reserve policy actions must at all times be the provision of the volume of bank reserves that is appropriate to the general economic climate of the time. Success in this endeavor has important bearing on actions (1) to avoid either inflation or deflation, (2) to sustain high level employment of human and physical resources, and (3) to foster economic growth. The appropriate volume and avilability will vary according to the state of the economy, i.e., as to whether it is sluggish or ebullient.

For the most effective performance of its statutory duties, it is essential that the Federal Reserve System should not be influenced by extraneous considerations having to do with the profits that result from its operations as long as the public interest benefits. One fundamental factor that denotes the special characteristics of the Federal Reserve Banks is that their residual profits ultimately flow to the account of the Treasury.

It follows from this position that member bank reserve requirements should not be used as a means to influence Treasury revenues or to provide a sheltered market for Treasury obligations. They should not be raised or maintained at higher levels than are indicated by sound monetary relationships. The mere suggestion that Federal Reserve actions were governed or affected by such extraneous considerations could impair the reputation of the Federal Reserve System for impartial judgment and affect confidence in the dollar as a medium of exchange.

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These fundamental propositions should not be read to imply in any sense whatever that the private banks should not assume their fair proportion of the nation's expenses. The Congress has the power to tax and if it should ever feel that commercial bank profits from the performance of their operations are excessive it can preempt a larger share of those profits to the public treasury through increased taxes on all commercial banks, nonmembers as well as members. This would be preferable to a request or directive to the Federal Reserve System to so operate its policy instruments as to affect member bank earnings, actual or potential, for any reason other than the requirements of a sound monetary policy.

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FIRST QUESTION BY MR. CURTIS

Theoretically the Federal Reserve System can supply reserves to, or withdraw reserves from, the money market on its own initiative either by purchasing or selling U. S. Government securities or by lowering or raising the reserve requirements of member banks. Technically the use of either instrument of policy can be adopted to achieve a desired level of net free or net borrowed reserves. It follows that after the operation has been concluded the mathematical expansionary effect and the mathematical restrictive effect on the money supply of the net free or net borrowed reserve position, so achieved, would be the same. Here the technical similarity ends.

In a number of respects, use of changes in reserve requirements to effectuate monetary policy differs from resort to open market operations, as follows:

A. Method of Diffusion.

A major difference is that a change in reserve requirements hits all member banks equally, irrespective of their individual situation or condition whereas the effects of an open market operation are felt by the member banks individually through the operation of market forces. For example, sales of securities in the open market may be reflected in withdrawals of deposits at some banks by some customers. The banks' adjustment to these withdrawals may involve sales of securities, which lead to deposit withdrawals and reserve losses at still other banks. In

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general, the most extended banks will feel the additional pressure most, but it is not possible to trace meticulously the direct chain of impact of an open market operation.

B. Size of Operation.

Open market operations lend themselves much more readily than do changes in reserve requirements to achieving small changes in the availability of reserves. They can be used readily to provide or withdraw reserves on any given day in amounts that vary from as much as $100 million (and frequently very much larger amounts) down to figures as small as the denominations of the securities that are traded. Changes in reserve requirements, on the other hand, because they are made as percentages of very large sums, normally change the availability of reserves by very much larger amounts. In the future under the new legislation, any change in the percentage will apply, at the very least, to one of the following four categories of deposits (using most recent figures as illustrations):

	Net Demand Deposits (Millions)	Time Deposits (Millions)
Reserve City (including former Central Reserve City) Banks	66,134	28,481
Country Banks	36,892	25,488
	103,026	53,969

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As a general rule, changes in reserve requirements, to be equable, must be generalized to include all net demand deposits or all time deposits. Even if such a change were as small as 1/4 of one per cent, which is much smaller than has been used in the past, and it were applied to net demand deposits, it would supply or withdraw bank reserves in the amount of $257,000,000 in one operation. If special circumstances permitted an adjustment to be made in reserve requirements of either reserve city member banks or of country member banks alone (and this would not happen frequently), an adjustment as small as 1/4 of one per cent would involve $165,000,000, if it were confined to the new class of reserve city member banks, and $92,000,000, if it were confined to country member banks.

These illustrations are in terms of changes of one-fourth percentage points in reserve requirements, one-half of the smallest ever applied to date to our member banks. One can, of course, by resorting to smaller and smaller fractions in theory make changes in reserve requirements appear capable of as minute adjustments as changes induced by open market operations. Very small fractional changes at relatively frequent intervals, however, would create very difficult problems of adjustment for member banks and would almost certainly be disruptive to the smooth flow of credit in the market.

This factor of size of impact is one reason why it is more difficult to use an increase in reserve requirements to contain a boom than it is to use a decrease to combat a recession. If

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an increase in reserve requirements is imposed at a time when member banks' holdings of excess reserves are low, or completely offset by borrowing at the discount window, there are only three options open to the banking system to achieve compliance: (1) by wholesale liquidation of loans in an amount several times the increase in reserves required (about six times at present), or (2) by sales of U. S. Government securities in comparable volume (i.e., about six times at present) to nonbank investors, or (3) by borrowing at the discount window a sum equal to the amount involved in an increase in reserve requirements. In the case of any combination of these, lower prices for U. S. Government securities could be expected. From the moment of the announcement, there would be a strong tendency for potential buyers of U. S. Government securities to defer their bids, thus tending to provoke a disorderly market that would force intervention by the System Open Market Account. Such intervention to restore orderly conditions might require purchases in greater amounts than were involved in the original increase in reserve requirements. As a result, the effort to combat overexpansion in a boom by reducing bank liquidity might induce disorder in the market for Treasury issues and, subsequently, a situation of even greater bank liquidity than had prevailed before the restraining action was initiated. These same problems do not arise when reserve requirements are reduced.

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There are occasions when a lowering of reserve requirements may be superior technically to an open market operation. For example, one such occasion arose very suddenly in June 1953 when a series of unforeseen developments in connection with Treasury tax payments produced a situation which needed a very large injection of reserves in a very short period. The reduction in reserve requirements ordered at that time exactly met the technical requirements. It is doubtful whether purchases of securities in the open market would have achieved a similar result.

C. Impersonality of Operation.

It is important that operations undertaken to effectuate the broad purposes of monetary policy be as impersonal as possible in their impact on various segments of the economy. They should affect broadly the availability and cost of borrowing and the return obtainable on saving in general rather than any particular form of borrowing or any particular type of saving.

From the point of view of impersonality, changes in reserve requirements are, in one sense, more impersonal than open market operations which, in addition to changing the availability of reserves, also add to or subtract from the volume of a particular type of securities in the market. To the extent, however, that open market operations are confined to short-term securities, these operations are also, in practice, quite impersonal in their effects.

Changes in reserve requirements are not at all impersonal in the extent to which they affect the competitive position of

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different types of banks. They affect directly only member banks of the Federal Reserve System. Nonmember banks which are subject only to State-imposed reserve requirements are left untouched unless the State requirements are varied automatically with those of member banks.

When resort is made to the open market instrument, the reserves are removed through an impersonal market transaction. The actual absorption of reserves from the market results from the purchase of securities from a willing seller. Thus, the first impact of an open market operation comes about because a transaction has been effected between a willing buyer and a willing seller, rather than as a result of a change in an official regulation. Apart from the publication of Federal Reserve statements, commercial banks are not aware of the absorption of reserves by Federal Reserve. Reserve losses to individual banks take the form of adverse clearing balances, which frequently occur in the normal course of business.

D. Expectations.

There is one major respect in which member banks seem to react differently during a recession to the provision of a given amount of excess reserves according to whether the stated excess is the result of a series of purchases of U. S. securities in the open market, on the one hand, or of a reduction in reserve requirements, on the other. This is in addition to the fact that a reduction in reserve requirements places additional lending power in all member banks simultaneously.

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It seems to be expected generally that an increase in reserve availability brought about by a change in reserve requirements is likely to be more permanent and that the added lending power will not be quickly withdrawn. Member banks, consequently, are likely to react more positively to a reduction in reserve requirements by moving promptly to expand and also to incorporate additional permanently desirable assets in their asset structures. They will be more likely to expand their long-term assets by purchasing mortgages and also to make customer commitments extending longer into the future, commitments for term loans, for new lines of credit, and for future mortgage financing.

This differential response has both favorable and unfavorable characteristics. It undoubtedly facilitates the quick adoption by businessmen of plans that lead toward expansion and emergence from the recession. It may, at the same time, however, commit the commercial banks to future extensions of credit that they would later rather not have made.

For example, a great many of the bank lines of credit that financed the very rapid expansion of instalment credit in 1955 were entered into during the third quarter of 1954 at roughly the same time that reserve requirements were lowered. It will never be possible to prove a cause and effect relationship between these two developments, but experience in both 1954 and again in 1958 suggests that this type of response on the part of member banks does accompany reductions in reserve requirements and that it may be quite dramatic on some occasions.

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E. Long-run Redundancies or Deficiencies of Reserves.

In 1927, the long inflow of gold from abroad after 1920 and the low rate of increase in currency in circulation as the use of checking accounts became more general finally reduced the demand for Reserve Bank credit to a point where there was a danger that the Federal Reserve Banks would lose operating contact with the market.

Should such a contingency recur, it would constitute a clear technical case for increasing reserve requirements, the increase to be effectuated preferably in a period when reserves were redundant. Resort to the reserve requirement arm would be indicated as a technical matter because the Federal Open Market Account would not be in possession of sufficient securities to operate effectively on the side of restraint in the market. The increases in reserve requirements in the mid-thirties represent an adjustment of this type.

A reverse technical situation would occur if growth in world output and correspondingly in world demands for gold as reserves should exceed additions to world gold stocks in such a way as to result in a deficiency of world gold supplies relative to needs for monetary reserves. Under such circumstances, a reduction in reserve requirements against deposits might be in order.

F. Relation to Treasury Operations.

With respect to the System's ability to act independently in pursuit of its statutory responsibilities, there is little difference between its use of open market operations and reserve requirements.

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The System does, in fact, take into account, in either case, Treasury financing activities, endeavoring to interfere with these as little as possible while pursuing its own objectives.

As pointed out earlier, however, because of their greater flexibility and the fact that their magnitude can be adjusted to current market developments, open market sales are less likely than reserve requirement increases to create market conditions unfavorable to a Treasury operation.

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SECOND QUESTION BY SENATOR DOUGLAS

It should be pointed out first that it is not, and has not been, the policy of the Federal Reserve System to "raise interest rates on short-term Government securities." The System's policies are directed toward the availability of bank reserves and are designed, in boom periods, to limit the availability of such reserves to the extent necessary to avoid an inflationary expansion of bank credit. In these circumstances, the resulting interest rates reflect the balance of private demands for and supplies of saving in the money and capital markets.

Relative movements of prices in free markets serve the classical economic function of guiding production, shifting resources and directing them into their most efficient use. The concentration of price increases among construction materials and producer durable goods in the 1955-57 period, to a large extent, represents the composition of demands that characterize an investment boom.

The Federal Reserve should not, and does not, attempt to control relative prices; its concern is with the over-all price level. The way in which the Federal Reserve supplies or absorbs reserves can have a number of important effects, but it does not have a differential effect on specific prices.

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QUESTION BY REPRESENTATIVE REUSS

An important factor in the heavy demand for credit which has generally characterized the postwar period has been the use of credit by consumers. This has included, on the one hand, short- and intermediate-term credit such as charge accounts and instalment credit and, on the other, long-term credit in connection with home mortgages. Since 1946 short- and intermediate-term credit has increased $38 billion to a total of $47 billion on June 30, 1959 and long-term mortgage loans to consumers, associated almost entirely with the purchase of homes for their own use, have risen by almost $100 billion to $117 billion as of June 30.

Whether the growth of this credit should be subjected to some form of selective restraint is a complex question involving judgments as to equity and administrative feasibility, as well as monetary policy. However, there is little question but that restrictive regulation of the terms offered to instalment and mortgage borrowers would effectively reduce the total demand for credit and thus relax somewhat the upward pressure on interest rates. Conversely, it is also certainly true that the liberalization of terms, both as to downpayments and maturities which has taken place since 1952 has contributed to the demand for credit and the upward pressure on rates in the recent period. This liberalization and expansion has been the result of the competition among private consumer lenders and instalment vendors, in the case of short- and intermediate-credit, while in the case of long-term credit the Federal Government itself has taken the lead in promoting progressively lower and lower downpayments and longer and longer maturities on real estate loans.

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As indicated above, the selective regulation of the use of credit by consumers raises many problems beyond those implied in the general restraint of credit-financed demands. Such regulation has been vigorously opposed by interested groups whenever it has been proposed. After weighing the many conflicting arguments enumerated in the study submitted by the Board in 1957 (see Part I, Volume I, Chap. 16), the Congress may determine that the balance favors establishment of permanent authority to regulate consumer credit. To be fully effective, such authority would have to cover long- as well as short- and intermediate-term credit and should be permanent, broad and flexible in character. Application of the regulations should be limited to periods when the need is sufficient to justify the considerable burden such regulation imposes on the businesses directly affected and toleration of the discriminatory aspects which are unavoidable.

The Board does not feel justified, at this time, in taking the initiative in a recommendation to Congress in this matter. The effectiveness and workability of this kind of selective regulation depends heavily on broadly based acceptance and support. Whether such support exists can best be determined in the forums of the Congress itself.

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SECOND QUESTION BY REPRESENTATIVE CURTIS

It is difficult to point to a particular program of Government expenditure as being inflationary. It is the whole balance of Government revenue and expenditure which contributes to inflation or its restraint. The Budget for 1960 promises at best a narrow and precarious balance or perhaps a small deficit. A substantial budget surplus, during a period when economic activity and private expenditures are rising so rapidly, would certainly be preferable.

The Ways and Means Committee announced on July 29 that it had agreed to the issue of up to $1 billion in revenue bonds prior to June 30, 1961, to finance the prospective deficit in the highway trust fund under existing legislation and to the transfer beginning July 1, 1961 of 2 percentage points of the excise tax on passenger automobiles or about $250 million per year to the highway trust fund. The Committee has also recommended to the Public Works Committee of the House a stretch-out in the program of highway construction.

There are difficult questions involved here as to the rate at which highways ought to be built and the means by which they should be financed. For the most part these are outside the area of competence of the Federal Reserve System. The least inflationary method of financing highway expenditures would, of course, be by increased taxes of one sort or another. This action by the Ways and Means Committee would not provide any additional net revenue to meet the cost of highway construction, but would merely shift some general revenue to the highway trust fund and bridge a financial gap that would exist until highway construction activity is slowed down.

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Although the revenue bonds which the recommendation contemplates would not be part of the public debt and would not be guaranteed by the United States Government, they would constitute additional borrowing that would be added to the sums to be borrowed for other Government purposes during the next year or two. As such, this additional borrowing would put further strain on the ability of the capital market to absorb both Government obligations and private issues and cause upward pressure on interest rates. Certainly the proposal to finance highway construction by the issue of revenue bonds would be more inflationary than financing this construction out of higher taxes.

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QUESTION BY REPRESENTATIVE COFFIN

Representative Coffin: What differences in techniques exist between raising or lowering money supply to counteract cyclical changes and raising the money supply in relation to long-range secular growth? Are there differences?

If there are, would you divide your answers into three points:

First, procedures to increase money supply to combat cyclical recession;

Second, procedures to restrict money supply to combat cyclical booms;

Three, procedure to increase money supply to keep up with the secular growth.

Can you answer that in reasonably short compass now?

Mr. Martin: I would rather have time to look at that and answer it in writing, if I could.

Representative Coffin: I think this perhaps will repeat some of the discussion, but I do not think it has been brought into sharp focus.

ANSWER

The Federal Reserve System has three major instruments available to it in determining the availability and cost of member bank reserves, thereby affecting bank credit and the money supply. These instruments are used in an interrelated manner in pursuit of the ultimate policy objectives of counteracting inflation and deflation and promoting steady economic growth.

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Although counteracting cyclical movements and fostering economic growth may be regarded as separate objectives of monetary policy, these objectives are not pursued independently. The System does not at one time counteract the cycle and at another time act to encourage growth. Nor does it use one instrument or technique for anticyclical purposes and another to provide the monetary basis for growth. Rather, efforts to mitigate the cycle necessarily encourage steady growth and efforts to promote sustainable growth necessarily tend to dampen cyclical movements.

In other words, in using the instruments at its command, the Federal Reserve is always guided by both short-term and long-term considerations. Its actions to mitigate short-run cyclical tendencies in either direction are always also influenced by the monetary growth needs of the economy, and vice versa. Thus, for example, even in a boom period with inflationary pressures, monetary policy has not been so restrictive as to cause contraction in the money supply. In recession periods, on the other hand, reserves have been supplied in such volume as to permit the money supply to grow more rapidly than would be consistent with long-term sustainable growth of the economy.

Although actions to offset cyclical tendencies and to encourage growth are not separable, it may be found useful if I set forth some of the considerations that guide the System in the use of its instruments in pursuit of these goals. It should be noted, however, that the particular combination in which the three major instruments are used is likely to vary with circumstances. While we may divide economic history into periods of prosperity and recession for analytical purposes,

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the problems that arise at any point of time are always unique in some respects. Decisions as to the combination of instruments appropriate to the current situation are always ad hoc decisions--they are not and cannot be predetermined by any set of rules. Furthermore, Congress has wisely placed the responsibility for these decisions in a group of men, rather than in any single individual. Some decisions rest with the Board of Governors, some with the Federal Open Market Committee, and some are shared between the Boards of Directors of the Reserve Banks and the Board of Governors. Among the men involved in these groups there are, and should be, differing views.

I shall confine my discussion to the three major instruments: open market operations, discount operations and reserve requirements. The Federal Reserve presently also has authority to prescribe margin requirements on stock market credit but this special purpose instrument is not utilized for the purpose of influencing total bank credit and the money supply. I shall, therefore, not cover it in this answer. At times in the past the Federal Reserve has also been authorized to prescribe downpayments and maturities with respect to consumer instalment credit and real estate credit. Since such authority does not exist at present I shall also not cover this type of instrument.[1]

1/ In my accompanying reply to a question from Representative Reuss I have set forth some of the considerations with regard to whether or not such authority should be re-established.

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Actions in Periods of Recession

First, without respect to their relative merits, open market purchases, lower discount rates, and lower reserve requirements would be appropriate to combat a cyclical recession. All of these actions, if they are timely, should be conducive to increased investment and to an increase in the money supply.

There appears to be general agreement that open market policy should be shifted, first to lessened restraint and then to active ease if the recessive forces continue. Paralleling reductions in the discount rate as the level of market rates adjusts downward are also widely accepted as appropriate. As reserves are supplied through open market operations, member banks may be expected to reduce their indebtedness to the Reserve Banks, and this relaxes one of the restraints on credit expansion appropriate to a boom period.

Some economists have argued that it is desirable to put a floor under the discount rate; i.e., not to reduce it to a very low level even when market rates fall. They base this argument primarily on the reasoning that a very low discount rate is not needed, when reserves are plentiful, and that changes in the discount rate over a narrower range may help, at least psychologically, to lessen the range of rate fluctuation both ways. Others would contend that the widest possible fluctuation both ways is desirable in order for monetary policy to make its maximum contribution to general economic stability.

Until quite recently, there was also general agreement that bank reserve requirements should be lowered and that, in fact, this was the most potent weapon in the Federal Reserve's arsenal of anti-recessionary policy actions. This assumes, of course, that the pre-

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recession level of requirements was high enough to permit a reduction without impairing their effective use as a fulcrum for monetary policy.

So far as I am aware, no one has questioned the effectiveness of reserve requirement reductions, or the fact that they have an important advantage over the other general instruments in a recession. Decreased reserve requirements affect all banks immediately and place every bank in the country under simultaneous pressure to lend or invest in order to maximize its earnings, whereas open market purchases have less immediate impact on many country banks.

Recent questions as to the desirability of using reserve requirement reductions to combat an economic downturn appear to be based on the ground that such action is difficult to reverse during periods of boom. This point has some validity and the limitations on the use of reserve requirement increases in periods of prosperity will be discussed in the next part of this answer. To the extent that such limitations exist, it would probably not be desirable ever to carry reductions below levels which would be appropriate from a long-run point of view.

To summarize at this point, all of the instruments of general policy may be appropriate to a downturn, depending upon its severity. The only limitation might be that reserve requirements should not be reduced below levels appropriate to longer run needs.

Actions in Boom Periods

Theoretically, all the same instruments are available to restrict growth in bank credit and the money supply in boom periods as are available to encourage monetary expansion in recession. There are, however, a number of significant differences. One difference stems

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from the fact that the problem in a boom is seldom one of literally contracting the monetary base, but rather one of restricting its expansion. Hence, unless redundant excess reserves remain from the preceding period of ease or there is a substantial inflow of reserves from other sources, a restrictive policy does not require that bank reserves be absorbed but simply that they be held stable or allowed to increase at a slower rate.

Open market operations are, generally speaking, the most quickly and easily reversible of all the instruments. In a period when restrictive monetary policy is appropriate, open market operations are likely to be utilized in a way that requires member banks to obtain a portion of the reserves to support monetary expansion by borrowing at the discount windows at the Reserve Banks.

While there is considerable difference of view on the timing and amount of increases in discount rates, so far as I know there would be almost complete agreement that these rates at the various Federal Reserve Banks should be moved up, as the general structure of interest rates responds to the increased demand pressures that develop in a boom period. Much has been written on the effectiveness of such action by the central bank, here and abroad. Some observers give much greater significance to discount rate changes than others, but there would be almost universal agreement that increases are appropriate in boom periods.

Reserve requirement increases raise a number of problems. As pointed out above, the objective of monetary policy in a boom is not to reduce the monetary base and force credit contraction, but to hold expansion within sustainable limits. Hence, a boom, _per se_, would not

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call for increased reserve requirements unless a large volume of excess reserves remained from the preceding recession or were appearing from other sources; e.g., a sustained gold inflow. While such an operation presents extremely delicate problems of timing, excess reserves "left over" from a period of monetary ease should be absorbed early in the recovery, before a boom develops.

A difficulty in the application of reserve requirement increases is that their effects are large and pervasive.[2] In a recession, a substantial, pervasive impact may be all to the good, but even in the most thoroughly diffused boom, the shock of a general increase in reserve requirements would be likely to produce undesirable effects in many areas.

With reserve requirements at their present levels, which are high by long-run historical standards, and with the substantial outflow of gold that has been taking place, the use of reserve requirement increases has not been a pressing practical problem in the recent period. However, the Board has under study techniques for reserve requirement adjustment, both in connection with implementation of the authority contained in Public Law 86-114, and in response to the request contained in the report of the House Banking and Currency Committee on S. 1120 that the Board explore possible improvements in the techniques of employing reserve requirements as an anti-inflationary tool.

Summarizing the action appropriate to restraint in a boom period, it might be said first that restraint on monetary expansion is always the most difficult and controversial phase of monetary

2/ A technical comparison of reserve requirement changes and open market operations is contained in the accompanying answer to a question by Representative Curtis.

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management, in this country and elsewhere in the world. This is due in large part to the inescapable fact that restraint is unpopular in all its ramifications. No possible combination of monetary instruments can ever overcome the "spoil sport" role in which the monetary authorities are inevitably cast in periods of advanced recovery and boom. People whose expenditure plans are adversely affected feel that the restraint discriminates against them. Those who go ahead, and who pre-empt the needed funds by bidding a higher rate of interest are not satisfied either. Even bankers and other institutional lenders, who are presumed by many to benefit from a restrictive policy, are concerned about the decline in the market value of outstanding securities they hold, and by the fact that they are not in a position to satisfy all of the loan requests they would like to satisfy.

All that the monetary authorities can do or should do, in the circumstances, is to center their policy around two objectives: (1) To hold monetary growth to a noninflationary rate; and (2) to avoid actions which might precipitate a crisis by tightening credit too quickly or which would distort the flow of credit and interfere with the free functioning of the allocative processes of the money and capital markets. To the extent that it is possible to generalize, this can usually be best accomplished by carefully conceived and conducted operations in the System's Open Market Account, and appropriate upward adjustments in the discount rate. These may need to be supplemented by reserve requirement increases in some circumstances.

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Provision for Long-Term Growth

As noted earlier, increases in the money supply to accommodate and facilitate secular growth in the economy are not generally associated with specific instruments of policy. The amount of additional reserves needed to provide for secular expansion of the money supply in any year is relatively small, compared to the amounts involved in either seasonal or anticyclical operations. Thus, the growth needs of the economy would generally be met by withdrawing less reserves or by supplying more than season or cyclical factors would otherwise indicate. The choice of instruments would be largely determined by the seasonal or cyclical situation prevailing at the time.

It might be noted in passing at this point that the question does not specifically refer to the use of the tools of monetary policy to effect seasonal adjustments. The volume of transactions entered into for this purpose, both in the Open Market Account and through discounts for member banks, sometimes reaches very large magnitudes. Hence, the selection of the appropriate instrument for either secular or cyclical purposes may be considerably influenced by the seasonal situation. Furthermore, substantial relaxation or tightening of monetary policy may be accomplished by not acting to offset the reserve effects of seasonal movements, rather than by positive action. For example, in January, when there is always a substantial return flow of currency to the banks, there would be an easing of reserve positions to the extent that the System did not sell securities to absorb reserves. Similarly, a tightening in reserve positions can be brought about to the extent that a seasonal outflow of currency or deposit expansion is not fully offset by System actions to supply reserves.

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Over a long period, our gold stock has increased, supplying reserves to the banking system and providing part of the basis for expansion of the money supply. On the other hand, in a growing economy, an increasing amount of cash is needed to carry on normal business. To the extent that currency in circulation expands to meet these needs, it operates as a drain on bank reserves. Over the long run, the relative size of these two magnitudes--gold, and currency in circulation--which are not normally subject to direct control by the monetary authority, will determine how much, if any, additional reserves need to be supplied to provide for growth in the total money supply. In some circumstances, providing the appropriate money supply for economic growth would be accomplished by the absorption rather than the expansion of reserves through monetary action, if, for example, gold were flowing in rapidly and currency in circulation were not increasing rapidly.

If we make the assumption that over the long run the increase in the monetary gold stock will roughly equal the increase in currency in circulation, as it has in the last thirty years or so, then it follows that the monetary authority should provide sufficient reserves in the course of its operations to permit an appropriate rate of growth in the demand deposit component of the money supply. This can be done either by allowing Federal Reserve credit outstanding to increase gradually over time, or by reducing the percentage of reserves member banks are required to hold.

One of the considerations governing the choice between these alternatives is the long-run soundness of the financial structure. Long-term growth in the demand deposit component of the money supply

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requires not only an adequate supply of reserves to the banking system, but also provision for an adequate capital structure. If deposits and risk assets grow more rapidly than the capital accounts, this gradually undermines the protection against loss that these capital accounts provide, first to the depositors, and second to the Government, the insurer of deposits through the F.D.I.C. The ratio of capital to liabilities and risk assets in the banking system will not be affected much, one way or the other, by monetary policy actions in the short run. In the longer run, however, the level of reserve requirements, along with many other factors, will play a part in determining the rate at which banks are able to add to their capital, either by retained earnings or the attraction of new investment. The level of reserve requirements that member banks are required to hold with the Federal Reserve will also affect, in the long run, the attractiveness of membership in the Federal Reserve System, and national chartering as against State chartering, in the case of both existing and newly-formed banks. These considerations are matters of concern, not only to the Federal Reserve, as a monetary authority, but to it and other Federal and State bank supervisory authorities.

Other things being equal, relatively high reserve requirements would tend to result in lower earnings for the commercial banks and a smaller rate of return on the capital invested in banking--and relatively lower reserve requirements would permit higher earnings and a larger rate of return on invested capital. Conversely, the earnings of the Federal Reserve would tend to be higher, if reserve requirements were high, and low if they were low--again assuming other things to be equal.

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These matters are of concern to the monetary authority to the extent that they affect the soundness of the financial structure and its ability to respond constructively to changing economic conditions and to play its role in over-all growth effectively. The financial structure includes, of course, not only the commercial banks but also the Federal Reserve System itself and the nonbank financial institutions.

No objective indicator of the appropriate long-run level of reserve requirements is available. Ultimately, as in so many things, there is no choice but to entrust the responsibility for decision in this area to the hands of some human being or group of human beings, whom we admonish to use their best judgment in the public interest. At present this authority is vested in the Board of Governors of the Federal Reserve System, with respect to banks that are members of the System.

This is an area in which it is not only possible, but desirable, for Congress to set an appropriate range within which the monetary authority should operate. The Congress has done this throughout the history of the Federal Reserve System and, as you know, made some modifications in the limits and bases with respect to reserve requirements in the current session. While some of the changes made by the Congress were not in accord with the recommendations of the Board, the limits prescribed in the Federal Reserve Act, as amended (roughly between 10 per cent and 22 per cent), appear to be reasonable and equitable, and the reserve requirements which the Board may specify from time to time, within those limits, should serve the immediate needs of monetary policy and provide for the continued sound growth of the financial system, which is one essential part of over-all economic growth.

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In the situation, as it develops--depending on gold flows, the currency demands of the public, and many other factors--Government security holdings of the Federal Reserve System may increase or decrease, on balance, and its profits and payments to the Treasury will vary accordingly. This incidental effect of the policies selected to make the maximum possible contribution to economic stability and growth should not, in our judgment, play any significant part in judgments as to the balancing of the instruments in either the short or long run.

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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

Joint Economic Committee

July 27, 1959

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THE GOVERNMENT SECURITIES MARKET AND ECONOMIC GROWTH

Mr. Chairman:

In this opening statement, I would like to comment first on one aspect of the problem you are considering--the importance of freely competitive markets to maximum economic growth. In so doing, I do not wish to understress the importance of any other conditions necessary to healthy economic growth. Indeed, if there is one essential for sustained growth that stands out above all others, it is the maintenance of a volume of real saving and investment sufficient to support continuous renewal, adjustment, and expansion of our total capital resources. As you know, the maintenance of adequate saving and investment depends upon broadly based and justified confidence in a reasonably stable dollar.

Role of Free Markets

No one here would deny that free markets are essential to the vital and vigorous performance of our economy. No one would urge that we encourage monopolistic practices or administered pricing, and few would advocate Government interference with the market process as a general principle. On the contrary, nearly everyone would agree that such developments are injurious to the best use of our resources, that they distort the equitable distribution of final product, and that they interfere with economic progress.

Differences of viewpoint on free markets arise only when the complexities of specific market situations make it difficult to discern whether markets are, in fact, functioning as efficiently as we might reasonably expect. Well-informed and well-intentioned observers will

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disagree as to whether an appropriate degree of competition exists in particular markets and, if not, as to what corrective steps, if any, it is appropriate for Government to take.

If the policies we follow in the financial field are to be fully effective in promoting growth and stability, they must be able to permeate the economy through the mechanism of efficient markets. This generalization applies to all markets, for all types of goods and services. Naturally, the Treasury and the Federal Reserve are most immediately concerned with financial markets, both because we have some direct responsibility for these markets, and because they represent the main channel through which the Government financial policies to foster growth and stability must pass.

The Market for Government Securities

We are especially concerned with the market for United States Government securities. With a Federal debt of $285 billion, Government securities are a common and important asset in the portfolios of businesses, financial institutions, and individuals. An efficient market for Government securities is obviously needed for the functioning of our financial mechanism. We are fortunate in this country to have such a market. From the standpoint of the Federal Reserve, it is hard to conceive of the effective regulation of the reserve position of the banking system without some such facility through which to conduct open market operations of large magnitude.

The initial results of our study of this market with the Treasury are encouraging in many ways. As was pointed out in the summary of the study made available to you on Friday, huge transactions

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are carried out every day in an orderly fashion and at very small cost to ultimate investors. One cannot fail to be impressed by the fact that there are dealers who stand ready, at their own initiative and at their own risk, to buy or sell large blocks of securities. Frequently, single transactions run into millions of dollars. Despite the absence of any assurance that a given purchase will be followed by an offsetting sale, dealers quote bid and ask prices that typically have a spread of less than 1/4 of 1 per cent on the price of long-term bonds and range down to a few one-hundredths of 1 per cent on Treasury bill yields.

If you have had an opportunity to examine the preliminary study manuscripts, you are aware that they do suggest that some improvements in the Government securities market may be in order. We would hope that these improvements can be made within the framework of existing authority and through voluntary cooperation with various market participants. There is, however, a possibility that further authority might be necessary or desirable. We expect to have a clearer idea about how to accomplish desirable improvements after we have had an opportunity to consider carefully the findings of the staff study just completed last week.

There is one possible change in the organization of the Government securities market that would not, as I view it, lead to improvement. That change would be the enforced conversion of the present over-the-counter dealer market into an organized exchange market. The reasons why this change would not be constructive or even practicable are set forth in the joint statement on the study's

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findings. On the other hand, any efforts on the part of existing organized exchanges to extend or strengthen the facilities now made available to buyers and sellers of Government securities should certainly be encouraged. There is no reason why better exchange facilities would not prove to be a helpful supplement to those provided by the present dealer market.

Another change affecting the Government securities market that has been suggested relates to Federal Reserve participation in it, and pertains in particular to the extension to longer term maturities of Federal Reserve open market operations. Some discussion of this suggested change is appropriate here, for it is not a matter encompassed by the Treasury-Federal Reserve study.

System Operations in Short-Term Government Securities

Since the Treasury-Federal Reserve accord in 1951, the System's day-to-day trading in Government securities has largely been in short-term issues. In 1953, after extensive re-examination of System operations in the open market, the Federal Open Market Committee formally resolved to make this a continuing practice.

I think that nearly everyone who has studied these matters would agree that the bulk of Federal Reserve operations must be conducted in short-term securities; that necessarily means largely in Treasury bills. The short-term sector of the market is where the greater part of the volume of all trading occurs. Dealer positions are characteristically and understandably concentrated in these shorter issues. Differences of view on whether System trading should extend outside the short-term area

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hinge upon whether or not some small part of our regular buying and selling should be done in the longer term area.

To appraise this difference in viewpoint, we need first to consider the basic economics of System open market operations. Federal Reserve operations in Government securities influence prices and yields of outstanding securities in three fundamentally different ways:

(1) They change the volume of reserves otherwise available to member banks for making loans and investments or paying off debts;

(2) They affect the volume of securities available for trading and investment; and

(3) They influence the expectations of professional traders and investors regarding market trends.

Of these effects, the first is by far the most important. Under our fractional reserve banking system, additions to or subtractions from commercial bank reserves have a multiple expansive or contractive effect on bank lending and investing power. Other things being equal, this means that any given change in System holdings of securities will tend to be accompanied by a change in commercial bank portfolios of loans and investments several times as large. Unlike many other institutional investors, commercial banks maintain Government security portfolios with a wide maturity distribution although the largest component will be short-term securities. Hence, the major effect on market prices and interest rates will result from the actions subsequently taken by commercial banks to expand or contract their asset portfolios, and the impact will be distributed throughout the market.

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With regard to the effect on the availability of securities in the market, substantial System purchases or sales of short-term securities exert a minimum influence on the market supply. For example, most of the $35 billion of bills outstanding is in the hands of potential traders. On the other hand, much the largest part of the marketable longer term issues is in the hands of permanent investors. Current trading in them is confined to a very small fraction of the outstanding volume. For this reason, the long-term area of the market shows greater temporary reaction than the short-term area to large purchase or sale orders.

Any attempt to use System operations to influence the maturity pattern of interest rates to help debt management would not produce lasting benefits and would produce real difficulties. If an attempt were made to lower long-term interest rates by System purchases of bonds and to offset the effect on reserves by accompanying sales of short-term issues, market holdings of participants would shift by a corresponding amount from long-term securities to short ones. This process could continue until the System's portfolio consisted largely of long-term securities. Accordingly, the System would have put itself into a frozen portfolio position.

The effect of thus endeavoring to lower long-term yields, without affecting bank reserves, would be to increase the over-all liquidity of the economy. Not only would the supply of short-term issues in the market be increased, but also all Government bonds outstanding would be made more liquid because they could be more readily converted into cash. The problem of excess liquidity in the

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economy, already a serious one, would be intensified. The Treasury now, even with the present interest rate ceiling, would have no difficulty in reaching the same result. It has merely to issue some $20 billion of short-term securities and use the proceeds to retire outstanding long-term debt. Fortunately, it is not contemplating any such action.

The effect of System open market operations on the expectations of market professionals, can be of critical importance depending upon the market area in which the operations are conducted. In the longer term area of the market, dealers, traders and portfolio managers are particularly sensitive to unusual changes in supply and demand. One important reason is that long-term securities are subject to wider price fluctuation relative to given changes in interest rates than are short-term issues. Therefore, trading or portfolio positions in them incur a greater price risk.

These traders and investors in long-term securities are aware that the System holds the economy's largest single portfolio of Government securities. They also know that the System is the only investor of virtually unlimited means. Consequently, if the System regularly engaged in open market operations in longer term securities with uncertain price effects, the professionals would either withdraw from active trading or endeavor to operate on the same side of the market as they believed, rightly or wrongly, that the System was operating.

If the professionals in the market did the former, the Federal Reserve would become in fact the price and yield administrator of the long-term Government securities market. If they did the latter, the total effect might be to encourage artificially bullish or bearish expectations

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as to prices and yields on long-term securities. This could lead to unsustainable price and yield levels which would not reflect basic supply and demand forces. The dangerous potentialities of such a development is illustrated by the speculative build-up and liquidation of mid-1958, described in detail in the Treasury-Federal Reserve study.

Either of these effects would permeate, and tend to be disturbing to, the whole capital market. Accordingly, instead of working as a stabilizing force for the economy, such open market operations in long-term securities could have the opposite result. In other words, if the Federal Reserve were to intrude in the adjustment of supply and demand in order directly to influence prices and yields on long-term securities or in a way that resulted in unsustainable prices and yields, it would impair the functioning of a vitally important market process.

Some public discussion of the Federal Reserve's present practice of conducting open market operations in short-term securities implies, it seems to me, that the System has assumed an intractable and doctrinaire position on this matter. This is not a correct interpretation of what we have done. We adopted this practice after a careful study of experience and of the effects of our operations upon the market and the banking system. In this review, we were naturally mindful of the specific tasks of the System, namely, to regulate the growth of the money supply in accordance with the economy's needs and to help maintain a stable value for the dollar.

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The practice or technique was adopted, not as an iron rule, but as a general procedure for the conduct of current operations. It is subject to change at any time and is formally reconsidered once each year by the Federal Open Market Committee in the light of recent experience. Exceptions can be, and have been, authorized by the Committee in situations where either Treasury financing needs, conditions in the money market, or the requirements of monetary policy call for such variations. The System, at times has been a subscriber to longer term issues in Treasury exchange offerings when appropriate, and at other times has purchased such securities in the market.

In other words, we endeavor to apply this practice flexibly as we do all of our practices in the administration of monetary policy. As I have stated to this Committee on other occasions, flexibility is an essential ingredient of our entire reserve banking operation. When reserve banking loses flexibility, it will no longer be able to do the job that is required of the central bank in the market economies of the free world.

Measurement of Economic Growth

Before concluding my statement, I want to mention one entirely different matter that has special relevance to the broad scope of this Committee's interest. That is the measurement of growth. As you know, one of the frequently used indicators of growth in the industrial sector has been the Board's index of industrial production. One of the great

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lessons we learn from the compilation of this index, which we try to do as carefully and competently as we know how, is that the mere matter of measuring growth is a very tricky thing.

As the structure of the economy keeps changing, the job of combining measures of its many parts into a single index cannot be done, despite our best efforts, without having to make major revisions every few years. We again have underway a basic revision, the final results of which will be available soon. The nub of what this revision shows is that the growth rate in the sectors covered by the Board's index has been materially greater over the past decade than has appeared from the unrevised index.

The statistical data that we have to use from month to month, can only be cross-checked in a comprehensive way when we have available the results of a full census. Congress authorized the Department of Commerce to conduct one of these in 1947, and another as of 1954. The immense task of digesting and reappraising the results of these censuses, and then refitting all of the monthly data into these basic benchmarks, has now progressed far enough to indicate that the revised index, with the 1947-49 period as the starting point at 100, will show a level of around 165 at mid-1959. That is 10 points higher than the figure shown by our unrevised index for June.

Some of this difference results because we are now able to include, with appropriate proportional weight alongside other items, more of the fuel and energy production that has been going on all the time without being represented in the index. More than half of the difference, however, results from improvements in measurement of presently included industries. The monthly movements of the revised and present indexes

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are quite similar, so that main effect of the revision in the total is to tilt upward this measure of industrial growth over the past decade. For example, it now appears that industrial output of consumer goods on a revised basis has risen at an average annual rate of 3.8 per cent as compared with 3.2 per cent shown by the unrevised index for the consumer goods sector. Population growth has been at a rate of 1.7 per cent per year.

Industrial production, to be sure, is only one of the ways that growth might be measured, but it is a measure in real terms and so is free of price influences. Crude measurements of growth in aggregate dollar terms can be seriously misleading, not only with respect to what the economy has done but also in marking out guidelines as to how we may reasonably expect the economy to grow in the years ahead. It is no achievement to have a rise of 10 per cent in the general price level such as occurred in the months after the Korean outbreak--even though that does puff up the figures on gross national product quite handsomely. The increase of 15 per cent in the current dollar value of gross national product from 1955 to 1957 was only half of what it seemed to be because it was inflated by a general price increase of 7 per cent.

Throughout its entire history, this economy has grown by staggering magnitudes. It is because I, for one, want to do everything I can to keep it growing that I urge the maintenance of free markets and reasonably stable prices as primary objectives of public policy.

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Chairman Martin

EXCERPT FROM TRANSCRIPT OF HEARINGS BEFORE THE JOINT ECONOMIC COMMITTEE ON JULY 30, 1959 RE AUDITS AND EXPENDITURES OF THE FEDERAL RESERVE SYSTEM

CM

Representative Patman. Mr. Martin, I want to ask you this. We had the hearings on the financial institutions bill in 1957, and I asked you a number of questions there about the attitude and the conduct of these Federal Reserve Banks in advertising that they own the Federal Reserve System, that they bought the money from the government and paid 100 cents on the dollar for it?

Mr. Martin. You are talking about the member banks?

Representative Patman. No, I am talking about the 12 Federal Reserve Banks. I showed you some of the literature they got out to show that they were claiming to the people that they owned the Federal Reserve System, that the member banks owned the Federal Reserve System.

Mr. Martin. Yes.

Representative Patman. One of them had a questionnaire that they tested the people on. The answers were to be to this question, the tenth question: "Capital stock in Federal Reserve Banks is owned by: (1) Treasury Department, (2) Federal Government, (3) its member banks".

The point they were trying to put over there, the people are often mistaken. They felt the Treasury Department owned it, the Federal Government owned it, but really the member banks owned the Federal Reserve Banks.

I asked you then and brought out the number of expenditures for a government institution to spend, if you would look into that, and you said you would look into every one of the points I raised in this

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connection. I wonder if you have contacted any of those banks about the kind of literature which they sent out which was misleading to the extent that they said that the Federal Reserve Banks were owned by the member banks.

Mr. Martin. Your comments on that and that testimony was given to all the presidents of the 12 Federal Reserve Banks, and it was discussed with all the presidents.

Representative Patman. Thank you, sir. I am glad you did that. The way I see it, and I believe you would see it the same way, these are really public funds, and that if you spend them for different parties and scholarships and things like that, that a postmaster could not spend funds for, I think it is wrong to spend it that way. I am glad that you called this to the attention of the presidents of the banks and the others, because they are engaged in the expenditure of funds in ways that cannot be condoned, that is, through the use of public funds for that purpose.

Mr. Martin. Mr. Patman, under the law each of the 12 Reserve banks has its own board of directors and --.

Representative Patman. That is right.

Mr. Martin. We have all this under constant review, and I, in disagreement with you, think we are one of the best audited organizations that I know of.

Representative Patman. Add self-audited, and I will agree. It is as good a self-audited organization as you will find.

Mr. Martin. Auditing of the type now going on is really what is essential in the Federal Reserve. We have outside public accountants

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that are brought in. We have had Arthur Andersen and we have had Price-Waterhouse that have audited. We have made available to you and you have had the audits of the Federal Reserve Board and the Federal Reserve Banks. These outside auditors have also gone to the individual Reserve banks to check on our audits and to see whether all the items are covered.

Representative Patman. Yes, sir. I have discovered that the audit is lacking in many respects. That is the reason I would like to see the General Accounting Office audit the Federal Reserve System.

Mr. Martin. Our auditors do not think so. We do not think so.

Representative Patman. I know that is your attitude. I have introduced a bill to that effect, and I am going to press it, because I believe it is in the public interest. I don't think that public money should be handled without the General Accounting Office or some independent audit of it.

Mr. Martin. Under our auditing procedures, we are having both a self-audit and an independent audit. I think we are one of the best audited organizations that I know of. As you can testify, there has never been anything in connection with the System that we have withheld from you or any other proper person when we have had inquiry about it. We cannot always dig it up in 24 hours when you go back to 1914. As you know, whatever mistakes we may make are not hidden away. Whatever mistakes of judgment there are, we try to correct them as rapidly as we can. I don't think we have made an undue share of errors of judgment in our administrative activities. I believe that the banks have been conducted--I am talking about the 12 Federal Reserve Banks--extremely efficiently.

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Representative Patman. Mr. Martin, I think you are clearly wrong. I know you are sincere in believing that you are conducting the affairs properly and all the banks are. I think it has been conducted in such a loose fashion that the presidents of these banks feel that they can spend public money for any purpose any private corporation could spend money. In fact, they actually argue that. When I gave out a statement recently showing the loose way in which public funds were handled, and wasteful and extravagant waste, some of the presidents of the banks were brazen enough to say, why, sure, they spent money that way, because private concerns spent money that way, and as long as they did what other private concerns were doing, it was all right. They honestly believed it. They failed to put themselves in the position of a postmaster in the town in which they were located, because they are in that position. They have no more right to spend the money than the postmaster has a right to spend the money that he collects in the sale of stamps. It is all public money. They should not be led to believe that they can spend it in such extravagant, wasteful manner as that. To that extent, I am disappointed in the Federal Reserve Board not doing a little--not brain washing, but educating them about what the law is on handling public funds.

Mr. Martin. I want to make this very clear, and I want it on the record, that I deny extravagance or misuse of funds in any form by the Federal Reserve System.

Representative Patman. Naturally you would, Mr. Martin.

Mr. Martin. That is all right. If I did not believe it, I would not make that statement.

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Representative Patman. You saw the many items that I picked out of your own audits, and you do not justify all of them, do you?

Mr. Martin. Mr. Patman, those items are being gone over item by item. I would say that many of those items were taken completely out of context, and it was not in my judgment a fair press release.

Representative Patman. I know.

Mr. Martin. You are raising the issue now, and I am merely putting it to you directly.

Representative Patman. They were quoted from your audits volume and page.

Mr. Martin. We have all these auditors give us their honest judgment, and we do not withhold anything from you. All I say is that the matters as listed by you were taken, in my judgment, out of context. We will in due course, as we always do, have a response to the House Banking and Currency Committee to every one of the items that you raised and state what our judgment is. We are in process of working on that now.

Representative Patman. I wish you would make it and I wish you would agree for the General Accounting Office to make an audit of the system, because the audits you make are not complete. They are not the kind of audit that a government auditor would want to make. They don't disclose things. They don't even go into things that a government auditor would go into. The General Accounting Office would really give you an audit, and I hope you agree for the General Accounting Office to audit the Federal Reserve System, and the Federal Reserve Board. If it is as clean as a hound's tooth as you think it is, you have nothing to fear,

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and I don't see why you should not agree to it. It is public funds. It is a public institution owned by the government, and there is no reason why you should not do it.

Mr. Martin. We have been over this many times, Mr. Patman, as you know. The Banking Acts of 1933 and 1935 covered this particular issue at considerable length. I again say that I think it would be a serious mistake to do that, because I think the central bank needs this authority and it was recognized in the Banking Act of 1933 and carried forward in the 1935 Banking Act. The impression that we are not audited is entirely incorrect. We are very carefully audited. Our expenses are gone through with a fine tooth comb. I don't hold out perfection for the System, and never have. But, I do not think it ought to be done. I believe if it should be done, it should be made a part of the Federal Reserve Act, and put into the Federal Reserve Act as such. At the present time the law does not provide for it.

Representative Patman. In 1933 and 1935 our country was suffering from the most serious depression in all history and proposals were made to change the banking laws. Congress hardly looked at it. There was very little discussion of it. It went through without any discussion almost, because everybody wanted to cooperate to do everything possible to get the country out of the depression. They were not looking at these things like some people were. A lot of things got into that 1933 and 1935 act that should not have been tolerated. No hearing has been conducted in the Congress since that time. I mean a general monetary hearing. Otherwise a lot of these things would have been gone into.

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On these audits, I would not say it is hypocritical or deceitful, but they are not full and complete, Mr. Martin. I don't know what the instructions to the auditors were. Did you give them instructions to just go into anything that they thought was material and important and should be disclosed? To tell private auditors that you select, and for the Government auditors to make an audit is different. Who were the auditors? Auditors from their own banks. When you audited the Chicago bank, you used some of the people in the Chicago bank to do the auditing. When you audited the New York bank, you used some of the people in that bank to help do the auditing. I think every audit will disclose that you used some of the people inside the very institution they were auditing in order to help do the auditing. If that is the right kind of auditing, all right, but I did not think you audited that way. I thought you had people to do the auditing that had some reason to pick out wrongs and irregularities and dishonesty, if any, and thefts if any, and embezzlement, if any. These auditors don't seem to be charged with that sort of a dedicated duty.

Mr. Martin, Mr. Patman, you play down one inquiry, of which you were chairman, that was conducted in 1952 for quite a period of time, in which all of these points were raised, and all of them were discussed at considerable length. I don't think there are any legitimate charges of embezzlement or theft or anything of that sort.

Representative Patman. No.

Mr. Martin. You have been using the words.

Representative Patman. I say, if any.

Mr. Martin. All right, if any. But there has not been any.

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Representative Patman. You don't know because you have not audited them. Your own people have been doing the auditing.

Mr. Martin. I don't think Price-Waterhouse are our own people. I don't think Arthur Andersen is our own people.

Representative Patman. They used some of your own auditors in helping them. Your reports show that.

Mr. Martin. They use office boys, too. You use office boys in the Congress.

Representative Patman. You are getting off the subject now.

Mr. Martin. No.

Representative Patman. They used people inside the banks.

Mr. Martin. In this matter of auditing you can spend a lifetime in it. I am not a professional auditor, but I have had a lot of experience with it. I have dealt with it in a great many situations, not only with the Federal Reserve, and it is not a simple matter. I insist that the auditing of the Federal Reserve System as done today is a first class job. That is my judgment and I give it to you. If I did not believe it, I would not say so.

Representative Patman. I believe you made some statement about the investigation of 1952. Up until then I don't think the Board had ever been audited, had it?

Mr. Martin. Yes. You are getting back at the history. At one point we had the General Accounting Office on the Board on part of our accounts. That was discontinued in the Banking Acts of 1933 and 1935. You indicated they did not know what they were doing, but Congress changed

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the law.

Representative Patman. It was not the General Accounting Office on the board. It was the Comptroller of the Currency on the Board.

Mr. Martin. No, not on the Board. The General Accounting Office was not on the Board, but they did audit some of our accounts prior to 1933. The Comptroller of the Currency and also Secretary of the Treasury were ex officio members of the original board.

Representative Patman. I say they were up until 1933.

Mr. Martin. But I am talking about audits. We went into it with you in your 1952 hearings. I don't like to see you play down your own hearings because I thought it was a first class job. We prepared a great deal of material. It is in several volumes. I really think it is worth all of us rereading. I think it was a good job.

Representative Patman. We are very proud of it, Mr. Martin, but that was a very small part, the auditing was a very small part of it.

Mr. Martin. All of the questions were gone into. I give you credit for this. I can't remember a time when I have been up here that you have not raised this point. So I commend you for persistence and energy. But I don't think it is fair to say it has not been raised very carefully.

Representative Patman. I will keep on raising it until we have an audit by the General Accounting Office, Mr. Martin.

Mr. Martin. I have no objection to your raising anything indefinitely. I say sincerely--

August 3, 1959.

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STATEMENT BY SECRETARY OF THE TREASURY ROBERT B. ANDERSON
BEFORE THE JOINT ECONOMIC COMMITTEE, 10:00 A.M., EDT,
FRIDAY, JULY 24, 1959

Our national economic objectives can be summarized under three broad headings: (1) continuity of employment opportunities for those able, willing, and seeking to work; (2) a high and sustainable rate of economic growth; and (3) reasonable stability of price levels. Each of these objectives is important; each is related to the others.

The rapid upsurge in economic activity of the past 15 months provides an appropriate background for your study of these national economic goals and the best methods of achieving them. The recent resurgence in output, income, and employment to record levels has once again demonstrated the basic strength and resilience of our free choice, competitive economy. Thus, we visualize the task with which your committee is confronted not as one of devising drastic changes in our techniques for achieving our economic goals. Rather, it is to evaluate, within the perspective of developments of the past few years and during the postwar period as a whole, the existing techniques toward the end of sharpening their use. There may perhaps be weapons not now in our arsenal that should be developed; there are no doubt ways in which existing techniques can be improved. But the performance of our economy supports the judgment that basically our economy is sound and healthy.

Much could be said about Government economic techniques -- their nature, interrelationships, strengths, and shortcomings. I am sure,

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however, that your Committee will explore these matters thoroughly, drawing both from current thinking and from the vast body of earlier study performed both by committees of the Congress and by private individuals and organizations.

Before discussing the Treasury-Federal Reserve study of the Government securities market, in which you have expressed particular interest, I should like to consider briefly economic growth as a goal of public policy.

Some in our country express a belief that the Government should undertake the primary role in promoting economic growth. It is my belief that in our system the Government is not the predominant factor in our Nation's economic advancement. It must foster and facilitate economic progress -- it cannot force it.

What we all seek is sound, sustainable growth -- not any kind of growth, or growth at any cost.

Should our efforts to spur progress lead to inflation, it will bring only disappointment and hardship. But when growth is in terms of goods and services that people need and can buy, it will bring great rewards.

Only within the past decade has economic growth been explicitly recognized as a major goal of public policy. This recognition, coupled with considerable public discussion of the importance of growth to our economy, provides an important reason for taking a careful look at growth as a national economic objective. What is

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economic growth? What determines the rate of economic growth in a free choice, market economy? And, finally, what is the proper role of Government in promoting a high and sustainable rate of economic growth?

What is Economic Growth?

The most commonly cited definition of economic growth is in terms of the annual advance in real gross national product; that is, growth in the dollar value of total output, adjusted for changes in price levels. For some purposes this is a good measure of economic growth; for others it is not.

An over-all measure of growth tells us nothing about its nature. For any period, we must get behind the broad figures to determine what type of growth has taken place. This is simply another way of saying that promotion of growth for its own sake may well result in either fictitious or unsustainable growth. An increase in output, to be meaningful, must consist of the goods and services that people want and are able to buy. It is not enough to select some hypothetical maximum of growth; the actual growth that occurs must consist of useful and desirable things as opposed to unwanted or undesirable goods.

Thus, in trying to decide whether growth over a period of years was at an adequate rate, we would first have to look within the total -- to get behind the figures -- and try to determine the

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characteristics of the growth. Some of the questions we would ask would be: How much did personal consumption expand relative to Government use of goods and services? Within the Government component, what portion consisted of defense spending as opposed to schools, highways, and other public facilities? How much of the increase in output consisted of goods the people did not want, and thus ended up in Government warehouses, being given away, or destroyed? What portion of total output was devoted to investment in the instruments of production, to modernization of plant and equipment, and to research? How much of our effort had to be devoted merely to maintenance of our productive plant, as opposed to net new additions?

There are other important questions. How were the fruits of the growth in output distributed among various groups in the economy? Did the growth carry with it certain imbalances that would hamper future growth? To what extent was temporary growth fostered by reliance on actions that impinged directly on the free choice of individuals and institutions?

These are but a few of the questions we should ask. They indicate that economic growth, in terms of a broad, aggregate figure, is not necessarily an end in itself. It must be growth of the right kind; it must be sustainable growth.

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What Determines the Rate of Economic Growth?

The role of public policy in fostering a high and sustainable rate of economic growth in a free choice, competitive economy can be properly assessed only on the basis of an understanding of the determinants of growth.

The factors influencing the rate of growth are manifold and complex. Among those of major importance is the pace of technological advance. No one can study the economic history of this or any other advanced industrial nation without being impressed by the vital contributions of the inventor, the innovator, and the engineer. A stagnant technology is likely to be accompanied by a stagnant economy. Man's ingenuity in tackling and solving his problems lies at the heart of the growth process.

This is perhaps another way of saying that growth and change are inseparably intertwined. If we would enjoy maximum growth, we must not only be willing to improve the production process through accepting new ways of doing things, but we must also actively seek out such techniques. Moreover, the integral role played by change and technological advance in the growth process contributes to unevenness in growth over time. Technological advance does not come at a steady, constant rate. Thus we cannot expect growth, to the extent it reflects such forces, to proceed at a steady rate, year in and year out.

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Technological advance, however, cannot alone assure a high rate of growth. The best ideas and the best techniques are of little benefit if the means are not available to translate them into operating productive processes. This requires real capital, which can only grow out of saving and productive investment. Thus, real capital formation -- which consists of the machinery and instruments of production, tools of all sorts, and new plant buildings -- is a basic ingredient of economic growth. An economy in which additions to the stock of capital equipment are small cannot be a rapidly growing economy.

The importance of an adequate rate of capital formation in the growth process deserves special emphasis. Broadly speaking, current output can be directed either into consumption goods, represented by durable and nondurable consumer goods and services, or into investment goods, represented principally by new industrial plant and equipment. So long as our economic resources are being utilized close to capacity -- as has indeed been the case almost continuously since 1941, the more of our output we devote to capital formation, the less that is available for current consumption. The more we consume, the less we can devote to capital formation.

This is a basic but, apparently, little understood principle of economics. There appear to be some observers who believe that, on top of providing adequately for national defense and devoting a

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considerably larger volume of current output to public projects, we can still achieve uninterrupted future growth in the private sector of the economy at a rate higher than ever before realized in this country. Perhaps this is possible; but it seems clear to me that it can occur only at the expense of current consumption. It can take place, in other words, only if we are willing to accept a lower current standard of living. With our pressing needs for adequate national defense, we cannot have an ultra-high "maximum" rate of economic growth in the future, requiring as it does heavy current investment in plant and equipment, without restricting current consumption. We cannot "have our cake and eat it too."

A third important requisite for a high and sustained rate of growth is reasonably full, efficient, and continuous use of our economic resources. Economic recession is the number one enemy of sustained growth in this country. Idle manpower and idle equipment represent production that is irretrievably lost. Moreover, inefficiencies in use of resources can also carry a heavy toll in terms of lost output.

It is important to emphasize that success in achieving high and sustained employment, and in providing useful job opportunities for our growing population, is closely related to our success in promoting an adequate rate of capital formation. In our highly industrialized economy, workers must have the machines with which to

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work. These machines will come into existence only to the extent that productive investment takes place.

In short, economic growth in a free choice, competitive economy tends to vary more or less directly with the pace of technological advance, the rate of capital formation, and the extent to which economic resources are effectively employed. To be effective, any Government program designed to foster growth must operate largely through these basic determinants.

Government's Role in Fostering Growth

Government can play an important role in fostering a high and sustainable rate of economic growth. One basic principle should be clear, however. In an economy in which major reliance is placed on individual initiative and decisions, and in which the alternative uses of economic resources respond, through the market mechanism, primarily to consumer demand, Government can and should play only a facilitating, not a predominant, role in the growth process.

The moving forces which promote growth in a free choice, market economy are basically the same as those that account for economic progress on the part of the individual. Thus the individual's desire for a higher and more secure standard of living for himself and for his family is the basic stimulus. This is the prime mover. To this end he studies, plans, works, saves and invests. He searches out new ways of doing things, developing new techniques and processes. Where

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such instincts as these are strong, the forces promoting growth in society as a whole are strong. Where they are weak, the impetus for growth is also weak.

The first role of Government in promoting growth is to safeguard and strengthen the traditions of freedom in our economy. Stated differently, the proper and effective role of Government is to provide an atmosphere conducive to growth, not directly to attempt to force growth through direct intervention in markets or through an improvident enlargement of the public sector of the economy. Indeed, Governmental efforts to promote growth that rely on, or subsequently lead to, excessive intervention in and direction of market processes can only impede growth in the long run.

The case for this approach to promoting growth is strengthened by the fact that technological advance flourishes in an atmosphere of freedom. Basic to technological advance is pure research; and a fundamental belief in our society is that pure research makes its greatest contribution when minds are free to meet the challenges of the future.

Government can also promote rapid, healthy growth by fostering competition in the economy. Competition sharpens interest in reducing costs and in developing more efficient methods of production. It places a premium on skills in business management. It stimulates business investment, both as a means of economizing in

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the production process by use of more efficient machinery, and by enlarging capacity in order to capture a larger share of the market. Healthy and widespread competition, in short, is the primary stimulant to efficiency in use of our economic resources, both human and material, through technological advance and by stamping out waste and inefficiency in productive processes.

Our tax system may hamper growth in a number of ways. One of the objectives of the study recently initiated by the House Ways and Means Committee, and in which the Treasury is cooperating, is to determine what changes can be made that will be conducive to healthy and sustainable economic growth. I am hopeful that this study will lead to significant results.

All of these methods of aiding growth are important. I am convinced, however, that Government can make a most significant contribution to growth primarily by using its broad financial powers -- fiscal, debt management, and monetary policies -- to promote reasonable stability of price levels and relatively complete and continuous use of our economic resources.

As noted earlier, a high rate of saving is indispensable in achieving a high rate of economic growth. Under conditions of near-capacity production, resources can be devoted to capital formation only to the extent that they are freed from output of goods for current consumption. This, in turn, is possible only to the extent that saving occurs.

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In the years since the war, incentives to save in traditional forms -- in savings accounts, bonds, and through purchasing insurance -- have been somewhat impaired by the conviction of some that inflation is inevitable. In my judgment, this is a mistaken conviction. But the fact remains that if we allow a lack of confidence to develop in the future value of the dollar, the desire to save will be weakened.

Full confidence in the future value of the dollar can be maintained and strengthened only by a concerted, broad-gauge attack on all of the forces and practices that tend to promote inflation. Some of these forces and practices may be new and thus require further study before they can be identified and before appropriate policies to control them can be devised. But there should be little doubt in our minds as to the proper role of general stabilization policies. Under present-day conditions, with production, employment, and income advancing rapidly to record levels, such policies should be directed toward self-discipline and restraint. This requires Federal revenues in excess of expenditures, to provide a surplus for debt retirement; flexible management of the public debt; and monetary policies directed toward preventing excessive credit expansion from adding unduly to over-all demand for goods and services.

Some observers have argued recently that we are not now confronted with monetary inflation, or with a situation in which "too much money is chasing too few goods." They point to the high degree of price

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stability during the past year as proof of this contention. This same argument could well have been made in mid-1955, when that recovery was also merging into the boom phase of the cycle. At that time, the consumer price index had actually declined slightly during the preceding 18 months; the wholesale price index had been stable for about 30 months. We failed to recognize at that time, just as we may be in danger of failing to recognize now, that the high levels of demand generated in the recovery had sown the seeds of later increases in prices. Thus, wholesale prices rose moderately in the last half of 1955, at a steady and relatively rapid rate throughout 1956, and moderately during 1957. Consumer prices, exhibiting the customary lag, did not begin to advance until the spring of 1956, but thereafter rose steadily until early 1958.

The important point is that effective control of inflation requires actions to restrain inflationary pressures at the time that such pressures are developing. To wait until the pressures have permeated the economy, and have finally emerged in the form of price increases, is to delay action until the situation is much more difficult to cope with.

Effective stabilization actions to limit inflationary pressures during this period of rapid business expansion, in addition to promoting stability of price levels, will stimulate sustained growth in still another important way. Such policies, by helping to assure

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that the current healthy advance in business activity does not rise to an unsustainable rate and then fall back, would promote relatively full and continuous use of our economic resources. I am firmly convinced that the degree of severity of a business recession reflects to a considerable extent the development of unsustainable expansion in the preceding boom. By exercising restraint and moderation during periods of prosperous business, we can keep booms from getting out of hand and, in so doing, minimize the impact of later adjustments.

Appropriate current Governmental policy to promote growth must be consistent with long-range objectives and not resort to quick expedients that endanger sustainable development. We must reject the arguments of those who would attempt to force growth through the artificial stimulants of heavy Government spending and excessive expansion of money and credit. If we would foster growth -- not of the temporary, unsustainable type, but long-lasting and rewarding -- we need first to reinforce our efforts to maintain reasonable price stability and relatively full and continuous use of our economic resources. Both logic and experience demonstrate clearly that heavy reliance on Government spending and monetary and credit excesses during a period of strong demand, rather than promoting growth, can lead only to inflation. Inflation tends to dry up the flow of savings and leads ultimately to recession -- the number one enemy of growth.

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We live in what is basically a free choice economy. Within rather broad limits, we are free to dispose of our labor, property, and incomes as we see fit. In disposing of our incomes, we are free to spend or to save, to invest or to hoard. So long as we maintain the basic freedoms that foster competitive enterprise and stimulate technological advance, and so long as we use our broad financial powers to promote stability in the value of our currency and to avoid the extremes of economic recession, I am confident that economic growth will proceed at a high and sustainable rate. The strength of our economy lies in its very reliance on the integrity, wisdom, and initiative of the individual. We must not weaken this basic strength.

The Government Securities Market Study

I will now make some brief observations on the Treasury-Federal Reserve study of the Government securities market.

Our national economic objectives are, of course, fundamental. It is only in relation to the successful achievement of these objectives that the financial policies pursued by our Government can have real meaning. Furthermore, fiscal, debt management, and monetary policies can make their maximum contribution to national economic goals only if they can operate in a market which is responsive to policy actions both in terms of basic understanding of those actions by the investing public and in terms of the efficiency and maximum usefulness of market organization.

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The Government securities market is the largest financial market in the world, with a daily trading volume of more than $1 billion. It is an extremely complex market and is sharply competitive. It is very responsive to trends and expectations as to business activity, Government policies, and international developments.

Its responsiveness and competitiveness, under widely varying circumstances, means that it can provide the proper environment for the successful flotation of the tremendous volume of frequent Treasury security offerings to the public, which last year alone totaled almost $50 billion, exclusive of the rollover of weekly Treasury bill maturities. Similarly, it can provide an efficient mechanism through which Federal Reserve monetary policy can operate. Moreover, it must provide for the smooth transfer of large amounts of Government securities among investors as liquidity and investment needs are satisfied.

The Treasury, the Federal Reserve, and the entire business and financial community, therefore, have a joint responsibility, collectively and individually, to encourage the market to resist any forces which threaten to impair its maximum performance. If market techniques become distorted or restrictive practices arise, the consequences can extend far beyond any immediate impact on investors, speculators, or suppliers of credit. It can undermine the basic contribution which a smoothly functioning Government securities market should make to the national welfare.

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It is with this realization of the importance of the Government securities market that the Treasury and Federal Reserve last spring undertook their joint study of the way in which the market operates, with particular reference to the market's performance around the time of the reversal of the economic downturn a little more than a year ago.

A study of market mechanisms is necessarily technical. The results of any such study are understandably less dramatic than studies of the broad aspects of fiscal, monetary and debt management policy which, together with general economic trends and expectations, provide the environment in which these market mechanisms operate.

Our joint Treasury-Federal Reserve study group has been working continuously toward the objectives which were laid out when the project was announced on March 9, 1959. Part I of the study group's factual report is now in final form; Parts II and III are only in preliminary form. All three parts are being made available for public release on Monday morning.

Your Committee already has a joint statement by Chairman Martin and myself relating to the study. The virtual completion of the factual study by the study group provides a background which Federal Reserve and Treasury policy officials can now carefully review as we work toward official conclusions and recommendations growing out of the study.

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These conclusions cannot be prejudged. Treasury and Federal Reserve officials have been following the progress of the study group with great interest, but because of the late completion of the Report, we have had little opportunity to examine the factual material which the study group has assembled.

As Chairman Martin and I state in the concluding paragraphs of our joint statement, markets are dynamic institutions which require adaptation to changing needs. The public interest is served only if the study of these adaptations is continuous, even though it may be intensified from time to time as in the present study.

We both recognize, and I want to emphasize it again, that improvements in market mechanisms, helpful though they may be, cannot be expected to solve the basic financial problems which our Nation faces -- the problems of fiscal imbalance during prosperous times, the tendency for the public debt to grow shorter in its maturity structure, the need for continuous flexibility in adapting monetary policies to varying circumstances, the need to encourage increased savings to finance soundly the Nation's heavy capital requirements, and the problem of the instability of financial markets as they react to turning points in economic cycles.

These are basic problems. We are glad to work with your Committee in seeking their solutions in the best interest of the public.

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Joint Statement Relating to the Treasury-Federal Reserve Study of the Government Securities Market by Robert B. Anderson, Secretary of the Treasury and William McChesney Martin, Jr., Chairman of the Board of Governors of the Federal Reserve System (presented for the record in connection with Secretary Anderson's appearance before the Joint Economic Committee, 10 a.m., EDT, July 24, 1959).

The objectives of national financial policy as pursued by both the Treasury and the Federal Reserve System have meaning, of course, only as they contribute to the sound functioning of our Nation's economy. For our economy to remain healthy and growing, market mechanisms must perform their essential function of providing a meeting place where the forces of supply and demand can operate to achieve the best utilization of resources. One of the problems which has constantly confronted us as a Nation has been how to protect freely competitive markets from forces which would hamper or restrict the performance of this essential function. Only as everyone concerned remains alert to new developments in marketing techniques and organization can we be assured that distortions and restrictive practices have not crept in, to the detriment of healthy growth. This is, of course, just as important and necessary in the financial sector as it is in other areas of the economy.

Developments in the Government securities market a year ago led the Treasury and the Federal Reserve System to undertake a joint study of current techniques and organization in that market. This joint statement is devoted to a discussion of the progress of the study thus far.

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Objectives and Conduct of Study

The immediate background of our joint study was the wide and rapid price fluctuation in the Government securities market during the economic recession and revival of 1957-58. These market movements were naturally a matter of concern to the Treasury in view of its debt management responsibilities. They were of equal concern to the Federal Reserve because of its responsibilities for over-all credit and monetary conditions.

In undertaking the study our purposes were to find out how organization and techniques in the Government securities market might be improved, and by what means the danger of future speculative excesses in this market might be lessened. The first step, we felt, was to provide the widest possible basis of factual information. Accordingly, we undertook a detailed and analytic study of the underlying causes of the 1957-58 movements. At the same time we undertook a broad re-examination and reconsideration of the market's general organization.

While experience of the Government securities market during a particular recent period thus provided a specific occasion for initiating this special study, both the Treasury and the Federal Reserve have recognized for some time the need for such a study. The last such study, with somewhat more

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restricted objectives, was made in 1952 under the auspices of the Federal Reserve's Open Market Committee. The Treasury did not participate in that study since it was primarily concerned with the interrelationship of the market and Federal Reserve operations. Since that time there have been many new developments in the market's machinery and practices, and both the Treasury and the Federal Reserve felt that these developments needed careful evaluation.

The published version of our study will consist of three parts. Part I, which is being made available for public release next Monday, consists, first, of a summary of informal consultations -- some conducted in person and some through written communication -- held with informed observers of the Government securities markets and important participants in that market. Part I also includes a special technical study of the possibilities of an organized exchange, or auction market, to take care of the major part of the huge volume of Government securities transactions. These are handled at present, as you know, in the over-the-counter or dealer market, where more than one billion dollars of transactions are handled in a typical trading day.

The informal consultations represented one of the major phases of our study program. These consultations had three objectives: first, to obtain informed impressions and

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judgments on basic causes of last year's market experience, especially toward midyear and after; second, to find out how market observers and participants viewed and appraised existing market processes and mechanisms; and third, to get the benefit of whatever suggestions might be made for improving and strengthening the market. While our consultations were limited by the special purposes of the study to those who were thoroughly acquainted with market practices, our aim throughout was to seek out the means whereby the Government securities market could function best in the public interest. In our inquiry the needs of the small buyers and sellers were considered carefully, along with those of the Government and of institutional and other large investors.

Consultants included various officials of large commercial banks, of insurance companies and savings banks, and of investment banking firms; primary dealers and intermediary brokers in the Government securities market; financial officers of several large nonfinancial corporations; a number of members and officials of the New York Stock Exchange; a group of financial economists; and a group of academic economists. In all, approximately 75 persons participated in individual or group consultation and about 30 others provided written comments. The individual and group consultations were held in Washington, D. C. and in New York City, and each lasted from an hour to a full day. The discussions with financial and academic economists were on a panel basis, but the remaining consultations were held separately on an informal basis with one or more individuals from a single organization.

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Part II of our study is a factual analysis of the performance of the Government securities market from late 1957 to late 1958. Rapidly changing market conditions in this period presented an unusually wide range of problems. To obtain the most complete information possible on the market forces at work, special questionnaire surveys were addressed to all major lenders and participants in the market. On the basis of the answers received, we were able to compile much new data relating especially to market developments from spring through early fall of 1958.

Concerning this second part of the study, it is gratifying to report that the responses to our detailed requests for new statistical information were exceptionally good--indeed, virtually 100 per cent.

Part III of the joint project consists of four supplementary and technical studies growing out of the suggestions and findings of the first two parts. We comment later on their particular focus and scope. Neither Part II nor Part III has been printed as yet, but both are being made available in preliminary form also for release Monday morning.

Before turning to the substance of the entire study itself, a word should be added about how the project was staffed. Both the Treasury and the Federal Reserve System assigned to the study senior personnel experienced in the observation and analysis of the Government securities market. In addition, the Treasury retained the services of a former staff official, having both debt management experience in the Treasury and practical experience in the market, as technical

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consultant on the study. Federal Reserve personnel were drawn mainly from staffs of the Board of Governors and the New York Federal Reserve Bank, but selected personnel from other Reserve Banks also shared in the work. A central Treasury-Federal Reserve staff group was given full responsibility for carrying out the project, and since early spring the members of this group have devoted a major share of their time to it.

Interpretation of the 1957-58 Market Experience

As noted earlier, our study of the Government securities market was focused on the wide swings in market prices and yields of Government securities from late 1957 through the fall of 1958, with special attention paid to the mid-1958 market experience. Through systematic re-examination of available data and the development of new data, we endeavored to find out what lessons could be derived from this experience which would be of benefit to investors generally as well as to those who are responsible for fiscal policy, debt management policy, and monetary policy.

We have not had sufficient time as yet to make a complete evaluation of all the data which have been brought to light by the joint study. Four general observations relating to private investment and credit extension, fiscal policy, debt management, and monetary policy, however, are pointed out by the staff group, as follows:

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First, for purchasers of marketable Government securities and for lenders, the risks of speculation on anticipated cyclical price movements of fixed-income Government securities, and particularly of speculation on slim margin, credit-financed holdings, have been widely learned.

Second, in the area of fiscal policy, there is the problem that recession deficits often run to very large size and are delayed beyond the turn in the economy; as a result they provide stiff financing competition when growing demands for the financing of recovery must be satisfied from a more slowly growing savings supply, and this competition for savings funds may have significant, but largely unavoidable, effects on securities prices and interest rates.

Third, in the area of debt management, there is the problem as to whether, in periods when easy credit conditions lend investor favor to longer term, higher yielding issues, a large and rapid shift in the maturity structure of the debt may result in supply and demand distortions, which may later have upsetting and disruptive effects on the market.

Fourth, in the area of monetary policy, there is the problem as to whether easy credit conditions and accelerating monetary expansion for counter-cyclical objectives may be carried to the point where banks and other lenders respond too actively to speculative demands for credit, so that lenders, in their zeal to keep their funds employed

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to fullest advantage, may too easily relax the credit standards which long experience has taught to be sound.

These broad conclusions arising out of our study point up a major financial dilemma which is faced in coping with recession in a free enterprise, market economy.

We all agree that reduction of economic instability is one of our major objectives. National financial policy--which refers to fiscal policy, debt management policy, and monetary policy in combination--is the primary means available to the Federal Government for cushioning recession and stimulating recovery.

Yet, the vigorous use of financial policy to promote economic stability runs the risk of being accompanied by instability in the financial markets, where flexible movement is an essential part of market mechanism. This appears to be a risk which we must take, while doing everything we can to minimize the incidence of instability in these markets.

We know, of course, that many difficulties arise in the effective use of fiscal policy in recession. Deficits in recession are incurred either automatically because of reduced tax receipts and increased social insurance payments or because of specific public policy actions taken to combat recession. These in turn have a direct impact on the prices of Government securities.

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The additional burden of increasing debt in such periods--particularly when preceded by inadequate budget surpluses for debt reduction during the preceding rise in the economy--may also have a psychological effect on investors. This may be expected because of the fact that investors are concerned about future budgetary policies as well as the size of the particular financing needs of the moment.

There are other perplexing dilemmas in periods of general economic instability which arise from the very flexibility of our market mechanisms. Investors, for example, are faced in recessionary periods with either keeping their funds highly liquid (with low earnings) or attempting to obtain higher yields available only on longer term investments and thus sacrificing liquidity. Concentration on liquidity would, of course, accentuate recession tendencies, while emphasis on higher yields would help to counteract such tendencies.

The Treasury faces difficult choices during a recession. The orthodox theory of debt management emphasizes short-term financing when resources are not fully employed. At such times, however, the long-term market is receptive to offerings--perhaps for the first time since the middle part of the previous upswing in the business cycle. When the Treasury enters such a period with a large and growing floating debt, it would seem advantageous to refinance some part of this debt at longer term. Such a course

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is also desirable to provide greater leeway in choosing financing alternatives when the recession-induced deficit is sooner or later encountered. And since a recession deficit when it occurs must be financed within a relatively short period of time, the Treasury must look forward to making heavy calls on available savings during the deficit financing period. In the second half of 1958, for instance--a recovery period, but one coinciding with heavy deficit financing requirements--the Treasury was obliged to absorb the equivalent of a third or more of the total new savings funds then available. The Treasury's problem of maintaining a debt structure adaptable to changing circumstances without itself contributing to instability of the economy is a formidable one.

Monetary policies, if they are to contribute to resolving our problems of general economic instability, must be deliberately and appropriately adjusted to combatting recession and they must be shifted when an upturn is evident. The timing and extent of monetary actions--like those in the fiscal field-- must surely be determined by other considerations in addition to their impact upon interest rates and the prices of securities. Again, however, such effects are not to be ignored.

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Some Findings About Market Functioning

While the study indicated certain broad lessons from the 1957-58 experience for both investors and national financial policy, and also highlighted some of the fundamental and conflicting dilemmas inherent in such a period, it focuses on the functional and mechanical aspects of the Government securities market in this setting of recession and recovery. A specific interest was the speculative and credit excesses that developed. Our objective in studying these developments was to arrive at possible adaptations of public policy and also of market institutions which might lessen the market's exposure to such excesses in the future.

The excesses which occurred last year were associated with the build-up in the Government securities market prior to the Treasury's offering in late May 1958 of a 2-5/8 per cent, seven-year bond as one option available in its June 15 refinancing of $9-1/2 billion of maturing obligations held by the public. The other option was a one-year 1-1/4 per cent certificate. Altogether the holders of about $7-1/2 billion of the maturing issues preferred the 2-5/8 per cent bonds -- a figure which was more than double what had been estimated by the financial community or by Government agencies as true investor demand. This was a surprise to the market and suggested that a sizable amount of the newly acquired securities were speculatively held. Nevertheless, there was general market agreement after the announcement was made that the market would be able to absorb the excess supply over a period of time.

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About this same time, however, market observers were beginning to realize that the Federal deficit in the year ahead would be the largest since World War II, and that most of it would have to be financed in the second half of 1958, coinciding with the period of heavy Treasury seasonal borrowing. At least part of the flow of economic information in the first half of June had been mildly encouraging; but it was not until around mid-June that market observers took into account that economic recovery might soon begin and that conditions of active ease in credit markets might be coming to an end. In this setting, liquidation of temporary holdings of 2-5/8 per cent bonds began and gathered rapid momentum, with an accompanying sharp decline in market prices of Government securities and an associated sharp rise in security yields. As you know, the opportunity for either profits or losses on the price behavior of a longer term bond is much greater than on short-term securities for a given change in interest rates.

This liquidation period, you may recall, occasioned intervention in the market, first by the Treasury in late June and early July to relieve the market of some of the excess supply of 2-5/8 per cent bonds issued at mid-June, and second by the Federal Reserve later in July to correct a disorderly condition which developed around the time of the international crisis in the middle-East and a Treasury financing.

Many observers have placed principal blame for this upsetting market episode on excessive speculation in the June refundings,

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financed by the use of credit extended on unduly thin margins. Our study shows that there was indeed a substantial volume of credit-financed participation in the June refunding -- about $1.2 billion. Considering that $7-1/2 billion of the 2-5/8 per cent bonds were issued, it is obvious that at least four-fifths of the subscriptions represented outright holdings. A significant share of these were probably also temporary holdings purchased in the hope of speculative gain. The outright holdings largely represented subscriptions on the part of commercial banks and business corporations.

In retrospect, one key to this widespread speculation may have been the absence of adequate information about current tendencies in the Government securities market itself, which is, of course, the pivotal market in this economy's financial organization. Much more important, however, is the fact that too many speculatively motivated exchanges into the 2-5/8 per cent bonds were apparently based on investor judgments that recession would continue for some time, and that long-term interest yields would decline further.

Speculation financed by credit created a particular problem in this instance because there were large blocks of holdings acquired by newcomers to the market who bought or made commitments to buy Government securities on very thin margin -- or in many cases on no margin at all. Several stock exchange houses made large commitments themselves and acted between lenders and

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speculators. Some commercial banks and business corporations, actively seeking higher yielding outlets for funds than were provided by Treasury bills and other short-dated securities, directly or indirectly helped to finance these operations.

The activities of one Stock Exchange member specializing in money brokerage facilitated the financing of a substantial volume of the June rights. These operations were found to be in violation of Stock Exchange rules. The enforced unwinding of these very large positions came at a particularly sensitive stage of the market decline and, combined with other liquidation of speculative holdings, put the market under severe supply pressure. The New York Stock Exchange has since modified its rules so as to prevent a repetition of this kind of speculative financing activity in the future.

While positions financed on credit were not the largest speculative element in the market at the time of the June refunding, they were certainly important in initiating and accentuating the June-July decline in market prices which accompanied the economic upturn. Once liquidation of the new Treasury bonds was underway and prices were declining sharply, it was inevitable that some margin calls and related selling to protect lenders' positions would occur. At the same time, there was substantial liquidation by holders who had done no borrowing at all as they realized that profits

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were not in prospect and sought to minimize or avoid losses by selling out. The development of the Lebanon crisis in mid-July and the growing awareness of the prospects of large Treasury deficit financing in a period of rising private demand for loan funds and accompanying expectations of tightening credit conditions, based in part on rumors of a shift in Federal Reserve policy, heightened market uncertainties during this period of liquidation. There also was considerable uneasiness due to fears that the large budgetary deficit would induce renewed inflationary pressures.

Over this entire period of rapid market change, the figures compiled for the study indicate that dealers operated chiefly in their normal primary function as intermediaries. As the June financing approached, dealers were called upon to absorb large amounts of short-term issues that were being sold to meet corporate liquidity needs over dividend dates and the June tax period. As a result, dealers' holdings of Government securities increased substantially. The enlargement occurred mainly in Treasury bills and in June "rights" (maturing issues eligible for the exchange), and these rights were largely exchanged for the 2-5/8 per cent bonds.

To make matters more difficult over the period covered by the June financing, dealers had to meet large maturities of repurchase agreements which they had made with nonfinancial business corporations. Under these agreements, corporations accumulating funds in earlier months invested a large portion of them by arrangements to buy

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Government securities and, at the same time, agreeing to resell the securities to dealers on a fixed date in June -- again to cover cash needs related to dividend and income tax disbursements at that time. The short-term securities underlying these arrangements had to be refinanced in June through placement by dealers with banks or other lenders.

When the June exchanges were completed dealers undertook to accomplish a distribution of their underwriting holdings of the new 2-5/8 per cent bonds. Such underwriting can result in losses as well as profits to dealers because of the market risks assumed by them. These risks proved to be real in the June financing. Normally, the distribution of the securities acquired in underwriting would have proceeded throughout the remainder of June and July. In view of the then-existing market uncertainties, dealers intensified their distribution efforts and cut back on their total positions generally. These activities also contributed to supply pressures in the market.

Once market decline had set in, investors, speculators, and dealers were obliged to make market judgments in the light of their own portfolio and speculative situations and their individual appraisal of current and future uncertainties. There were times in this period, we were told by market participants, when dealers in order to protect their own capital positions would accept large-size orders to sell only on an agency basis, promising to make the best effort possible to carry out the customers' requests. The volume of Government security transactions by the dealer market, however, continued large throughout the decline.

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The question still to be answered from our examination of the 1957-58 market experience is just what specific findings and interpretations may be drawn about market excesses and mechanisms. While any specific conclusions at this stage are subject to later modifications or supplement, the following are the main ones drawn by the study group in the preliminary version of Part II of the study (Chapter VIII).

"(1) Investor and speculator judgments in the late spring period preceding the June refunding were made largely in the light of information pertaining to an economic situation of one to two months earlier. This lag in the flow of economic information was a factor of basic import in conditioning expectations in this critical period of market development. The role of changing market expectations as to the economic outlook in this period of 1958 clearly emphasizes the need for an adequate supply of current information about trends in the economy generally to facilitate the orderly functioning of financial markets.

"(2) Underlying the late spring speculative positioning of Government securities was a very low absolute level of short-term market interest rates, as well as an unusually wide spread between short- and long-term market yields. This low short-term rate level, together with the prevailing yield structure, vitally influenced the shaping of market expectations of further increases in Government bond prices. It further provided the incentives that led to unusual adaptations of customary credit instruments and terms,

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which facilitated a rapid swelling in the market's use of credit. This development made the market vulnerable to liquidation pressures.

"(3) These conditions in the market, along with investor expectations of still higher prices of Government bonds, resulted in a situation whereby market participants in the June refunding were encouraged to convert an undue amount of short-term issues into longer term issues, thus oversupplying the longer term area of the market and at the same time sharply reducing the market supply of short-term instruments. Pressure on earnings created by the low level of short-term yields led many banks and some corporations to reach out for the higher yields available in the June financing in an effort to protect their earnings.

"(4) Speculative positioning of "rights" to the June refunding on the part of outright owners, together with the conversion into 2-5/8 per cent bonds of a disproportionate amount of their investment holdings of the maturing issues, was of greater volume than speculative positioning by investors who financed by credit. A large number of banks and business corporations participated in this outright speculative positioning.

"(5) Although speculation on an outright basis in the June financing was larger than credit-financed speculation, the latter was excessive considering the size of the refunding operation. Moreover, liquidation of credit-financed positions appeared almost immediately upon the settlement date for the refunding for various reasons and both triggered and accentuated the declining phase of the market.

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"(6) The equity margins put up in this period by credit speculators were, in too many instances, either nonexistent or too thin. Despite the low margins, the losses suffered on credit-financed transactions were incurred chiefly by the borrowers rather than the lenders.

"(7) In the speculative market build-up, the use of the repurchase form of credit financing as a vehicle to carry the speculative positions of nonprofessional and unsophisticated participants proved to be unsound. Use of this particular type of financing instrument, in effect, resulted in lenders advancing credit to unknown borrowers of unknown credit standing or capacity.

"(8) Even among known borrowers of professional standing, the use of the repurchase agreement device was stretched in terms of the types of the security which it covered. In the past, this instrument was employed in the dealer market mainly to finance securities of the shortest term. In its 1958 market usage, the instrument was extended in numerous instances to longer term securities where the maturity bore little or no relationship to the date of termination of the agreement.

"(9) Where used in the mid-1958 period to finance holdings of longer term securities, the repurchase agreement technique in some cases provided a convenient means to circumvent owners' equity requirements that would have been applicable on loans, through margins required by lenders.

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"(10) The use of forward delivery contracts in the pre-June market build-up involving "rights" to the June exchange offerings, though of lesser magnitude than repurchase financing, nevertheless, facilitated an excessive amount of speculative positioning in this issue without any commitment of purchaser funds.

"(11) In the pre-June market build-up, dealers and brokers were not always aware that their credit standing was in effect used by others to underwrite speculation with no equity. The preponderance of June "rights" among the forward delivery contracts would suggest a strong preference for "new" Treasury issues as the mechanism for this speculation.

"(12) The total number of commercial banks outside New York City and also the total number of nonfinancial corporations drawn into the credit financing of the mid-1958 speculative build-up was relatively small, and the major portion of the credit extended was from only a few banks and business corporations.

"(13) In the late spring market build-up, some lending by New York City banks, collateralled by Government securities, was at rates and margins that, under the prevailing market psychology and the then existing conditions, was conducive to the financing of speculative positions.

"(14) The sizable increase in dealer positions prior to the Treasury's June 1958 financing was partly associated with the heavy volume of market trading in that period. Although

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largely concentrated in short-term securities, the expansion dealer positions did provide a market for these issues which facilitated the lengthening of portfolios and speculative positioning by many investors during the period, particularly banks.

"(15) Even though dealer positions at the time of the June refunding were heaviest in the short-term maturities in the market, liquidation of these positions in the following three months, though largely necessary to protect dealer capital positions, did add significantly to the supply pressures otherwise present in the market during this liquidation phase.

"(16) The extensive use of the repurchase instrument for financing all types of Government securities in late spring of 1958 resulted in very large repurchase maturities in mid-June coincident with other churning in the money market in connection with settlement for the Treasury refunding. The necessity of refinancing the securities underlying these repurchase transactions put the Government securities market under heavy internal strain at that time.

"(17) The absence of a Treasury tax anticipation security maturing at mid-June led to much corporate interest in the June maturities as corporations made use of these issues to invest accumulating funds to meet their June tax and dividend needs. This accounted for a considerable part of the market churning at the time of the refunding.

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"(18) The availability of regularly issued statistical information about the market itself might have succeeded to some extent in forewarning market participants and interested public agencies of potential speculative dangers around mid-1958. The fact of the matter, however, is that no such objective information was available to either group to gauge the extent of the speculative forces that were present in the market.

"(19) In the closing months of 1958, when many commercial banks were experiencing seasonal credit demands, study data show a movement of funds from the Government securities market to the banks effected through the vehicle of the repurchase agreement. In other words, some dealers were functioning as money brokers, acting as principals in obtaining funds from business corporations under repurchase arrangement and in turn supplying funds to banks under a reverse repurchase arrangement (resale agreement) with them. Question can be raised regarding the appropriateness of a money brokerage function as part of the dealer operation.

"(20) Most of the decline in market interest rates on Government securities, following confirmation in the late fall of 1957 that economic recession had set in, was effected within a short-time span -- less than four months. The sharp rise in market rates on Treasury issues, following confirmation after mid-1958 that economic recovery had begun, was likewise effected in a short-time span -- about four months. Although liquidation of Government security positions, built up in hopes of speculative gains in the

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June refunding, played a central role in accentuating the rise in market interest rates after mid-1958, it does not necessarily follow that the upward interest rate movement of the entire recovery period would have been smaller if the earlier speculative distortions had been avoided. Upward pressures on interest rates from cyclical Federal deficit financing in combination with expanding private demands for financing, given the savings supply over these months, would still have resulted in a substantial, if not identical, rise in market interest rates."

An Organized Exchange or a Dealer Market?

At the hearing of the Joint Economic Committee earlier this year on the President's Economic Report, there was some discussion of the functioning of the Government securities market. The question was raised whether the market might not be more effective if it were a formally organized exchange or auction-type market, with maximum current publicity on transactions, rather than an informal over-the-counter dealer market, subject to more limited public observation.

As part of this current study of the Government securities market, accordingly, we not only raised this question with market participants but asked our study group to provide a special technical evaluation of the suggestion. The New York Stock Exchange also gave very careful consideration to the question and reported its conclusions to us.

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A specialized market tends to develop in a particular form as the individual participants compete to serve more efficiently and economically the needs of buyers and sellers of the kind of security or commodity traded. The present market mechanism for Government securities has grown as a specialized market ever since World War I. Transactions in Treasury issues in the 1920's were carried out both on the New York Stock Exchange and through the over-the-counter dealer market. Even during the early 1920's, however, a steady decline in transactions on the auction market represented by the Exchange and a steady rise in the volume handled on dealer markets was taking place. By the mid-1920's, the dealer market was dominant and agency transactions of the Federal Reserve Bank of New York for the account of the Treasury were moved to the dealer market.

Only marketable Treasury bonds are listed on the New York Stock Exchange and this has been true throughout its history. Therefore, the introduction of the Treasury bill in 1929 and its subsequent development as the primary liquidity instrument of the money market -- a development accelerated by war and postwar financial trends -- further added to the importance of the over-the-counter dealer market. The growth in the Federal debt in the 1930's and during the war years, together with the broader participation of large financial institutions in the market greatly increase the size of typical market transactions in Governments. Large transactions are more efficiently

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managed in a dealer-type market, and consequently the number of transactions that could be effectively handled through the auction mechanism of the Exchange continued to decline. By 1958 trading in Government bonds on the Exchange had dwindled to an insignificant volume in comparison with trading in such securities in the over-the-counter dealer market.

The standards of performance to be applied in evaluating the present dealer market are, of course, related to the specific job which the market has to do as well as to the public interest in a well-functioning market economy. The job to be done first of all is the matching up of purchases and sales by investors and traders. But it also involves the Treasury as issuer of new securities and the Federal Reserve through the execution of its monetary policies. It is the conclusion of our joint study to date that both the broad public interest and the special interests of the Treasury and the Federal Reserve -- which are, of course, designed only to serve the public interest -- are being effectively served through the present market. Those who participated in our study, including a broad range of investors as well as dealers and brokers, were virtually unanimous in the view that the present type of over-the-counter dealer market in Government securities is preferable to an exchange, auction-type market. Even if confined to bonds, and therefore excluding bills, certificates and notes, the exchange-type market was regarded as an unsatisfactory alternative.

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Probably the most important standard of performance required of the Government securities market in serving existing interests is its ability to handle without disruptive price effects the typically large transactions that arise as large institutional holders adjust their liquidity and investment positions. These individual transactions -- by commercial banks in adjusting their reserve and portfolio positions, by corporations adjusting to their cash flow needs around dividend and tax dates, or by savings institutions or other institutional investors in making portfolio changes -- often run to many millions of dollars, particularly in short-term issues. If these holders were unable to purchase and sell readily in such large amounts, their interest in Treasury issues would decline.

The dealers in Government securities appear to have developed better facilities and techniques for handling large transactions promptly and without excessive price effects than would be possible in an organized exchange. They do this by purchasing and selling for their own account; by maintaining substantial inventories of securities in different maturity categories; by a chain of transactions with other dealers -- purchases, sales, and exchanges or swaps; and by keeping themselves informed, through their nationwide organizations or correspondent networks, of major sources of supply and demand for Government securities throughout the country. In its operations, the dealer market acts as a buffer to equalize hourly and daily movements in supply and demand, and to absorb the impact

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of large individual transactions that might otherwise result in abrupt price effects or undue delays in execution of orders.

The specialized dealer market provides a number of other services that institutional customers consider to be valuable. The cost of a transaction in this market is very small because of the large volume of business, because of keen competition among dealers, and because dealer profits do not depend solely on trading margins. A significant part of dealers' earnings is derived from managing their own portfolios and from supplying, through repurchase agreements, investment instruments which have the exact maturity date needed by customers. Such operations also, of course, involve risk of loss.

The dealer market is effectively organized to serve customers throughout the country even though its organization is informal. Transactions are completed promptly by telephone and customers know the price or price range when the order is placed for execution. Moreover, through their intimate experience with the highly technical aspects of each Treasury issue as well as the ways in which the Treasury, the Federal Reserve, and the money market operate generally, dealers provide specialized market advice that customers value. The primary dealers further provide important services in the secondary distribution of new Treasury issues. They also provide a convenient point of contact for Federal Reserve open market operations in short-term Government securities.

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The major defects attributed by some critics to the dealer market in U. S. Government securities reflect three features: first, the market is concentrated in a relatively small group of primary dealers and therefore may not be as competitive as an organized exchange market; second, there is little information about its operations, without supervision or formal rules governing its practices, despite its special public interest; and third, the market is not geared to handling small and odd-lot transactions nor is it especially interested in them.

As to competition, there is no question that the primary dealer market is very highly competitive, even though it comprises only twelve nonbank firms and five bank dealers, most of whom have central offices in New York City. There is necessarily spirited competition between the dealers for the available volume of trading business. Any offers to sell at a price even slightly below the market usually are quickly taken advantage of, as are offers to buy at anything above whatever the price may be at the moment. In volume, the Government securities market is by far the largest financial market in the country. It handles each year a dollar volume of transactions approximating $200 billion, or more than five times as much as the dollar volume of transactions in all corporate stocks as well as bonds on the New York Stock Exchange.

The dealers are principally wholesalers and their customers consist of several hundred nonfinancial corporations, several thousand commercial banks who submit orders both for their own account and for

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customers, other security brokers and dealers handling transactions for customers, hundreds of insurance companies, mutual savings banks, pension funds, and savings and loan associations throughout the country, the special funds of State and local governments, personal trust accounts, and some individual investors of substantial means. These investors and traders who use the market to buy or sell are generally themselves expertly informed and experienced in investment matters: each is seeking the best return on the funds he places in Government securities; each is continuously comparing these returns with those on alternative investment opportunities; and each of the larger investors, who regularly use the services of several dealers, is constantly comparing the relative performance of the dealers with whom he is in contact.

In this type of highly competitive market, the dealer who succeeds must execute the buy or sell orders of these numerous and varied investors promptly and efficiently and the business must be handled in accordance with high ethical standards. Moreover, if he is to obtain future business, such investment advisory services as the dealer renders his customers must stand the test of time.

Each of the primary dealers, through one means or another, operates throughout the country because broad coverage is essential to the maintenance of a sufficient volume of business for profitable operations. This is probably a major reason why there are not more

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dealer firms active in the market. Another reason, according to information received in this study, is that the number of qualified and experienced personnel available to staff new firms is relatively small.

Regarding the criticism of market mechanics, it is true that the dealer market makes available to the public practically no information on its operations other than market bid and offer quotations. There is no requirement for making available either to the public or to a duly constituted authority the records of dealer net positions in securities or amounts borrowed, such as are required of members of the New York Stock Exchange.

The lack of formal rules, supervision, and adequate information leaves the market open on occasion to suspicion that it may not always be operating in the public interest. It has been suggested that in instances dealers' interests may conflict with those of customers, that dealer operations may unduly accentuate swings in securities prices, and that dealer advice may not be entirely accurate. There was, however, little or no evidence gathered in the study that such problems are common in the dealer market. All of the market customers consulted in the present study expressed their full confidence in the Government securities dealers, individually and as a group, and testified to their high standards of integrity and business practice.

Concerning small transactions in the market, consultants to the study have indicated that they generally go through other brokers

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and dealers and commercial banks, and that when they reach the market they are handled promptly by dealers at a relatively low cost that is in part subsidized by the large transaction. As the dealers are organized primarily to handle large transactions, it is understandable that they view the small deals as an accommodation, and do not actively encourage them. It seems clear that if facilities designed more specifically to serve small investors' interests in marketable bonds are to be established, there would have to be some additional incentive provided.

The New York Stock Exchange, prompted by our study, reviewed the potentialities for re-establishing a vigorous auction-type market in Government securities on the Exchange. After extended consideration of the matter, however, Exchange officials concluded that, even though such a development was theoretically possible, problems raised by the suggestion would be insurmountable unless both the Government and the Exchange shifted a number of fundamental policies.

One specific problem to be resolved is the difficulty under existing conditions of encouraging Exchange specialists to take the financial risk of making a market in Government securities. The specialists would be in competition with established Government securities dealers. In addition, they might on many occasions need to build up very large positions in Government securities, since this is a heavy volume market and, when sharp price movements occur, quotations on maturities throughout the list tend to move together much more so than in the market for specific corporate stocks or

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bonds. Finally, because of the public nature of transactions at Exchange trading posts, specialists taking positions to make orderly and continuous markets would be unduly exposed to possible raids by nonmember dealers and other large traders.

There is also the problem of developing an adequate incentive for handling Government securities on the Exchange through a commission schedule that would be competitive with narrow spreads prevailing in the dealer market.

Other conditions set by the Exchange for an effective auction market under its auspices would be:

(a) A larger supply of long-term Government bonds in the market, especially of bonds attractive to individual investors through tax exemption or other special features since these investors now find only limited interest in Governments other than savings bonds.

(b) The placing on the Exchange of all Federal Reserve agency transactions in bonds, possibly plus official support of the Exchange market; and

(c) A potential requirement for the execution of all transactions of member firms in Government bonds on the Exchange, except for some "off-floor" trades in special circumstances.

(d) Some protection of the position of member firms who are acting as Government security dealers.

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The Exchange did not suggest that its facilities could be adaptable at all to trading in Treasury bills, certificates of indebtedness, or notes, which together constitute more than half of the outstanding marketable Federal debt and are also the issues in which the overwhelming volume of market transactions takes place.

These conditions make it clear to us that it would be difficult to develop an auction-type market for Government securities on a broad scale under the existing organized exchange mechanism.

The alternative approach of improving the mechanism and institutions of the present Government securities market, by carefully studying and remedying defects in the dealer market as they come to light, appears to us to promise results that will serve the public interest. At the same time, the New York Stock Exchange should be encouraged to develop further the auction facilities it now provides for transactions in Government bonds. The total market cannot be harmed and may indeed be improved by more active competition between the Exchange market and the dealer market in bond trading.

Areas for Improving Market Mechanisms and Functioning

Our study was launched, as stated earlier, in the hope that the suggestions advanced and problems revealed might indicate certain improvements in the way the Government securities market operates, with particular emphasis on the prevention of future speculative excesses in the market. In the light of consultants' suggestions and of findings of our factual review of the 1957-58 market experience,

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our study group initiated four supplementary studies to evaluate possible means of improving the market's functioning. These are in the nature of working papers for consideration by Treasury and Federal Reserve officials. As their preparation has just been completed in preliminary form, they have not yet been reviewed. Hence, they cannot be interpreted as reflecting any official recommendations for market improvement. There may also be other supplementary studies undertaken as we re-examine market processes and mechanisms and we naturally intend to pursue this phase of our inquiry as far as will serve a constructive purpose.

A first area of supplementary study pertains to the adequacy of statistical and other information relating to the dealer market. As mentioned earlier, it is commonly recognized that openly competitive and efficient markets are characterized by informed buyers and sellers. A broad range of objective information needs to be available to serve effectively the interests of all market participants, including the Treasury as issuer of securities for the market and the Federal Reserve as it participates in the market in regulating overall credit and monetary conditions. In this light the present flow of information relating to the market is inadequate, a point that was agreed to by many of our study consultants.

As a result, our study group undertook a thorough analysis of the information that ought to be regularly available. We were encouraged in this by the excellent cooperation received from dealers

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and other market participants in supplying information for our review of market experience in 1957-58. We believe, therefore, that a reporting program can be worked out by the Federal Reserve and Treasury staffs to put an adequate information program into active operation in the not too distant future.

A second area of supplementary study is the credit financing of Government securities transactions. Last year's market experience has clearly indicated that at times an undue amount of speculation financed on thinly margined credit can be detrimental to the market and that competition of lenders in extending credit to prospective holders may result in deterioration in appropriate equity margin standards. This experience raises the question of the need for some action to assure that sound credit standards will be consistently maintained by lenders in credit extension backed by Government securities and also to keep the total volume of such credit from expanding unduly at times.

Our study has indicated that there are three approaches which the Government might consider in dealing with this problem: first, a statement by bank supervisors to each lending institution within its jurisdiction indicating minimum margins to be adhered to as standard; second, a requirement that each investor participating in the exchange of maturing Treasury issues for new issues state his equity position in those securities in compliance with Treasury standards (plus the continuing requirement by the Treasury of

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appropriate deposits on subscription to its new issues offered for cash); and third, the introduction of special margin regulation, similar to that now applicable under the Federal Reserve Board Regulations T and U to the purchasing or carrying of corporate securities. The latter type of regulation would, of course, require Congressional action, since present law specifically exempts Government securities from this type of credit regulation. It must be re-emphasized here that these are merely possible approaches; they have not yet been fully appraised by either Treasury or Federal Reserve officials and other alternatives may be developed in the light of additional study.

A third area for special study is the use of the repurchase arrangement in credit financing of Government securities. This is not a new method of credit financing, but it is a method that is easy to apply to Government securities transactions and, because of its flexibility and adaptability, has become much more popular in recent years. Government securities market activity last year brought to light certain uses of repurchases that were not in the public interest when such financing was arranged without the borrower putting up adequate margin. The study discusses various alternatives which might be applied to prevent future abuse.

A fourth area of special study of the existing mechanism of the Government securities market relates to its present lack of formal organization. In our consultations, a number of market participants

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and observers suggested that the market might be improved and strengthened through cooperative action of primary dealers themselves, working through a dealers'association. Various specific functions that an association might perform to improve the market's functioning were indicated, including: (a) the adoption of standard rules to assure fair treatment of buyers and sellers in both large and small transactions; (b) the development of standard practices to help maintain dealer solvency; and (c) greater liaison between the Treasury and the dealers in Treasury financing operations. It was also suggested that a dealers'association could be useful in identifying primary dealers in Government securities both to improve dealer service and to apply any market rules which may be adjudged in the public interest. Since the possible advantages of such an organization as well as its possible disadvantages obviously require careful and detailed examination, the task of this supplementary study has been to make this much-needed evaluation.

A question that naturally arises at this point is whether in the light of the present study there will be any occasion later for special legislative requests pertaining to the operation of the Government securities market. This question cannot be answered yet. Before it is, we must try to determine what can be accomplished in improving market processes and mechanisms without legislative action and then ask whether these improvements are enough. The fact of the study itself, together with educational efforts undertaken by

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the Treasury and Federal Reserve System, has already set in process a fuller appreciation on the part of market participants of the undesirable effects of certain market practices. If we find that desired improvement of market mechanisms and institutions requires new statutory authority, we will propose appropriate legislation to the Congress.

Markets are dynamic economic institutions. They require successive adaptation to changing needs. From the standpoint of the public interest, study of these adaptations is never-ending. Study efforts may be intensified from time to time, as in the case of the present Treasury-Federal Reserve study, but they are basically continuous. Continuing observation and study of the Government securities market is a responsibility which both the Treasury and the Federal Reserve recognize.

In conclusion, we repeat that improvement in the processes and mechanisms of the Government securities market will in no way solve our problems of fiscal imbalance. Nor can they correct our problems of too much short-term public debt; of our need for continuous flexibility in our approach to monetary policies; of attaining a volume of savings which will match our expanding investment needs; or of the cyclical instability of our financial markets. These are basic problems. We must all work toward their ultimate solution in the public interest.

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Note:

Joint Economic Committee statement reprinted in Commercial and Financial Chronicle for August 6, 1959.

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August 4, 1959.

Dear Jim:

Just a line to tell you how much I enjoyed the testimony of the insurance group before the Joint Economic Committee. I think it is a very worthwhile contribution indeed.

I also wanted to write in response to your letter of July 17 inviting me to be a luncheon speaker on Tuesday, December 29. Unfortunately I must decline as I take the Christmas-New Year period to participate in a family reunion. All of my family is pretty well scattered these days and it is only at this time of the year that we can get together so I know you will understand this. This is a personal disappointment to me as I would enjoy being with you.

My best, as always.

Sincerely yours,

Wm. McC. Martin, Jr.

Mr. James J. O'Leary,
President,
American Finance Association,
488 Madison Avenue,
New York 22, New York.

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Lehman--5171

FOR IMMEDIATE RELEASE
July 30, 1959

CONGRESS OF THE UNITED STATES
JOINT ECONOMIC COMMITTEE

Senator Paul H. Douglas (D., Ill.), Chairman of the Joint Economic Committee, today released the attached outline of the Committee's Study of Employment, Growth, and Price Levels, and the titles of special studies being prepared by outside consultants and members of the Committee staff. There is also attached a list of the technical staff on the Study of Employment, Growth, and Price Levels, and a summary of the status of the hearings.

The study began with preliminary hearings on March 13. The Committee since that date has held 5 additional hearings, their current hearings on the Government's Management of its Monetary, Fiscal, and Debt Operations being part of this series.

The study of Employment, Growth, and Price Levels is being conducted under S. Con. Res. 13 and the Committee's final report is due January 31, 1960. The special studies and staff reports will be completed during the fall in time for Committee consideration in connection with preparation of the Committee report.

In releasing these materials Chairman Douglas pointed out that "This is the most comprehensive study of the problems of economic stability which has been undertaken by any public body since World War II.

"The hearings we have already held demonstrate the widespread interest and concern in how we can reconcile the objectives of providing substantially full employment and achieving an adequate rate of economic growth, while maintaining substantial stability in the price level. The Committee and the staff, as is demonstrated by the list of outstanding technical consultants preparing special analyses and the expert witnesses appearing in the hearings, are attempting to conduct the most comprehensive and objective factual and analytical study possible within the limits of time imposed by the resolution authorizing the study."

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July 30, 1959

TO: Members of the Joint Economic Committee

FROM: Staff of Study of Employment, Growth and Price Levels

The Study of Employment, Growth and Price Levels has now reached a point where a general outline can be made public. Attached are:

1. An outline of the substance of the Study.

2. A list of outside studies that have been commissioned.

3. A list of projects being conducted by the Study staff.

4. Status of Committee Hearings.

5. A list of staff members.

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Joint Economic Committee
Employment, Growth, and Price Levels

July 30, 1959

GENERAL OUTLINE OF STUDY

The following outline indicates the major problems to which the Study addresses itself and the work being done on them.

I. Employment

Three facets of the employment problem are being analyzed:

A. the determinants of the total size of the labor force;

B. the variations in employment caused by recessions, and the sources of instability which remain in the economic system;

C. structural unemployment -- a major study, in terms of particular frictions, industries, areas, age brackets, and other characteristics, by the Bureau of Labor Statistics.

II. Economic Growth

A. The significance of economic growth for the attainment of national objectives will be shown.

B. There will be a detailed analysis of the historical record, particularly since World War II, looking at different sectors of the economy and seeking the determinants of this historical growth.

C. The determinants of growth will be studied, including: the rate of investment, the size, training, skill and productivity of the labor force, the resource base, the role of research and development, adequate provision of the requisite public services, and the effect of recessions on growth.

III. Prices

A. Several empirical studies of the inflation of the last decade are under way. These studies seek to penetrate below the levels of broad economic aggregates, to examine the inflation in terms of the problem areas. Analyses include price and wage movements by industry, price changes of services, rising costs of federal, state and local governments and the identification of particular bottlenecks

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that have occurred. The role of prices in our changing international trade position is also being explored.

B. Studies of price and wage policies are being prepared, exploring the economic and administrative experience in foreign countries and in the United States.

IV. Policies to Achieve the Objectives

Several studies are being made to see how different policies serve to promote the objectives of the Employment Act. These studies contain the historical background and the available evidence on the general economic effects of the policies; the implications of alternative combinations of policies will also be explored. Monetary policies, fiscal policies, debt management and U. S. foreign economic policies will be given particular attention.

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Joint Economic Committee
Employment, Growth & Price Levels

July 29, 1959

LIST OF CONSULTANTS AND STUDIES

Name and Institution	Subject
1. Bureau of Labor Statistics	An Analysis of Structural Unemployment
2. Robert Lampman University of Wisconsin	Economic Growth and the Elimination of Poverty
3. Sidney Alexander MIT	Determinants of Investment: A Critical Survey of Empirical Findings
4. H. Rowen Rand Corporation	National Security and the American Economy
5. Joseph L. Fisher Resources for the Future	Adequacy of the Resource Base for Growth
6. Seymour Harris Harvard University	The Inequities of Inflation
7. Hendrik Houthakker Stanford University	Household Behavior, Income and Assets under Inflation
8. Charles Schultze University of Indiana	Empirical Studies of the Recent Inflation
9. Mark Leiserson Yale University	Survey of Wage and Price Setting in Western Europe
10. Werner Hirsch Washington University, St. Louis, and Resources for the Future	Analysis of State and Local Government Service Costs
11. Carl Kaysen Harvard University	Brief Memorandum on Anti-Trust Policy and Similar Policies to Halt Inflation
12. Emmett Redford University of Texas	Administrative Aspects of Various Policies for Price Stability
13. J. Gurley Brookings Institution	Evaluation of Post-War Behavior of Financial Intermediaries
14. Warren Smith University of Michigan	Debt Management
15. E. M. Bernstein Independent Consultant (former Research Director, Intl. Monetary Fund)	The Relation of American Stability and Growth and the Economy of the Rest of the World

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Joint Economic Committee
Employment, Growth and Price Levels

LIST OF INTERNAL PROJECTS

George W. Bleile:	Price Behavior of Services in Last Decade
Michael J. Brower:	The Historical Record on Economic Growth
Otto Eckstein:	The Economics of Steel Prices and Wages
Otto Eckstein:	Factors Determining the Long-Run Rate of Growth
Padraic P. Frucht:	America's Role in the World Economy
John H. Kareken:	The Economic Impact of Monetary Policies
James W. Knowles:	Potential Growth of the Economy
Harold M. Levinson:	Price and Wage Behavior in the U. S. Economy in the Last Decade -- A Sector-by-Sector Analysis
Norman B. Ture:	The Economic Impact of Fiscal Policies
Thomas A. Wilson:	The Effects of Recession on Economic Growth

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JOINT ECONOMIC COMMITTEE
EMPLOYMENT, GROWTH, AND PRICE LEVELS

July 30, 1959

Status of Hearings

The Joint Economic Committee will complete next week the sixth set of hearings in connection with its study of Employment, Growth, and Price Levels. Three additional hearings are scheduled during September, October, and November. Following is a schedule showing hearings already held and topics and dates for the last three hearings.

Part 1 -- The American Economy: Problems and Prospects.
Hearings held March 20, 23, 24 and 25. Printed.
Number of witnesses: 4.

Part 2 -- Historical and Comparative Rates of Production, Productivity, and Prices.
Hearings held April 7, 8, 9 and 10. Printed.
Number of witnesses: 5.

Part 3 -- Historical and Comparative Rates of Labor Force, Employment, and Unemployment.
Hearings held April 25, 27 and 28. Printed.
Number of witnesses: 7.

Part 4 -- The Influence on Prices of Changes in the Effective Supply of Money.
Hearings held May 25, 26, 27 and 28. Printed.
Number of witnesses: 4.

Part 5 -- International Influences on the American Economy.
Hearings held June 29, 30, July 1 and 2. In process.
Number of witnesses: 11.

Part 6 -- Government's Management of its Monetary, Fiscal, and Debt Operations.
Hearings held July 24, 27, 28 and 29 in Washington.
Hearings to be held August 5, 6 and 7 in New York.
Number of witnesses: Washington: 9.
New York: 6.
[Washington and New York hearings to be published in separate volumes]

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Following are the topics and dates of the last three hearings as approved by the Steering Committee [we expect to announce very soon the participants for Part 7] --

Part 7 -- The Effect of Monopolistic and Quasi-Monopolistic Practices upon Prices, Profits, Production, and Employment.
Hearings to be held September 21, 22, 23, 24 and 25.

Part 8 -- The Effect of Increases in Wages, Salaries, and the Prices of Personal Services, Together with Union and Professional Practices upon Prices, Profits, Production, and Employment.
Hearings to be held September 28, 29, 30, October 1 and 2.

Part 9 -- Constructive Suggestions for Reconciling and Simultaneously Obtaining the Three Objectives of Maximum Employment, an Adequate Rate of Growth, and Substantial Stability of the Price Level.
Hearings to be held October 26, 27, 28, 29, 30, November 2, 3, 4, 5 and 6.

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The two subcommittees of the Joint Economic Committee also plan to hold hearings during the fall months:

Chairman Bolling has announced hearings of the Subcommittee on Economic Statistics to be held November 16, 17, 18, 19 and 20, in connection with its study of "Comparisons of the United States and Soviet Economies."

The Subcommittee on Automation and Energy Resources, Representative Patman, Chairman, has tentatively scheduled hearings for October 12, 13, 14, 15 and 16, in connection with its examination into the long-run adequacy of United States energy resources as a complement to technological advances and the application of improving technology to the production and efficient use of the energies required for sustained economic growth.

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Joint Economic Committee
Employment, Growth and Price Levels

STAFF

Otto Eckstein, Technical Director
*John W. Lehman, Administrative Officer
*James W. Knowles, Special Economic Counsel

Senior Economists

Padraic P. Frucht
John H. Kareken
Harold M. Levinson
*Norman B. Ture

Junior Economists

George W. Bleile
Michael Brower
Charles B. Warden, Jr.
Thomas A. Wilson

* Assigned from permanent Joint Economic Committee Staff

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LEHMAN -- 5171

FOR RELEASE: THURSDAY A.M.
July 2, 1959

CONGRESS OF THE UNITED STATES
JOINT ECONOMIC COMMITTEE
STUDY OF EMPLOYMENT, GROWTH, AND PRICE LEVELS

Chairman Paul H. Douglas Announces
Hearings on the Government's Management of its
Monetary, Fiscal, and Debt Operations

Washington, D.C., July 24, 27, 28, 29
New York City, August 5, 6, 7

Senator Paul H. Douglas (D. Illinois), Chairman of the Joint Economic Committee, today announced the sixth set of hearings to be conducted within the framework of the Committee's study of Employment, Growth, and Price Levels. In releasing this schedule of hearings on the Government's management of its monetary, fiscal, and debt operations, Senator Douglas stated:

"I believe that there is general agreement on two propositions: (1) that we should aim, as a nation, at the simultaneous achievement of maximum employment, an adequate rate of growth, and a stable level of prices; and (2) that the Government's most potent general tools to help bring about the simultaneous achievement of these three objectives are the practices it follows in the management of its monetary, fiscal, and debt operations. Recent events, particularly the pressing problems in regard to debt management, lend emphasis to the economic importance of arriving at sound rules for the Government's conduct of its expenditure, revenue, debt, and monetary activities.

"In its current investigation of these matters, the Joint Economic Committee fortunately is able to draw on its several previous studies of these problems. The sixth set of Committee hearings that I am announcing today is intended to supplement these studies by developing additional facts concerning the ways in which monetary, fiscal, and debt management policies work out in practice and how they can affect employment, growth, and price levels."

The schedule for the hearings is attached, giving the names of the participants, and the dates, time, and place of the hearing.

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Schedule of
Hearings on the Government's Management of its
Monetary, Fiscal, and Debt Operations

Washington, D. C. -- July 24, 27, 28, 29
New York City -- August 5, 6, 7

FRIDAY, July 24 -- Old Supreme Court Chamber, Senate Wing, The Capitol

10:00 a.m. ROBERT B. ANDERSON
Secretary of the Treasury

MONDAY, July 27 -- Old Supreme Court Chamber, Senate Wing, The Capitol

10:00 a.m. WILLIAM McCHESNEY MARTIN, Jr.
Chairman, Board of Governors of
the Federal Reserve System

TUESDAY, July 28 -- Old Supreme Court Chamber, Senate Wing, The Capitol

10:00 a.m. GEORGE T. CONKLIN, Jr.
Vice President Finance, The Guardian
Life Insurance Company of America, New York

Accompanied by:

SHERWIN C. BADGER
Financial Vice President, New England
Mutual Life Insurance Company, Boston

ROBERT B. PATRICK
Vice President, Bankers Life Co. of Des Moines

RICHARD K. PAYNTER, Jr.
Executive Vice President,
New York Life Insurance Company

JAMES J. O'LEARY
Director of Economic Research
Life Insurance Association of America, New York

WEDNESDAY, July 29 -- Old Supreme Court Chamber, Senate Wing, The Capitol

10:00 a.m. JOHN OHLENBUSCH
Senior Vice President, Bowery Savings Bank, New York

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WEDNESDAY, August 5 -- Court Room 110, U. S. Courthouse
Foley Square, New York City

10:00 a.m. ROBERT G. ROUSE
Vice President, Federal Reserve Bank of New York, and Manager, Open Market Account

2:30 p.m. GIRARD L. SPENCER
Partner, Salomon Bros. & Hutzler, New York

THURSDAY, August 6 -- Court Room 110, U.S. Courthouse
Foley Square, New York City

10:00 a.m. MURRAY F. BROWN
Executive Vice President
C. F. Childs and Company, New York

2:30 p.m. ALFRED H. HAUSER
Vice President
Chemical Corn Exchange Bank, New York

FRIDAY, August 7 -- Court Room 110, U. S. Courthouse
Foley Square, New York City

10:00 a.m. MAURICE A GILMARTIN, Jr.
Partner, Charles E. Quincy & Co., New York

2:30 p.m. HERBERT N. REPP
President, Discount Corporation of New York

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June 24, 1959.

Dear Jim:

Thank you for your nice note of June 23 and I am enclosing a copy of my prepared statement before the House Ways and Means Committee. While it has not been officially announced by the Joint Committee, I am expecting to testify during the week of July 27 and am interested, and pleased, to learn that you will be appearing also. I hope we can be helpful.

With all good wishes,

Sincerely yours,

Wm. McC. Martin, Jr.

Enclosure

Mr. James J. O'Leary,
Director of Economic Research,
Life Insurance Association of America,
488 Madison Avenue,
New York 22, New York.

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Life Insurance Association of America

488 MADISON AVENUE,

NEW YORK 22, N.Y.

BRUCE E. SHEPHERD, Executive Vice President
EUGENE M. THORÉ, Vice President and General Counsel
HENRY R. GLENN, General Counsel and Treasurer
JAMES J. O'LEARY, Director of Economic Research
ALBERT PIKE, JR., Actuary
ROBERT B. CRANE, Secretary

MANUEL M. GORMAN, Associate General Counsel
KENNETH L. KIMBLE, Associate General Counsel
ELDON WALLINGFORD, Associate General Counsel
JAMES ANDREWS, JR., Assistant General Counsel
JOHN V. BLOYS, Assistant General Counsel
GEORGE H. DAVIS, Associate Actuary
RALPH J. McNAIR, Assistant Vice President

June 23, 1959

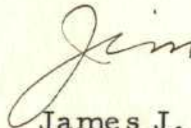
Mr. William McC. Martin, Chairman
Board of Governors of the Federal Reserve System
Washington 25, D.C.

Dear Bill:

I would appreciate very much receiving a copy of the statement you made recently before the House Ways and Means Committee. You will be interested to know that the Joint Economic Committee has requested that representatives of the life insurance business appear before the Committee on July 28 to discuss questions of monetary, debt management, and fiscal policy. I am just starting to get together some ideas and I thought that your statement would be most helpful.

With very best regards.

Sincerely,



James J. O'Leary
Director of Economic Research

JJO'L-IH

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PAUL H. DOUGLAS, ILL., CHAIRMAN
JOHN SPARKMAN, ALA.
J. W. FULBRIGHT, ARK.
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JOHN F. KENNEDY, MASS.
PRESCOTT BUSH, CONN.
JOHN MARSHALL BUTLER, MD
JACOB K. JAVITS, N.Y.

OTTO ECKSTEIN,
TECHNICAL DIRECTOR

Congress of the United States

JOINT ECONOMIC COMMITTEE
(CREATED PURSUANT TO SEC. 5 (A) OF PUBLIC LAW 304, 79TH CONGRESS)

STUDY OF EMPLOYMENT, GROWTH, AND PRICE LEVELS
(PURSUANT TO S. CON. RES. 13, 86TH CONG., 1ST SESS.)

WRIGHT PATMAN, TEX., VICE CHAIRMAN
RICHARD BOLLING, MO.
HALE BOGGS, LA.
HENRY S. REUSS, WIS.
FRANK M. COFFIN, MAINE
THOMAS B. CURTIS, MO.
CLARENCE E. KILBURN, N.Y.
WILLIAM B. WIDNALL, N.J.

JOHN W. LEHMAN,
ADMINISTRATIVE OFFICER

JAMES W. KNOWLES,
SPECIAL ECONOMIC COUNSEL

June 23, 1959

The Honorable William McChesney Martin
Chairman
Board of Governors of the
Federal Reserve System
Washington 25, D. C.

Dear Mr. Chairman:

I am pleased that you are able to accept the invitation of the Joint Economic Committee to participate in its hearings on the Government's management of its monetary, fiscal, and debt operations. The objective of this sixth set of hearings being conducted in connection with the Committee's study of Employment, Growth, and Price Levels is to explore the effects of Government expenditures, taxation, budgetary surpluses and deficits, and of monetary and debt policies upon employment, growth, and price levels. We are particularly interested in the ways in which the Government's practices and policies in these several areas interact with each other and tend to either support or offset each other.

We have scheduled these hearings for as late in July as feasible in order that we could have the benefit of the results of the study of the Government securities market which you are conducting in cooperation with the Treasury.

The session at which you are to participate is scheduled at 10:00 a. m. on Monday, July 27th, and will be held in the Old Supreme Court Chamber, Room P-63, Senate Wing of the Capitol. Details as to time, place, and other participants in this sixth set of hearings will be given in a press release which will be sent you in a week or so.

We should like to receive the day before the hearing 100 copies of your statement for use of the Committee and the press at the time of the hearing. They should be sent to Mr. John W. Lehman, Clerk, Joint Economic Committee, Room G-133, New Senate Office Building. If you have any questions, please get in touch with either Mr. Lehman or Mr. James W. Knowles--both can be reached at Capitol 4-3121 (Code 180), Extension 5171.

Faithfully yours,

Paul H. Douglas, Chairman

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PAUL H. DOUGLAS, ILL., CHAIRMAN
JOHN SPARKMAN, ALA.
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JOHN W. LEHMAN,
ADMINISTRATIVE OFFICER

JAMES W. KNOWLES,
SPECIAL ECONOMIC COUNSEL

June 23, 1959

The Honorable William McChesney Martin
Chairman
Board of Governors of the
Federal Reserve System
Washington 25, D. C.

Dear Mr. Chairman:

This is to confirm the invitation extended orally by Mr. Knowles of our Committee staff for Mr. Robert G. Rouse, Vice President of the Federal Reserve Bank of New York and Manager of the Open Market Account, to appear as a witness before the Joint Economic Committee at a hearing to be conducted in New York City Wednesday, August 5th, at 10:00 a. m.. We understand Mr. Rouse may be accompanied by one or two of his associates in the operation of the Open Market Account.

The hearing at which Mr. Rouse is to appear is one of several in the sixth set of Committee hearings being conducted in connection with the Committee's study of Employment, Growth, and Price Levels. This particular set of hearings is devoted to a study of the Government's management of its monetary, fiscal, and debt operations. We wish to have Mr. Rouse appear and answer various technical questions concerning the operations of the Open Market Account and the market for Government securities.

The session at which Mr. Rouse is to participate will be held in Court Room 110 of the United States District Courthouse, Foley Square.

If there are any questions in regard to Mr. Rouse's appearance or about the hearing itself, please get in touch with Mr. Knowles who can be reached at Capitol 4-3121 (Code 180), Extension 5171.

Faithfully yours,

Paul H. Douglas
Chairman

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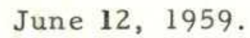

June 12, 1959.

Note:

Mr. Shay confirmed to Mr. Martin today that he would appear before the Joint Economic Committee at 10 a.m. on Monday, July 27.

Also in connection with these hearings, committee will meet in New York in August in connection with the mechanical operations of the market--on August 5 with Mr. Rouse and Mr. Roosa; next two days with some of the dealers.

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LEHMAN -- 5171 FOR IMMEDIATE RELEASE

CONGRESS OF THE UNITED STATES
JOINT ECONOMIC COMMITTEE

STUDY OF EMPLOYMENT, GROWTH, AND PRICE LEVELS

Chairman Paul H. Douglas Announces
Hearings on International Influences on
the American Economy

Senator Paul H. Douglas (D. Illinois), Chairman of the Joint Economic Committee, today announced the fifth set of hearings in connection with the Committee's broad study of Employment, Growth, and Price Levels. In releasing the schedule of hearings, Senator Douglas stated:

"Successful pursuit of economic policies leading to maximum employment, an adequate rate of growth, and a stable level of prices depends, in part, on our success in making the adjustments required because of our changing economic relationships with the economies of the other nations of the world. For this reason, the Joint Economic Committee in its fifth set of hearings will turn to the study of international influences on employment, growth, and prices in the United States.

"What is the present position of the United States' economy vis-a-vis the world economy? How has our international economic situation been changing and what are the prospects for the foreseeable future? What is the significance for our economy of the instability of world prices for raw materials? What are the implications for the American economy of the emergence of free trade areas of which the European Common Market may be only the first? What is the significance of our recent loss of gold and is it likely to continue? What is the significance of the changes underway in the underdeveloped countries for the American economy in the years ahead?"

The schedule for the hearings is attached, giving the topics, the names of the participants, and the dates, time and place of the hearings.

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CONGRESS OF THE UNITED STATES
Joint Economic Committee

Schedule of Hearings
on
International Influences on the American Economy
June 29, 30, July 1, 2,
1959

MONDAY, June 29, 10:00 a. m. --- Old Supreme Court Chamber, Room P-63
Senate Wing, The Capitol

I. America's Position and Prospects in the World Economy

WILLIAM DIEBOLD, Council on Foreign Relations
New York

TUESDAY, June 30, 10:00 a. m. --- Old Supreme Court Chamber

II. Balance of Payments and the Significance of International Gold Movements

ROBERT E. BALDWIN, Professor of Economics, University of California, Los Angeles

CHARLES P. KINDLEBERGER, Professor of Economics, Massachusetts Institute of Technology

WALTHER LEDERER, Office of Business Economics, U. S. Department of Commerce

WILSON E. SCHMIDT, Professor of Economics, George Washington University

WEDNESDAY, July 1, 10:00 a. m. --- Old Supreme Court Chamber

III. The Significance of the European Common Market to the American Economy

GEORGE W. BALL, Attorney, Cleary, Gottlieb, Friendly and Ball, Washington, D. C.

EMILE DESPRES, Professor of Economics, Williams College

TIBOR SCITOVSKY, Professor of Economics, University of California, Berkeley

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THURSDAY, July 2, 10:00 a. m. --- Old Supreme Court Chamber

IV. The Significance of Changes in the Underdeveloped Countries for the American Economy

REYNOLD E. CARLSON, Professor of Economics, Vanderbilt University

RAYMOND F. MIKESELL, Professor of Economics, University of Oregon

SIMON ROTTENBERG, Professor of Economics, University of Chicago

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Chairman Martin

Lehman -- 5171

FOR IMMEDIATE RELEASE
MAY 11, 1959

CONGRESS OF THE UNITED STATES
JOINT ECONOMIC COMMITTEE

Staff Appointments for Study of Employment, Growth and Price Levels

Senator Paul H. Douglas (D., Illinois), Chairman of the Joint Economic Committee, today announced the appointment of the following economists to be assigned to the Committee's study of Employment, Growth, and Price Levels. The three senior economists named to the staff study are: Dr. John H. Kareken, Dr. Harold M. Levinson, and Dr. Padraic Frucht.

Dr. Kareken, a monetary economist, is on leave from the School of Business Administration, University of Minnesota. He was born in Buffalo, N.Y. in 1929 and holds a B.A. degree from the University of Buffalo. He received a doctorate at Massachusetts Institute of Technology where he also taught. Since September 1956 he has been Associate Professor of Economics at the University of Minnesota. Dr. Kareken has written widely in the field of monetary policy.

Dr. Levinson is on leave from the University of Michigan where he is Associate Professor of Economics in the Department of Economics. He has specialized in the field of labor economics and is the author or co-author of several books in that field, including "Unionism, Wage Trends, and Income Distributions", and "Labor Relations and Productivity in the Building Trades." Dr. Levinson also served as price analyst with the Office of Price Administration. He was born in 1919 in Boston, Mass., and is a graduate of the University of Michigan from which he received a M.B.A. in 1942 and a Ph.D. in 1950. He has been at the University of Michigan since 1945.

Dr. Frucht will cover the international economic aspects of the study as well as being assigned as special economist for the minority. Dr. Frucht was born in 1921 and graduated from Brown University in 1947. He received a Ph.D. from Harvard University in 1956 and comes to the study staff from the research staff of the U. S. Chamber of Commerce. Previous to that he was Assistant Professor of Economics at Lawrence College in Appleton, Wisc. His additional fields of specialization are industrial organization, price and allocation theory, and monetary theory and policy.

In addition to the senior economists listed above, the committee announced the appointment of two assistant economists--Thomas Wilson and Michael Brower of Boston, Mass.; and two junior economists--George W. Bleile of Chicago, Ill., and Charles B. Warden, Jr., of Washington, D. C.

The committee study is being conducted under the direction of Dr. Otto Eckstein, whose appointment was announced on April 13.

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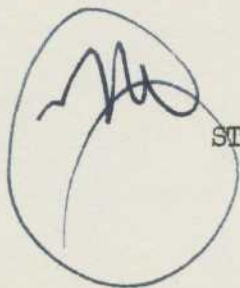
FOR RELEASE: TUESDAY A.M.
April 28, 1959



CONGRESS OF THE UNITED STATES
JOINT ECONOMIC COMMITTEE

STUDY ON EMPLOYMENT, GROWTH, AND PRICE LEVELS

Chairman Paul H. Douglas Announces
Hearings on Money and Credit

Senator Paul H. Douglas (D. Illinois), Chairman of the Joint Economic Committee, today announced the fourth set of hearings in connection with the Committee's broad study of economic policies. In releasing the schedule of hearings, Senator Douglas stated:

"The task of these next hearings in the Joint Economic Committee's inquiry is to review the 'classical' inflation and deflation caused by increases and decreases in the effective supply of money and credit. The Committee is interested in determining the circumstances under which changes in the money supply lead to changes in prices and those under which no price change follows. For example, if substantial resources of labor and capital are unemployed, will an increase in the money supply lead to an increase in prices? In addition, the Committee will study the effect of changes in the effective supply of money on growth, employment, and economic stability."

The experts, with their subjects, and the dates and places of the hearings are given below:

MONDAY, May 25, 10:00 a.m. --- Room 457, Old Senate Office Building

I. The Quantity Theory

MILTON FRIEDMAN, Professor of Economics, University of Chicago

TUESDAY, May 26, 10:00 a.m. --- Room 457, Old Senate Office Building

II. Money Supply and Velocity: The Historical Record

RICHARD T. SELDEN, Professor of Economics, Vanderbilt University

WEDNESDAY, May 27, 10:00 a.m. --- Old Supreme Court Chamber, Senate Wing, Capitol

III. Income-Expenditure Approach to the Analysis of Money Relationships

ROBERT EISNER, Professor of Economics, Northwestern University

THURSDAY, May 28, 10:00 a.m. --- Old Supreme Court Chamber, Senate Wing, Capitol

IV. Institutional Frictions in Money and Credit Markets

JOHN G. GURLEY, Professor of Economics, University of Maryland

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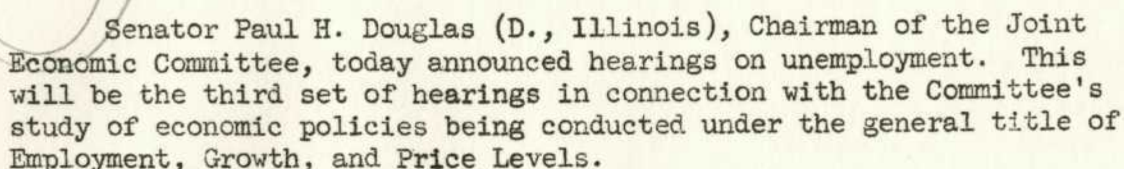
FOR RELEASE: MONDAY A.M.
April 20, 1959

CONGRESS OF THE UNITED STATES
JOINT ECONOMIC COMMITTEE

STUDY OF EMPLOYMENT, GROWTH, AND PRICE LEVELS

Chairman Paul H. Douglas Announces
Hearings on Unemployment



Senator Paul H. Douglas (D., Illinois), Chairman of the Joint Economic Committee, today announced hearings on unemployment. This will be the third set of hearings in connection with the Committee's study of economic policies being conducted under the general title of Employment, Growth, and Price Levels.

These hearings April 25, 27 and 28 will focus on how unemployment and employment are measured; what the data reveal about the characteristics of the unemployed; the influence of changes in techniques and in markets on the amount and location of longer-run unemployment; what the long-run historical record reveals about changes in unemployment and the labor force under changing conditions; and on the effects of past and current personnel practices on labor mobility and the reemployment of the unemployed.

The witnesses, with their subjects, and the dates and places of the hearings are given below:

SATURDAY, April 25, 10:00 a.m. -- Old Supreme Court Chamber, Room P-63
Senate Wing, The Capitol

I. Unemployment: Measurement and Characteristics

EWAN CLAGUE, Commissioner, Bureau of Labor Statistics

PETER HENLE, Assistant Director of Research AFofL-CIO

MYRON SILBERT, Vice President, Federated Department Stores, Inc.

MONDAY, April 27, 10:00 a.m. -- Senate District Committee Hearing Room
Room 6226 New Senate Office Building

II. The Historical Record:

Labor Force Under Changing Conditions

CLARENCE LONG, Professor of Economics, Johns Hopkins

Long Term Factors in Labor Mobility and Unemployment

STANLEY LEBERGOTT, Bureau of the Budget and Harvard University

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TUESDAY, April 28, 10:00 a.m. -- Senate District Committee Hearing Room
Room 6226 New Senate Office Building

III. Past and Current Personnel Practices Affecting Labor Mobility and Re-employment of the Unemployed

JOSEPH CHILDS, Vice President, United Rubber, Cork, Linoleum and Plastic Workers of America

GERRY MORSE, Vice President, Industrial Relations, Minneapolis-Honeywell Corporation

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FOR RELEASE: FRIDAY A.M.
March 13, 1959

CONGRESS OF THE UNITED STATES
JOINT ECONOMIC COMMITTEE

Chairman Paul H. Douglas Announces Hearings
on
The American Economy at Mid-Century:
Problems and Prospects

Preliminary Hearings

Senator Paul H. Douglas (D., Illinois), Chairman of the Joint Economic Committee, today announced the four days of preliminary hearings opening the broad inquiry by the Committee into over-all economic policies which was announced on February 16, 1959.

Four witnesses, each of whom represents a different point of view, have been invited to discuss with the Committee the problems and prospects of the American economy at mid-century as it faces the challenges of the dynamic decade of the 1960's.

In making the announcement, Senator Douglas stated:

"As we approach the challenges growing out of the dynamic changes likely to occur in the decade of the 1960's, we must take a sober, analytical look at the American economy. What is its condition at mid-century? How did it arise? What are the problems that we face in meeting the challenges ahead? What are the prospects?

"The goals of the American people upon which we are all substantially agreed -- including a maximum rate of use of resources, an adequate rate of economic growth, and stability of the price level -- are long-term goals. From time to time, these general goals must be reinterpreted in more specific terms, balanced to the requirements of the current and prospective situation of the economy, both at home and abroad, and to new opportunities.

"In opening the Committee's inquiry, to be conducted on a number of fronts this year, the Committee will conduct four days of hearings, March 20, 23, 24 and 25, 1959. At each of these sessions, we will have a distinguished American who will analyze these problems and prospects of the American economy at mid-century.

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"Each of the individuals has been chosen to represent a different point of view, representative of a significant segment of American thought on economic issues."

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FRIDAY, MARCH 20, 10:00 a.m., Old Supreme Court Chamber
Room P-63, Senate Wing, The Capitol

SUMNER H. SLICHTER,
Professor of Economics
Harvard University

MONDAY, March 23, 10:00 a.m. Room 6226, New Senate Office Building

NEIL H. JACOBY
Dean, Graduate School of Business Administration
University of California, Los Angeles

TUESDAY, March 24, 10:00 a.m. Room 6226, New Senate Office Building

LEON H. KEYSERLING
Consulting Economist, Washington, D. C.
President, Conference on Economic Progress
[Formerly Chairman, Council of Economic Advisers]

WEDNESDAY, March 25, 10:00 a.m. Room 6226, New Senate Office Building

MARRINER S. ECCLES
Chairman, First Securities Corporation, Utah
[Formerly Chairman, Board of Governors of the Federal Reserve System]

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For Release February 16, 1959
Monday A. M.'s

From the Office of Sen. Paul H. Douglas
109 Senate Office Building, Washington, D.C

JOINT ECONOMIC COMMITTEE ANNOUNCES
BROAD OUTLINES OF ECONOMIC INQUIRY

The Joint Economic Committee of the House of Representatives and Senate today announced that it will undertake a broad inquiry into over-all economic policies shortly after issuance of its forthcoming report on the President's Economic Report.

The study will consider the problems of providing substantially full employment and an adequate rate of economic growth, as well as maintaining price stability and preventing inflation.

The full text of the announcement released by Senator Paul H. Douglas (D., Ill.), Chairman of the Committee, follows:

ANNOUNCEMENT BY SENATOR PAUL H. DOUGLAS (D., ILL.)
CHAIRMAN, ON PLANS FOR THE INQUIRY ON ECONOMIC POLICY
BY JOINT ECONOMIC COMMITTEE

The people of the United States want the American economy to realize three sets of objectives:

1) To provide substantially full employment.
2) To achieve an adequate rate of economic growth.
3) To maintain substantial stability in the price level and thus prevent inflation.

There are those who openly or secretly believe that these aims are incompatible. One group believes that the third objective can only be achieved at the expense of the first two and would sacrifice an adequate degree of growth and a high rate of employment in order to achieve price stability. Another group, emphasizing adequate growth and full employment, is willing to have us suffer from some inflation in order to achieve its primary objective. There are also those who believe that it is of great importance to increase the revenue of the U. S. Government by assuring substantially full employment and economic growth.

Nothing is more needed than a careful and impartial study of whether it is possible to reconcile these objectives and if so, how. The Joint Economic Committee in line with its duty under the Employment Act of 1946 proposes to make just such a study and after the preparation of its comments on the President's Economic Report will embark upon it.

Among the subjects which it plans to investigate are:

1) Historical and comparative rates of unemployment, production and prices.
2) Inflation and deflation of the "classical" types caused by increases and decreases in the effective supply of money and credit and the effects of these on growth, employment and economic stability.

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3) The effect of monopolistic and quasi-monopolistic practices upon prices, profits, production and employment.

4) The effect of increases in wages, salaries and the prices of personal services, together with union and professional practices, upon prices, profits, production and employment.

5) The effect of governmental expenditures, taxation, and budgetary surpluses and deficits and of monetary and debt management policies upon price levels, production and employment.

6) International influences affecting prices, production, trade and employment.

7) Constructive suggestions for reconciling and simultaneously obtaining the three objectives of substantially full employment, an adequate rate of growth, and substantial stability of the price level.

The study will be under the general direction of the Committee as a whole, although specific task forces may be created to deal with subdivisions of the fields of inquiry, and a bipartisan steering committee will be set up. As adequate appropriations are obtained, a special staff will be engaged.

Further announcements will be made at appropriate times as the work progresses

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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

Housing Subcommittee

of the

Senate Banking and Currency Committee

July 29, 1959

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The vital social importance of accommodating the needs of the public for good housing is unquestionable. A decade has already passed since the Congress underlined this fact by declaring that "the general welfare and security of the Nation and the health and living standards of its people require . . . the realization as soon as feasible of the goal of a decent home and a suitable living environment for every American family . . ."

A basic question, however, raised by S. 57, the "Housing Act of 1959," is this: How far and how fast we can move toward that objective and at the same time meet without undue strain the many other pressing demands upon our economy?

We have already made considerable housing progress in the postwar years. Since 1950, well over 11 million dwelling units have been placed under construction. This is an impressive achievement --a total exceeding the inventory of all housing in existence at the turn of the century.

Progress has been recorded, too, in conserving and improving the older habitable portions of our housing stock which comprise an important share of our national wealth and in which the majority of our households live. As a result of the construction of millions of new dwellings and marked improvements to existing ones, our housing supply today consists of more units than ever before. The average quality of these homes is the highest in history.

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Despite the fact that we have moved closer in recent years to the goal of decent housing for everyone, the number of persons quartered in inadequate accommodations is still a matter of serious concern. Here again, the question arises: To what extent can we accelerate our progress further in the present period of broad economic expansion and mounting inflationary pressures and expectations?

Unfortunately, the rapid growth and improvement of the housing supply in the postwar period has been accompanied by a sharp rise in costs. For the entire period since World War II, prices of building materials, as well as prices of homes, have risen more than general wholesale prices or prices of all consumer goods and services. The relative inflation of building materials prices and of residential construction costs has intensified over the past year.

This inflationary advance in housing costs and prices, coupled with a liberalization in lending terms, has been associated with unprecedented demands for mortgage credit to help finance the purchase of new houses and the transfer of existing ones. Home mortgage needs have dominated the capital markets since World War II and represented the largest single use of capital funds. In the postwar period, nonfarm home mortgages have accounted for over one-third of the over-all increase in outstanding net debt, including all mortgages, securities, and other obligations. Since

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the end of 1949, the volume of nonfarm home mortgage debt outstanding has more than tripled to well over $120 billion presently.

To preserve the integrity of this debt structure as well as to meet housing needs in the future requires more than ever before the maintenance of sound standards of mortgage finance, as well as stability of prices and capital values generally in the economy. Overdrafts upon capital markets for home mortgage funds or overstimulation of building activity under currently developing boom conditions in the economy could precipitate or intensify a later downturn. Even now, the Federal Government has assumed a huge volume of commitments in underwriting FHA-insured and VA-guaranteed home mortgage loans and in insuring deposits and shares in financial institutions which hold a major portion of all mortgage debt.

In the light of these general observations, I should like to examine some of the provisions of S. 57 which have a significant bearing upon mortgage finance and economic growth and stability. The Board believes that certain features of the bill are desirable and necessary at this time to the continuance of vital housing programs under way. Among such provisions are the extension of the FHA Title I property improvement loan insurance program, the FHA mortgage insurance program for armed services housing, the Voluntary Home Mortgage Credit Program, and the increase in general mortgage insurance authorization for the Federal Housing Administration. With regard to the latter, it would be preferable to remove all limits on FHA

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insurance in force. Such limitations serve no useful purpose. Moreover, should that step be taken, Congress would still have an opportunity, through the appropriations process, to review annually the standards under which the program is carried on.

Raising maximum interest rates on insured mortgages under several FHA programs, as authorized under certain sections of S. 57, would also be a desirable step. Complete flexibility of interest rates might be even better. Mortgage insurance reduces investment risk to lenders. Experience suggests that under flexible interest rates, market forces would set a lower rate on insured than on uninsured mortgages with otherwise similar terms. Interest rates, fluctuating freely according to market conditions, would in fact be desirable for all housing programs.

Certain other features of S. 57 appear to the Board to be inappropriate for enactment at this time when mortgage lending and housing starts are at or near record levels and when growing pressures in the capital markets are being reflected in high and rising interest rates. I refer specifically to provisions which would provide discretionary authority to reduce again minimum downpayments on homes with FHA-insured mortgage loans, and to extend further the maximum term on Federally-underwritten home mortgages.

The former proposal, if put into effect, would permit a 5 per cent reduction in the downpayment on a $14,000 house with an

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FHA mortgage, to a minimum of $455. On an $18,000 house, the reduction would be 38 per cent, to a minimum of $855. You will note from the attached table that minimum downpayments proposed in S. 57 are well below the ones authorized by statute in earlier years, but exceeded from time to time by administrative regulation. On a new $14,000 house with an FHA-insured mortgage loan, for example, the minimum downpayment requirement enacted early in 1950 was $2,800. This statutory limit was reduced in 1954 to $1,700, in 1957 to $900, and in 1958 to the present figure of $480. As mentioned earlier, S. 57 would reduce the limit further to $455.

The latter proposal would extend the maximum term on FHA-insured and VA-guaranteed home mortgages and on VA direct home loans to 35 years from the present limit of 30 years. If effective in the market, such an extension would tend to increase the amount of outstanding mortgage debt by lowering repayment rates, even though the number of credit transactions and the amounts loaned remained unchanged.

This is no time for measures to encourage additional borrowing either by home buyers or by the Treasury that would place additional demands upon our strained capital markets. During the first half of 1959, nonfarm home mortgage debt outstanding climbed an unparalleled amount. In only six months it rose about $7 billion compared with an increase of $10 billion in the entire year of 1958, and $12-1/2 billion in the record year of 1955. The current threat

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to sustained housing activity is not that mortgage lending terms are too strict, but that savings may be inadequate to accommodate the volume of housing demanded under current financing terms.

The unprecedented growth so far this year in nonfarm home mortgage debt outstanding has been sustained in part through a high level of mortgage warehousing, a record volume of mortgage purchases by the Federal National Mortgage Association, and a record amount of outstanding Federal Home Loan Bank advances. To place capital markets under additional pressure through any further reduction in downpayments or any further extension in maturities would be untimely and unwarranted. Now is the time to encourage a higher rate of saving--not a higher rate of borrowing.

Now is the time, in fact, for the Federal Government of this, the most advanced country in the world, to continue to demonstrate its capacity for leadership by exercising financial discipline. This would make clear to all peoples that its economic policy is wisely directed to the maintenance of economic stability as well as economic growth. As a nation, we must continue to serve as an anchor to which other democracies can tie without any doubt about the strength of that anchor to hold firm against the tides of inflationary forces.

Nearly a century ago, Benjamin Disraeli said: "The best security for civilization is the dwelling, and upon proper and becoming dwellings depends more than anything else the improvement

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of mankind. Such dwellings are the nursery of all domestic virtues, and without a becoming home the exercise of those virtues is impossible."

That statement is as true now as it was then. In striving toward the end of "proper and becoming dwellings," however, we must be certain that the means we use and their timing are also "proper and becoming" to our over-all goals of long-run economic stability and sustained economic growth. That is what the Board has tried to keep in mind in considering some of the provisions of S. 57.

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Minimum Statutory Downpayments on New Homes with Mortgages Insured by the FHA under Sec. 203 (b) (2) of the National Housing Act, 1950 to date

Appraised value of new home	Date of Enactment				
	April 1950	August 1954	July 1957	April 1958	Proposed in S. 57
$10,000	$1,250	$ 700	$ 300	$ 300	$ 300
12,000	2,400	1,200	600	360	360
14,000	2,800	1,700	900	480	455
16,000	3,200	2,200	1,200	780	655
18,000	3,600	2,700	1,800	1,380	855
20,000	4,000	3,200	2,400	1,980	1,455

Note: Statutory minima have been exceeded at times by higher minimum requirements imposed by administrative regulation. Limits given in the table exclude Presidential discretionary authority, authorized at certain times, to permit certain further reductions under specified circumstances. Recently, the statutory minima given in this table have also applied to existing houses.

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July 21, 1959

The Honorable John J. Sparkman,
Chairman, Subcommittee on Housing,
Senate Committee on Banking and Currency,
Washington 25, D. C.

Dear Mr. Chairman:

This is to advise that pursuant to your letter of July 17, 1959, I will be glad to testify before your Subcommittee at 10 a.m. on July 29 in connection with the Subcommittee's consideration of the President's veto message on the housing bill (S. 57).

Sincerely yours,

(Signed) Wm. McC. Martin, Jr.

Wm. McC. Martin, Jr.

cc: Miss Muehlhaus
Mrs. Cotten

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Miss Muehlhaus

July 31, 1959

The Honorable A. Willis Robertson,
Chairman, Banking and Currency Committee,
United States Senate,
Washington 25, D. C.

Dear Mr. Chairman:

This is in reply to your request for the Board's views on S. 2378, now pending before the Senate Committee on Banking and Currency, a bill containing provisions on FHA insurance programs, housing for the elderly, Federal National Mortgage Association, urban renewal, college housing, armed services housing, and miscellaneous matters.

Many of the comments I made on S. 57 while testifying before the Senate Housing Subcommittee on Wednesday, July 29, would also be applicable to S. 2378. The Board favors provisions of S. 2378 that would extend the FHA insurance program for armed services housing, the FHA Title I property improvement loan insurance program, and the Voluntary Home Mortgage Credit Program. Likewise the Board favors the proposed increase in general mortgage insurance authority for the Federal Housing Administration, although, as I indicated in my testimony, the Board would deem it wiser to remove all limits upon FHA insurance in force. These limits have no useful purpose. If they were removed, Congress would still have an opportunity, through the appropriations process, to review annually the standards under which the program is operated.

The Board has strong reservations about certain other provisions of S. 2378. One concerns the proposed reduction in statutory minimum downpayments on homes with FHA-insured mortgages, about which I commented in my testimony. This reduction does not appear warranted under present circumstances when construction and mortgage lending are near or at record levels, pressure on capital markets is strong and increasing, and general economic activity is rapidly expanding. What is needed now are measures to increase the rate of saving, not the rate of borrowing.

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Another provision of S. 2378 would exclude FHA-insured home mortgage loans held by national banks from the limits currently imposed by the Federal Reserve Act on the amount of real estate loans that a national bank may hold in relation to its capital and surplus or its time and savings deposits. Such a relaxation of limits would have the effect of increasing the total amount of other real estate loans that a national bank could hold. Thus it would tend to lengthen the average maturity of bank assets and diminish bank liquidity. This statutory change does not seem desirable.

In conclusion, the Board wishes to state once again its deep concern about the problems of inflationary developments in the American economy and to express its hope that every effort will be made to harmonize housing programs with fiscal and monetary policies directed toward achieving economic stability which is essential to sustained growth.

Sincerely yours,

(Signed) Wm. McC. Martin, Jr.

Wm. McC. Martin, Jr.

KBW/RMF/MS:sjm

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July 30, 1959.

The Honorable John J. Sparkman,
United States Senate,
Washington 25, D. C.

Dear Senator Sparkman:

This is to clarify two points which came up during my testimony yesterday before the Housing Subcommittee.

In my prepared statement, the remark was made that "in the postwar period, nonfarm home mortgages have accounted for over one-third of the over-all increase in outstanding net debt, including all mortgages, securities, and other obligations." The question was raised whether or not this included internal corporate financing. Internal financing was excluded.

A second question concerned the place where Benjamin Disraeli made the statement which I quoted. He did so in a speech given in London on July 18, 1874.

Sincerely yours,

(Signed) Wm. McC. Martin, Jr.

Wm. McC. Martin, Jr.

RMF:cbd
7/30/59

W. in Muehlhaus

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July 28, 1959.

Chairman Martin:

Re testimony on Housing hearing

1. You are certain to be asked if you agree with the President's characterization of S. 57 as "inflationary", and, if so, why. (S. 57 is the bill vetoed by the President.) Veto message attached.

2. More than likely you will be asked if you were consulted by the White House on what action the President should take on S. 57, and, if so, what your recommendation was. (The Board's letter to the Budget Bureau referred to the inflationary implications of S. 57 but made no specific recommendation re veto.

3. Much of S. 57 originated with bills in the second session of the last Congress (1958) on which you testified before the Senate Housing Subcommittee in May 1958. At that time you indicated that you did not view the proposed legislation "with any particular alarm", but that any inflationary impact would "depend on the way it is handled." (The legislation then in question died in the House at the close of the session and much of it was revived in January 1958 as S. 57.

4. You are very apt to be asked--as you were by Senator Javits at the Joint Economic Committee hearing in February of this year--whether the budget must be balanced to the penny or whether there is room for flexibility--say, a $100 million or $1 billion over. (You replied that "we are not seeking a penny balancing budget operation" although you were later careful to say that "I don't speak for the Administration.")

5. You probably will be asked whether Senator Bush's bill S. 2378 is preferable to either S. 57 or S. 612 (the Administration bill.) (Mason of HHFA has testified that while the Administration has not formally approved S. 2378, that bill would probably be an acceptable compromise between S. 57 and S. 612.)

6. If Senator Fulbright is present, he will probably quiz you on the matter of "front-door" versus "back-door" financing. He is interested in the college housing and urban renewal provisions and seems to oppose the requirement of S. 2378 that would necessitate appropriations (front-door) for these projects.

J.W.S.

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Not for Publication

July 28, 1959

Further Comments for Use in
Connection with Chairman Martin's Statement on S. 57

Concerning urban renewal, the Board believes that this important program should be continued by authorizing some reasonable increase in capital grant authority. As the Board has stated before, however, it has reservations about programs such as urban renewal that, once approved, proceed without relation to economic and fiscal conditions. It would be well to provide that planning will be carried on in an orderly fashion while retaining discretion of the physical work and disbursement of grants.

The liberalization of real estate lending practices of Federal savings and loan associations, proposed in Sec. 807 (c) of the bill, seems highly questionable. This provision would permit the associations to make loans under certain conditions to finance the acquisition and development of land for primarily residential usage. Such a practice might involve the associations in activities connected with urban land acquisition and development that could be highly speculative in nature. Past experience has demonstrated that the financing of urban land development has often been carried on with a greater element of risk than that associated with the financing of completed residential developments. The Board does not believe that funds entrusted for investment to Federally chartered and insured savings and loan associations should be loaned for this purpose.

Sec. 813 would exclude FHA-insured home mortgages held by national banks from the limits currently imposed by the Federal Reserve

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Act on the amount of real estate loans which a national bank may hold in relation to its capital and surplus or its time and savings deposits. This relaxation of limits is tantamount to increasing the total amount of real estate loans that a national bank could hold. It would also work to lengthen the average maturity of bank assets. Such a change does not appear warranted.

Nor would this seem the time to enact new direct lending programs such as those proposed in S. 57. One would authorize $50 million for a new program of direct loans to assist private nonprofit corporations to provide housing and related facilities for persons aged 62 years or over. Loans amounting to as much as 98 per cent of estimated total development cost could be advanced for terms as long as fifty years and at interest rates which might be below the current cost of funds to the Treasury.

The other program would establish a new $62.5 million program of direct loans to educational institutions for construction or rehabilitation of classrooms, laboratories, and related facilities, including initial equipment, machinery, and utilities. Loans as high as 100 per cent of total development cost would be made over terms as long as fifty years and at interest rates which might also be below the current cost of funds to the Treasury. However desirable these programs may be when other demands on the economy and on the Government credit are less urgent, neither program seems desirable now, when fiscal and debt management problems are already grave.

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Miss Muehlhaus

August 19, 1959

The Honorable George Meader,
House of Representatives,
Washington 25, D. C.

Dear Mr. Meader:

During the briefing session on yesterday before the Foreign Operations and Monetary Affairs Subcommittee of the House Committee on Government Operations, you raised questions concerning the amount of outstanding mortgage debt.

Our estimate is that the total real estate mortgage debt outstanding at the end of March 1959 was $175.5 billion as compared to $57.5 billion at the end of March 1949. These totals, of course, include nonfarm home mortgage debt, which amounted to $120.7 billion at the end of March 1959 and $34.1 billion at the end of March 1949.

Please let us know if we can be of any further help to you.

Sincerely yours,

(Signed) Wm. McC. Martin, Jr.

Wm. McC. Martin, Jr.

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Note:
Mr. Martin took with him, for briefing session with Subcommittee, attached excerpt from his prepared statement before Committee on Finance, U.S.Senate, August 13, 1957.

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The Federal Reserve Act of 1913 was the outgrowth of prolonged Congressional study of the history of central banking in other countries and of our own experience, particularly with the First and Second Banks of the United States. The Congress, seeking to avoid either political or private domination of the money supply, created an independent institution which is an ingenious blending of public and private participation in the System's operations under the coordination of a public body--the Federal Reserve Board--here in Washington.

This question of "independence" has been thoroughly debated throughout the long history of central banking. On numerous occasions when amendments to the Federal Reserve Act were under consideration the question has been reexamined by Congress and it has reaffirmed its original judgment that the Reserve System should be independent--not independent of Government, but independent within the structure of the Government. That does not mean that the reserve banking mechanism can or should pursue a course that is contrary to the objectives of national economic policies. It does mean that within its technical field, in deciding upon and carrying out monetary and credit policy, it shall be free to exercise its best collective judgment independently.

The Reserve System is an instrument of Government designed to foster and protect the public interest, so far as that is possible through the exercise of monetary powers. Its basic objective is to assure a monetary climate that permits economic growth together with stability in the value of

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our money. Private citizens share in administering the System but, in so doing, they are acting in a public capacity. The members of the Board of Governors and the officers of the Federal Reserve Banks are in a true sense public officials. The processes of policy determination are surrounded with carefully devised safeguards against domination by any special interest group.

Broadly, the Reserve System may be likened to a trusteeship created by Congress to administer the nation's credit and monetary affairs -- a trusteeship dedicated to helping safeguard the integrity of the currency. Confidence in the value of the dollar is vital to continued economic progress and to the preservation of the social values at the heart of free institutions.

The Federal Reserve Act is, so to speak, a trust indenture that the Congress can alter or amend as it thinks best. The existing System is by no means perfect, but experience prior to 1914 suggests that either it or something closely approximating it is indispensable. In its present form, it has the advantage of being able to draw upon the knowledge and information of the directors and officers of its 12 banks and 24 branches in formulating and carrying out credit and monetary policies.

The Board of Governors, as you know, is composed of seven members appointed by the President and confirmed by the Senate, each for a term of 14 years. In appointing the members of the Board, the President is required to give due regard to a fair representation of the financial,

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agricultural, industrial, and commercial interests, as well as the geographical divisions of the country. From among these members the President designates a Chairman and a Vice Chairman for terms of four years. Some of the functions of the Board of Governors are (1) to exercise supervision over the Federal Reserve Banks; (2) to fix, within statutory limits, the reserves which member banks are required to maintain against their deposit liabilities; (3) to review and determine the discount rates which are established biweekly at each Federal Reserve Bank, subject to approval of the Board in Washington; (4) to participate, as members of the Federal Open Market Committee, in determining policies whereby the System influences the availability of credit primarily through the purchase or sale of Government securities in the open market; (5) to fix margin requirements on loans on stock exchange collateral; and (6) to perform various supervisory functions with respect to commercial banks that are members of the System and to administer Federal Reserve, Holding Company, and other legislation.

Each Federal Reserve Bank has a board of nine directors, of whom six are elected by the member banks. Of these, three are bankers, one from a large, one from a medium, and one from a small bank. Three more must not be bankers, but must be engaged in some nonbanking business. The other three members are appointed by the Board of Governors in Washington, which also designates one to be the Chairman and another the Deputy Chairman. None of these three may be an officer, director, employee, or

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stockholder of any bank. The directors of a Reserve Bank supervise its affairs. Subject to approval of the Board of Governors, they appoint the President and First Vice President. Subject to review and determination by the Board of Governors, they establish discount rates.

The stock of each Federal Reserve Bank is held by the member banks of its district. This stock does not have the normal attributes of corporate stock; rather, it represents a required subscription to the capital of the Reserve Bank, dividends being fixed by law at 6 per cent. The residual interest in the surplus of the Federal Reserve Banks belongs to the United States Government, not to the Bank's stockholders.

The Federal Open Market Committee consists, according to law, of the seven members of the Board of Governors, together with five Presidents of the Federal Reserve Banks. Four of these five Presidents serve on a rotating basis; the fifth, the President of the Federal Reserve Bank of New York, is a permanent member of the Committee. Since June 1955, when its Executive Committee was abolished, this Committee has usually met at three-week intervals to direct the sale and purchase of securities in the open market. In practice, all 12 Presidents attend these meetings and participate freely in the discussion, although only those who are members of the Committee vote.

The Federal Reserve Act also provides for a Federal Advisory Council of 12 members. One is elected by the Board of each Reserve Bank

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for a term of one year. The Council is required by law to meet in Washington at least four times each year. It is authorized to confer directly with the Board of Governors respecting general business conditions and to make recommendations concerning matters within the Board's jurisdiction.

The work of the System requires a continuous study and exercise of judgment in order to be alert to the way the economy is trending and what Federal Reserve actions will best contribute to sustained economic growth. Such decisions are often hard to make because of the existence of cross-currents in the economy. Even in generally prosperous times, some parts of the economy may not fare as well as others. Credit policy must, however, fit the general situation and not reflect unduly either the condition of certain industries experiencing poor business, or that of other industries enjoying a boom.

The objective of the System is always the same--to promote monetary and credit conditions that will foster sustained economic growth together with stability in the value of the dollar. This goal may be thought of in human terms. The first part may be considered as concerned with job opportunities for wage earners; the latter as directed to protecting those who depend upon savings or fixed incomes, or who rely upon pension rights. In fact, however, a realization of both aims is vital to all of us. They are inseparable. Price stability is essential to sustainable growth. Inflation fosters maladjustments. In some periods these broad aims call for encouraging credit expansion; in others, for restraint on the growth of credit.

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Miss Muehlhaus

AUG 11 1959

The Honorable Porter Hardy, Jr.,
Chairman, Subcommittee on Foreign Operations
and Monetary Affairs of the
Committee on Government Operations,
House of Representatives,
Washington 25, D. C.

Dear Mr. Chairman:

Referring to your letter of August 3, 1959, this is to advise you that Jerome W. Shay has been designated to confer preliminarily with your Subcommittee's Chief Counsel, Mr. John T. M. Reddan. Mr. Shay, who is the Board's Legislative Counsel, talked briefly with Mr. Reddan on August 7.

Sincerely yours,

(Signed) Wm. McC. Martin, Jr.

Wm. McC. Martin, Jr.

230 Tuesday 8/18

JWS:ac

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CONGRESS OF THE UNITED STATES
House of Representatives

Foreign Operations and Monetary Affairs Subcommittee
of the
Committee on Government Operations

Washington, D. C.

August 3, 1959

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

Dear Mr. Chairman:

The Foreign Operations and Monetary Affairs Subcommittee of the Government Operations Committee has been assigned the responsibility of examining, from the standpoint of economy and efficiency, the operations of the Board of Governors of the Federal Reserve System.

In order that the Subcommittee may properly discharge its duty with respect to your organization, full knowledge and understanding of all phases of the Board's activities are, of course, a necessary prerequisite. Therefore, as a first step in this direction, it is requested that you designate some member of your staff to confer preliminarily at an early date with the Subcommittee's Chief Counsel, John T. M. Reddan.

Sincerely yours,

(Signed) Porter Hardy, Jr.

Porter Hardy, Jr.
Chairman

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Foreign Operations and Monetary Affairs Subcommittee
of the
House Committee on Government Operations

Democrats

Porter Hardy, Jr. (Va.), CHAIRMAN
Henry S. Reuss (Wis.)
Elizabeth Kee (W. Va.)
John S. Monagan (Conn.)

Republicans

George Meader (Mich.)
Robert P. Griffin (Mich.)

Ex-Officio

William L. Dawson (Ill.),
Chairman, Full Committee

Clare E. Hoffman (Mich.),
Ranking Minority Member,
Full Committee

Porter Hardy, Jr.-Democrat, Churchland, Norfolk County, Va. (2d Congressional Dist., which includes Norfolk and Portsmouth); businessman-farmer; born 1903; father, Methodist minister; Randolph-Macon College, BA 1922; LL.D. 1955; attended Graduate School Business Administration, Harvard University, 1923-24; Norfolk Rotary Club (honorary member); Hampton Roads Maritime Association; Hampton Roads Post, American Society Military Engineers; elected to 80th Congress (1946) and each succeeding Congress.

Henry S. Reuss-Democrat, Milwaukee, Wis. (5th Congressional Dist.); born 1912; Cornell University, A.B.; Harvard Law School, LL. B.; Asst. Gen. Counsel, OPA, 1941-42; World War II service, Army; Chief, Price Control Branch, Office of Military Government for Germany, 1945; Deputy General Counsel, Marshall Plan, 1949; former Pres., White Elm Nursery Co., Hartland, Wis.; former director, Marshall & Ilsley Bank, Milwaukee; former director, Niagara Share Corp., Buffalo, N. Y.; former member, Legal Advisory Committee, National Resources Board; elected to 84th Congress (1954) and each succeeding Congress.

Elizabeth Kee-Democrat, Bluefield, W. Va. (5th Congressional Dist.); elected to Congress in 1951 to fill unexpired term in 82d Congress of deceased husband (Congressman John Kee) and re-elected to each succeeding Congress.

John S. Monagan-Democrat, Waterbury, Conn. (5th Congressional Dist.); born 1911; Dartmouth College, A.B., 1933; Harvard Law School, LL. B., 1937; lawyer; mayor, Waterbury, 1943-48; 86th Congress is his first term.

George Meader-Republican, Ann Arbor, Mich. (2d Congressional Dist.); born 1907; University of Michigan Law School, J.D., 1931; served as assistant counsel and later as chief counsel to Senate special committee investigating national defense program (Truman-Mead Committee), 1943-49--in addition to other matters, worked on Congressman May-Garsson brothers case; chief counsel to Senate Banking and Currency Committee Subcommittee (Fulbright) investigating RFC, 1950; elected to 82d Congress (1950) and each succeeding Congress.

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Robert P. Griffin-Republican, Traverse City, Mich. (9th Congressional Dist.); born 1923; Central Michigan College, A.B. and B.S.; University of Michigan Law School, J.D.; World War II service, Army; lawyer, firm of Williams, Griffin, Thompson, & Coulter; elected to 85th Congress and re-elected to 86th. (Co-author of Griffin-Landrum labor bill.)

Committee Assignments

Porter Hardy, Jr.

Armed Services
Government Operations

Henry S. Reuss

Banking and Currency
Government Operations
Joint Economic Committee

George Meader

Government Operations
Judiciary

Robert P. Griffin

Government Operations
Education and Labor

Elizabeth Kee

Government Operations
Veterans' Affairs

John S. Monagan

Government Operations

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