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Series V, Subseries D

Hearings, June 1957

(34)

STATEMENT OF JOHN A. ADAIR
PRESIDENT, EXCHANGE NATIONAL BANK, ATCHISON, KANSAS
BEFORE SUB-COMMITTEE ON SMALL BUSINESS, SENATE BANKING & CURRENCY COMMITTEE
WASHINGTON, D. C. June 6, 1957

My name is John A. Adair, and I am president of the Exchange National Bank of Atchison, Kansas. I am not only a banker but a small-businessman employing 30 people. Much of our business involves the extension of credit to small business organizations and consultation with their principals. Considering the fact that I have initiated a questionnaire in respect to the recommendations made to your Committee today, to each of the 600 National and State Federal Reserve Member banks in the 10th Federal Reserve District which comprises Nebraska, Kansas, Oklahoma, Colorado, New Mexico, and parts of Missouri and Wyoming, the replies to which will be made available to this committee at a later date, it is possible that some of the views expressed may represent a cross-section of banking opinion and therefore of more value to you gentlemen than if they were solely mine.

My purpose here today is threefold.

First, I wish to oppose passage of those sections of H.R. 7474, "Small Business Act of 1957", which would authorize and appropriate $500,000 for the making of loans to small business as provided in Section 102 (c) and 106 (a) and establish a permanent independent agency to further expand the direct or indirect lending activity of the Federal Government.

Secondly, I wish to urge that your committee consider certain amendments to S. 1451, "Fiaancial Institutions Act of 1957", already endorsed by the full committee and passed by the Senate which will encourage a greater flow of funds from the private banking and credit system to small business and those segments of private enterprise which constitute sound risks yet from time to time credit risks which banks either would not or legally could not assume without a guaranty. Furthermore, I do not believe that the essence of these proposals will prove either controversial or unacceptable to the regulatory agencies concerned.

Thirdly, I wish to invite the committee's attention to the very serious problems facing the largest segment of corporate small business in the country, namely the 10,000 commercial banks each with deposits under $6 million net worth, typically ranging downward from $400,000. These banks necessarily have much to do with the extension of credit and perhaps of equal importance financial counsel to the nation's small-businessman whether he is in agriculture, commerce or manufacturing. A number of factors which inhibit the small bank in performing this vital function can and must be removed if timely legislative initiative is taken by your Committee during this session of Congress. In other respects, the long-term profit environment in which these banks operate and their competitive position can and must be improved by constructive legislative action, predicated upon sound research and the gathering of a fresh point of view and new facts obtained in part from small-businessmen and bankers who would welcome an opportunity to be heard at regional hearings conducted throughout the country by your and an appropriate committee of the House of Representatives.

I. In support of my first recommendation that it is undesirable for the Federal Government to establish a permanent Small Business Administration with a $500,000 call on the Treasury for the purpose of making loans to small business, I nevertheless wish to emphasize my concurrence with the objectives of H.R. 7474 to help small business. The long-run health of the economy requires the continual fostering of young enterprise. Small businesses are best suited to certain types of production and service and will continue to be responsible for the employment of millions of people in this country. Small business will forever be the backbone of our American prosperity.

The results of numerous banking studies confirm the dependence of small business upon a readily available source of credit. Our commercial banking credit mechanism, the capstone of our capitalistic free-enterprise system, unique in the world, is comprised of approximately 14,000 banks, more than 2/3 of which are small unit banks scattered over the length and breadth of the land. The lending activities of these banks are ideally suited to serve the financial needs of all business, including small business. Recent studies by Federal Reserve Banks which reveal the size of loans to American business and agriculture underline the fact that a large majority of bank loans are of a size which undoubtedly represent extensions of credit to small business. There is also evidence that commercial banks are tailoring their loans to meet the borrower's needs. The number of term loans is increasing; their repayment is geared to earnings after taxes and reflects projected debt repayment ability from depreciation and amortization accruals.

Although the commercial banking mechanism may be deficient in some respects and can be improved, perhaps the most convincing arguments in support of stimulating the greatest possible use of private credit as opposed to increased direct lending is available in a letter of the Board of Governors of the Federal Reserve System dated December 18, 1944, to the Honorable James E. Murray, Chairman of the Special Committee of the Senate to Study Problems of American Small Business, from which I quote in part:

"....Although the liquid resources of business as a whole, including small business, have increased greatly during the war, there will be enterprises that must resort to credit in order to accomplish their individual reconversion and readjustment. The credit needs of a substantial number of these can be met by the banks in the form of regular bank loans. The Board believes, however, that in many cases the financial needs of worthy enterprises, particularly during the reconversion period, will represent degrees of credit risk that banks ordinarily should not be expected to assume.

"The desired extension of the credit area to cover these situations may be brought about either by encouraging the private banking and credit system of the nation to perform the task or by further expansion and innovations in direct lending by the Government. The Board emphatically favors the former course.

"The Board recognizes that whenever private credit appears to be restricted or otherwise inadequate pressure for increased Government lending is inevitable. However, no expansions of Government activity in the field of credit should be permitted unless and until it is clearly demonstrated that the private financial system is either unable, or able but unwilling,

to do the job. The supply of funds today in the hands of the private banking system is abundantly adequate for all demands of reconversion and readjustment of business. Bankers are actively seeking outlets for increased commercial and industrial lending. The Board believes that as long as private enterprise in finance can and will do the work, it should be encouraged and aided in doing so."

"The foregoing are the general views of the Board as it sees the problem at this time and on the basis of information available to it. The discussion has been limited to the credit needs of small business, as specified by your letter. The Board wishes, however, to emphasize its view that the problem of small business cannot be met satisfactorily by pumping out more and more credit. Programs in other fields would have greater importance. Chief among them would be a modification of the corporation income tax giving substantial and preferential advantages to smaller corporations and to new ventures. This would encourage the flow of equity capital to such enterprises and correspondingly reduce the need for credit not obtainable from banks on the usual basis. Another aid to small business would be a provision for better access to industrial research and the use of patents. In the opinion of the Board, such measures would be much more effective in maintaining the competitive position of small business than any of the current proposals to provide more credit through some form of governmental assistance."

It can be argued:

First, that this point of view was of a previous Board whose philosophy was not akin to that in office today, and

Second, that the Board's recommendations in 1945 were in anticipation of "the immediate and temporary problems of war contract termination....the renewal and resumption of civilian operations of every type including increased lending activities of the smaller banks ....a need of every form of business and industrial financing by small war plants whose expanded borrowings have been guaranteed by war agencies but who must approach their banks for financing during a period of uncertain changes with wartime guarantees continued."

In reply, I am confident that the Federal Reserve Board, the Federal Advisory Council, the Boards of the individual Federal Reserve Banks, and members of their Industrial Advisory Committees, if polled, would not be in favor of encouraging the trend toward multiplication of Government credit agencies with its inherent threat to our private banking system, which passage of the Small Business Act of 1957 would involve.

In further reply to those who would object to my flashback to the uncertain economic backdrop of 1945, are not many firms today facing cutbacks or cancellations of Government contracts? Are not the profit margins of many businesses very insecure? Are we not actually in a very uncertain period when business large and small is facing its private bankers, who are doing a magnificent job of helping industry carry staggering inventories and receivable requirements compounded by the inflation? Is not small and large business and its bankers continuing to face up to the terrific and perhaps impossible problem of financing new plants with old depreciation dollars, after 30% and 52% income taxes, which virtually eliminate the possibilities of expansion from retained earnings?

I am certain that the Federal Reserve Board today does not forecast the future as less uncertain than in 1945 (or for that matter with any less degree of accuracy either) nor do I believe that the Board would say that the period ahead is one in which a Government credit agency might be expected to do a job for which private banking was incapable or for which Government was better fitted. It is in the light of this reasoning that I recommend against passage of the principal lending sections of the Small Business Act of 1957.

II. Your committee is urgently requested to amend the Financial Institutions Act of 1957 if and when it reaches conference committee, as follows:

In place of revoking existing authority of the Federal Reserve Banks to make loans direct to industry under Section 13(b) the bill should be amended to authorize the Federal Reserve Banks to guarantee financing institutions against loss on loans made to business enterprises or to make commitments to purchase such loans from commercial banks. The percentage of the loan to be guaranteed would vary with specific cases, but in no case would it exceed 80 or 90%.

Arguments used in support of repealing Section 13(b) were:

a. From the testimony of C. Canby Balderston, Vice Chairman of the Federal Reserve Board, in 1955: *

"....Section 13(b) of the Federal Reserve Act which authorizes the Federal Reserve Banks to make loans for working capital purposes to establish businesses when credit is unavailable on a reasonable basis from usual sources....was put into our Federal Reserve Act during the depression of the 1930's and has now largely accomplished the purpose for which it was enacted. Therefore, the Federal Reserve would favor its repeal now. Such repeal would release to the Treasury some $27 million which has been tied up in connection with Section 13(b)."

b. Quoting from Senate Staff Report no. 121, 85th Congress, First Section, Financial Institutions Act of 1957:

The Section 13(b) "provisions....which were first enacted in 1934 authorized the Federal Reserve Banks to make working capital loans and commitments to established industrial or commercial businesses. This authority has been utilized very little in recent years and in any event appears to be inconsistent with central banking functions."

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* Before Sub-committee on Small Business of the Senate Committee on Banking & Currency, May 11, 1955, in connection with Senate Bill S. 381 which proposed appropriating surpluses from Federal Reserve Banks for the purpose of establishing loan insurance funds and organizing investment companies.

c. Quoting from the statement of J. L. Robertson, Member, Board of Governors, Federal Reserve Board, in hearings Study of Banking Laws, Part II, page 854:

"The bill would have the effect of repealing the present authority of the Reserve Banks under Section 13(b) of the Federal Reserve Act to make working capital loans and commitments to business enterprises. The repeal of this authority which has been utilized very little in recent years would be in accord with the position heretofore taken by the Board in this matter."

From the above, it's apparent that no case was made for retention or modification, improvement and extension of Section 13(b) direct lending or loan guarantee authorities. In support of preserving this vital function of the Federal Reserve Banks, I submit that:

Mr. Balderston's statement is not borne out by the facts set forth in Exhibits A-1 and A-2. These offer conclusive proof that Section 13(b) lending authorities have served very important purposes, which may be ever-recurrent. Note the need for credit:

In 1938, a shortlived but severe period of economic recession
And in 1940 more of the same
In 1941-1943, the early war years
And again in 1950-1951, the Korean war period
In 1952, when we again experienced a brief recession

In my opinion, we may expect to experience again similar periods of demonstrated need for Section 13(b) credit. Whether or not such circumstances were or were not in keeping with Congressional intent when these provisions were enacted is a matter of speculation. There can be no argument that these powers have and can continue to be used.

The committee's and Mr. Robertson's justification for discarding the authority because "it was little used in recent years" overlooks:

a. An important and increased use during the recent years 1951 and 1952.
b. The presence of peak prosperity years as the obvious cause of little use in the more recent years 1954-1956. With this must be coupled the obvious fact (which may be borne out by a questionnaire sent the 600 banks in the 10th Federal Reserve District) that the banking industry's lack of knowledge of these lending powers and the absence of pressing need contribute substantially to their lack of use at this time.

References to Section 13(b) on the Senate floor contained in the Congressional Record of March 21, 1957, page 3644, state that Section 13(b) was passed prior to the passage of the RFC. The further implication was that direct lending by a Government agency supplanted the private lending functions of the commercial banks in conjunction with the Federal Reserve Banks. The facts are that RFC commenced making loans in 1930 and its liquidation was commenced several years ago. It was not Congress's thought that the RFC was a substitute for Section 13(b).

Senatorial comment when the Bill was being debated included a statement that

Section 13(b) was only used four times in 1956, which was correct. The statement was also made that "in the course of 25 or 26 years, it has rarely been used." This was obviously in error. The Bill was passed 23 years ago and over 3700 commitments were made, comprising 3/4 of a billion dollars of loans. Such is hardly "rare use".

From the floor discussion it was also suggested that a "disaster fund" in the Department of Agriculture and loans available by the present Small Business Administration would handle any lack of credit otherwise available to business through its local bank with a 13(b) Federal Reserve Bank participation. This thinking is deplorable and tends to confuse direct "grants" for disaster relief and subsidy payments by the Federal Government with the extension of sound loans by the private banking mechanism in the absence of the usual sources of credit to businesses whose continued operation is vital to the economic life of a community.

The committee's attention is invited to several other most vital and significant "qualities" of Federal Reserve Banks Section 13(b) credit. Please refer to ExhibitsB which sets forth loan data in the 10th District during the period 1946-1956.

1. The nine loans made were to relatively small businesses, measured in terms of number of people employed by the borrower.

2. Measured in the terms of size of credit, only two of the nine loans made were under $250,000 and thus classified in the so-called "Small Business category".

3. Your committee's attention is again invited to both Exhibits A-1 and B-1 as evidence of the fact that the commercial bank participants in 13(b) commitments were not ducking the risk. Further investigation will undoubtedly prove that losses sustained have been small. This is confirmation of the fact that each 13(b) recipient of credit had to demonstrate that it was creditworthy and his proposition "sound".

4. Measured in terms of potential economic hardship to which the employees, their families, and the communities would have been exposed had these loans not been made, the story is quite different; losses to society would have been substantial. If the reserve bank is required to submit to your Committee the flesh and blood statistics on a national scale reflecting the number of employees and size of the town in which the borrower were located, I am confident that you gentlemen will approve this proposal to amend S. 1451 and provide for continuance and extension of loan guarantee authorities of the Federal Reserve Banks of this country.

5. Inflation has cut the lending limits of all individual banks in this country and thus increased the need for commercial bank loan participation outlets.

6. National and Member banks are at a further disadvantage in Kansas and in other states in that their cash reserves by law are lodged with Federal Reserve Banks and therefore unavailable as a source of profit to correspondent banks. Consequently, these banks have a limited leverage when it comes to placing with a correspondent the excess portion of a somewhat risky or problem loan to a company whose continued existence is dependent upon bank credit and whose continuance in business in your home town may be vital to your bank and to your community. Thus the need for access to credit participations

with the Federal Reserve Banks.

The third reference above held that Section 13(b) "appears to be inconsistent with central banking functions." Frankly, gentlemen, I do not know what these are. But may I again quote from the Federal Reserve Board's letter of December 18, 1944, which was in respect to the Wagner-Spence Bill. This bill embodies principles which the Board considers sound. It abolishes the direct lending features of Section 13(b) of the Federal Reserve Act and, without additional Congressional appropriation, extends and makes more workable a loan-guarantee mechanism by which the private banking system could meet more fully the credit needs of business and industry.

"Arguments in behalf of this bill have already been presented by Chairman Eccles to the Senate and House Committees on Banking and Currency. The arguments in favor of the bill, as changed by three limiting amendments suggested by the Chairman in the hearings, may be summarized as follows:

"The bill would encourage a greater flow of funds from the private banking and credit system into those marginal credit risks which banks would not assume without a guarantee.

"All loans would originate with banks or other private financing institutions. Amounts, terms, collateral and other details of proposed loans would be worked out between the borrower and the financing institution to which he applies. Thus the operation of the plan would be decentralized throughout the United States.

"Credit extensions in the marginal area of risk would be encouraged by guarantees up to 90 per cent of those loans on which banks may desire guarantees. The lender would share in the risk to the extent of 10 per cent or more, which would be a sufficient exposure to prevent lending institutions from involving the guarantee fund in careless or excessive credit hazards.

"No new appropriation would be required. An appropriation made by Congress in 1934, amounting to $139,000,000, would be adequate to guarantee a total of more than $500,000,000 of loans outstanding at any one time.

"The benefits of the guarantee would go primarily to the smaller units of business and industry. For the small businesses that are regarded by bankers as marginal or debatable credit risks, the guarantee would be the deciding factor in establishing their credit. Term lending, in which the risk factor is generally higher, would be especially encouraged.

"The plan would be administered by experienced personnel in the Federal Reserve Banks who are administering the V-loan and T-loan programs, a similar credit mechanism. Financing institutions are already familiar with services of the Federal Reserve Banks in this field. Thus no new personnel, controls over banking, or untried activities or principles, are involved.

"Finally, no competition between direct Government lending and the private credit system would be involved. On the contrary, the guarantee plan would encourage the existing

private system to extend credit which otherwise might be furnished by the Government or not at all. The trend toward multiplication of Government credit agencies, if continued, may threaten the destruction of the private banking system."

Other recommended amendments to Financial Institutions Act of 1957, S. 1451 and H.R. 7026, which will aid commercial banks in the extension of credit to small business are:

a. Increase the lending limit of National and Federal Reserve Member banks from 10% of capital and surplus to 15% of capital and surplus by amending Section 34(a) of Title I.

b. Eliminate the provision of Section 42(f) of Title II, which requires that Member banks maintain reserves against public funds. The state bank law in Kansas and a number of other states imposes no such requirement on state banks and consequently places them in a better position profitwise or permits these banks to maintain larger deposits with correspondent banks.

c. Eliminate the prohibition contained in Section 45(c) of national banks in cities over 5,000 from receiving premium income from the sale of insurance on the lives of borrowers or policies protecting loan collateral. This provision places these banks at a competitive disadvantage with local finance companies and savings & loan associations. The public now demands insurance protection of its loans. The loss of future profits from this business will prove to be very harmful to many banks.

III. As a final suggestion to your committee, let me urge that it undertake as a separate project a study of the problems of small business - commercial banks. A continuance of the prevailing corporate tax structure and other banking laws is slowly but surely destroying their earning power and competitive position. A serious problem of continuity of ownership and management exists.

The shift of population from rural areas to cities and from large urban centers to suburbs has disturbing overtones. The consequences of either more inflation or deflation will have serious effect on the banks, their small business customers, and on the economy.

The regulatory agencies are in sorry shape in a number of respects. An audit of their mission and performance is a must. The availability of detailed facts and figures concerning banks and banking will permit conclusive research. The conduct of regional hearings will permit Congress to come to closer grips with the need for further constructive legislation.

Industrial Loans and Commitments by Federal Reserve Banks
Under Section 13b of the Federal Reserve Act

June 19, 1934-December 31, 1956

EXHIBIT A-1

(Amounts in thousands of dollars)

Date (last Wednesday or last day of year)	Applications approved to date * Number	Applications approved to date * Amount	Approved, but not completed amount 1/	Loans outstanding 2/ amount	Commitments outstanding amount	Financing Institution Participations Outstanding 3/ amount
1934	984	49,634	20,966	13,589	8,225	1,296
1935	1,993	124,493	11,548	32,493	27,649	8,778
1936	2,280	139,829	8,226	25,526	20,959	7,208
1937	2,406	150,987	3,369	20,216	12,780	7,238
1938	2,653	175,013	1,946	17,345	14,161	12,722
1939	2,781	188,222	2,659	13,683	9,220	10,981
1940	2,908	212,510	13,954	9,152	5,226	6,386
1941	3,202	279,860	8,294	10,337	14,597	19,600
1942	3,423	408,737	4,248	14,126	10,661	17,305
1943	3,471	491,342	926	10,532	9,270	17,930
1944	3,489	525,532	1,295	3,894	4,165	2,705
1945	3,511	544,961	320	1,995	1,644	1,086
1946	3,542	565,913	4,577	554	8,309	2,670
1947	3,574	586,726	945	1,387	7,434	4,869
1948	3,607	615,653	335	995	1,643	1,990
1949	3,649	629,326	539	2,178	2,288	2,947
1950	3,698	651,389	4,819	2,632	3,754	3,745
1951	3,736	710,931	3,513	4,687	6,036	11,985
1952	3,753	766,492	1,638	3,921	3,210	3,289
1953	3,765	803,429	1,951	1,900	3,569	3,469
1954	3,771	818,224	520	719	1,148	1,027
1955	3,778	826,853	305	702	2,293	1,103
1956	3,782	832,550	--	794	2,365	1,129

1/ Includes applications approved conditionally by the Federal Reserve Banks and under consideration by applicant.

2/ Includes industrial loans past due three months or more, which are not included in industrial loans outstanding in weekly statement of condition of Federal Reserve Banks.

3/ Not covered by Federal Reserve Bank commitment to purchase or discount.

NOTE--The difference between amount of applications approved and the sum of the following four columns represents repayments of advances, and applications for loans and commitments withdrawn or expired.

*In case of a revolving line of credit the "number" includes only the original application but the "amount" includes all disbursements made under the loan.

Applications For Industrial Loans
and Commitments Approved By
Federal Reserve Banks, By Years
For Period 1934 - 1956

EXHIBIT A-2

Year	Number	Amount (in millions of dollars)
1934	984	$ 50
1935	1,009	75
1936	287	15
1937	126	11
1938	247	24
1939	128	13
1940	127	24
1941	294	67
1942	221	129
1943	48	82
1944	18	34
1945	22	19
1946	31	21
1947	32	21
1948	33	29
1949	42	14
1950	49	22
1951	38	60
1952	17	56
1953	12	37
1954	6	15
1955	7	9
1956	4	6
	3,782	$ 833

NOTE--In case of a revolving line of credit the "number" includes only the original application but the "amount" includes all disbursements made under the loan.

FEDERAL RESERVE BANK OF KANSAS CITY

13 b Activity
1946 - 1956

EXHIBIT B

Year	Number Applications Received	Number Commitments Made	Total FRB Exposure	Total Member Banks Exposure	Principal Amount of Loans	Principal Repayment of Loans	Number Employed by Borrower	Population of Communities* of Lending Bank	Number of Loan Commitments Made
1946	1	1	$3,750,000	$1,250,000	$5,000,000	$5,000,000	50	686	3
1947	-						90	11,335	1
1948	-						104	12,792	1
1949	-						110	78,791	1
1950	3	1	500,000	500,000	1,000,000	1,000,000	115	456,622	3
1951	1	1	390,000	210,000	600,000	600,000	246		
1952	-						300		
1953	2	2	248,000	62,000	310,000	310,000	801		
1954	1	1	1,920,000	480,000	2,400,000	400,000			
1955	2	2	448,000	112,000	560,000	560,000			
1956	1	1	208,000	52,000	260,000	-			
	11	9	$7,464,000	$2,666,000	$10,130,000	$7,870,000			

*6 in Kansas. 3 in Missouri.

Total Loans Purchased: None

Total Loans Charged Off: None

[COMMITTEE PRINT]

MAY 13, 1957

85TH CONGRESS
1ST SESSION

S.

[A BILL IN THE NATURE OF A SUBSTITUTE FOR S. 719]

IN THE SENATE OF THE UNITED STATES

JUNE , 1957

Mr. ---------- introduced the following bill; which was read twice and referred to the Committee on Banking and Currency

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A BILL

To make capital more readily available for financing small business and thus to promote, foster, and develop the domestic and foreign commerce of the United States, and for other purposes.

1 *Be it enacted by the Senate and House of Representa-*
2 *tives of the United States of America in Congress assembled,*

3 TITLE

4 SECTION 1. This Act may be cited as the "National
5 Investment Company Act of 1957."

6 DECLARATION OF POLICY

7 SEC. 2. It is the policy of the Congress—
8 (a) to foster the development and growth of inde-
9 pendent small-business enterprises with the objective of

1 enabling them to make their maximum contribution to
2 productive investment and employment and to the eco-
3 nomic stability and growth of the Nation;
4 (b) to make capital for such enterprises more
5 readily available in adequate amounts and on reasonable
6 terms;
7 (c) to facilitate maximum participation of private
8 financial institutions and investors in financing these
9 enterprises; and
10 (d) to supplement the existing facilities of banks
11 and other private financial institutions by providing for
12 the establishment of privately owned national investment
13 companies.

14 TITLE I—NATIONAL INVESTMENT COMPANIES

15 ORGANIZATION OF NATIONAL INVESTMENT COMPANIES

16 SEC. 101. (a) National investment companies may be
17 formed for the purpose of operating under this Act by any
18 number of persons not less than five, who shall subscribe
19 to the articles of incorporation of any such company; except
20 that in the case of any company in whose stock one or more
21 Federal Reserve banks invest, the Federal Reserve bank or
22 banks may alone subscribe to the articles of incorporation.
23 The total number of national investment companies formed
24 by Federal Reserve banks pursuant thereto shall not exceed
25 one in each of the several States, the District of Columbia,

1 the several Territories and the several possessions of the
2 United States, and the Commonwealth of Puerto Rico.
3 (b) The articles of incorporation of any national invest-
4 ment company shall specify in general terms the objects for
5 which the company is formed, the name assumed by such
6 company, the area or areas where its operations are to be
7 carried on, the place where its principal office is to be lo-
8 cated, and the amount and classes of its shares of capital
9 stock; and the articles may contain any other provisions not
10 inconsistent with this Act that the company may see fit to
11 adopt for the regulation of its business and the conduct of its
12 affairs, including provision for cumulative voting in election
13 of directors. Such articles and any amendments thereto
14 adopted from time to time shall be subject to the approval
15 of the Board of Governors of the Federal Reserve System
16 (hereinafter called the "Board").
17 (c) The articles of incorporation and amendments
18 thereto shall be forwarded to the Board for consideration and
19 approval or disapproval. In determining whether to ap-
20 prove the establishment of such a company and its proposed
21 articles of incorporation, the Board shall give due regard,
22 among other things, to the need for the financing of inde-
23 pendent small-business enterprises in the area in which the
24 proposed company is to commence business, the general
25 character of the proposed management of the company, the

1 number of such companies previously organized in the
2 United States, and the volume of their operations. After
3 consideration of all relevant factors, the Board may in its
4 discretion approve the articles of incorporation and issue a
5 permit to begin business.

6 (d) Upon issuance of such permit, the company shall
7 become and be a body corporate, and as such, and in the
8 name designated in its articles, shall have power—

9 (1) to adopt and use a corporate seal;

10 (2) to have succession for a period of thirty years,
11 unless extended as provided in section 110 (g), or unless
12 sooner dissolved by the act of the shareholders owning
13 two-thirds of the stock or by an Act of Congress, or
14 unless its franchise becomes forfeited by some violation
15 of law or regulation issued hereunder;

16 (3) to make contracts;

17 (4) to sue and be sued, complain, and defend in
18 any court of law or equity;

19 (5) by its board of directors, to appoint such of-
20 ficers and employees as may be deemed proper, define
21 their authority and duties, fix their compensation, re-
22 quire bonds of such of them as it deems advisable and
23 fix the penalty thereof, dismiss such officers or em-
24 ployees, or any thereof, at pleasure and appoint others
25 to fill their places;

1 (6) to adopt bylaws regulating the manner in which
2 its stock shall be transferred, its officers and employees
3 appointed, its property transferred, and the privileges
4 granted to it by law exercised and enjoyed;
5 (7) to establish branch offices or agencies subject
6 to the approval of the Board;
7 (8) to acquire, hold, operate, and dispose of any
8 property (real, personal, or mixed) whenever necessary
9 or appropriate to the carrying out of its lawful func-
10 tions;
11 (9) to act as depository or fiscal agent of the United
12 States when so designated by the Secretary of the
13 Treasury;
14 (10) to operate in such area or areas as may be
15 specified in its articles of incorporation and approved by
16 the Board; and
17 (11) to exercise the other powers set forth in this
18 Act and such incidental powers as may be reasonably
19 necessary to carry on the business for which the com-
20 pany is established.
21 (e) The board of directors of each national investment
22 company shall consist of nine members all of whom shall be
23 elected annually by the holders of the shares of stock of the
24 company.

1 CONVERSION OF STATE DEVELOPMENT CORPORATIONS

2 SEC. 102. (a) Any State development corporation in-
3 corporated by special law of any State or organized under
4 the general laws of any State may, by the vote of the share-
5 holders owning not less than 51 percent of the capital stock
6 of such corporation, with the approval of the Board, be con-
7 verted into a national investment company under this Act.
8 For a period of six months following enactment of this Act,
9 or for such longer period as the Board may determine, no
10 Federal Reserve bank or banks shall form a national invest-
11 ment company, except by such conversion, in any State,
12 Territory, possession, the Commonwealth of Puerto Rico,
13 or the District of Columbia in which a State development
14 corporation is in being as of the date of enactment of this Act,
15 unless such development corporation shall have stated in
16 writing to the Board that such corporation does not intend
17 to convert into a national investment company as herein
18 provided.

19 (b) In such case the articles of association and organi-
20 zation certificate may be executed by a majority of the
21 directors of the corporation, and the certificate shall declare
22 that the owners of 51 per centum of the capital stock have
23 authorized the directors to make such certificate and to
24 change or convert the corporation into a national investment
25 company. A majority of the directors, after executing the

1 articles of association and the organization certificate, shall
2 have power to execute all other papers and to do whatever
3 may be required to make its organization perfect and com-
4 plete as a national investment company. The shares of any
5 such corporation may continue to be for the same amount
6 each as they were before the conversion, and the directors
7 regardless of number, may continue to be directors of the
8 corporation until the election of the board of directors is held
9 in accordance with section 101 (e).

10 (c) When the Board has given to such corporation a
11 certificate that the provisions of this Act have been complied
12 with, such corporation, and all its stockholders, owners, and
13 employees, shall have the same powers and privileges and
14 shall be subject to the same duties, liabilities, and regula-
15 tions, in all respects, as shall have been prescribed by this
16 Act for corporations originally organized as national invest-
17 ment companies.

18 CAPITAL-STOCK PROVISIONS

19 SEC. 103. (a) Each company organized under this Act
20 shall have a paid-in capital and surplus equal to at least
21 $5,000,000 before it shall commence business. In order to
22 facilitate the formation of national investment companies,
23 each Federal Reserve bank is hereby authorized, notwith-
24 standing any other provisions of law, to invest in the shares
25 of stock of one or more such companies formed by any Fed-

1 eral Reserve bank under section 101 hereof, but with a view
2 to the ultimate disposal of such stock to banks and other pri-
3 vate investors as herein provided. Each Federal Reserve
4 bank which forms a national investment company shall invest
5 in shares of stock of such company in an amount equal to
6 at least $5,000,000, or an amount which, when added to
7 the amounts, if any, of shares subscribed by other Federal
8 Reserve banks, member banks, nonmember banks, financial
9 institutions, corporations, partnerships, or other persons, shall
10 equal the sum of $5,000,000. In no event shall any Federal
11 Reserve bank invest in shares of national investment com-
12 panies if as a result thereof it will hold an amount of such
13 shares aggregating more than 4 percent of the aggregate
14 amount of the combined capital and surplus of all its member
15 banks.

16 (b) The shares of stock in any national investment
17 company shall be eligible for purchase by member banks of
18 the Federal Reserve System, nonmember banks, financial
19 institutions, corporations, partnerships, or other persons.
20 Each member bank is hereby authorized, notwithstanding
21 any other provision of Federal law, to acquire and hold an
22 amount of such shares equal to not more than 4 percent of
23 the capital and surplus of member bank. Upon the demand
24 of any such eligible purchaser, a Federal Reserve bank
25 which holds shares of stock in a national investment company

1 shall, with the approval of the Board, including approval as
2 to price, sell to such eligible purchaser all or a portion of
3 such shares.

4 (c) The aggregate amount of shares in any such com-
5 pany or companies which may be owned or controlled by
6 any stockholder, or by any group or class of stockholders,
7 may be limited by the Board; and no one stockholder, other
8 than a Federal Reserve bank, shall at any time, without
9 the approval of the Board, own or control more than 10
10 percent of the total outstanding shares of any such company.

11 BORROWING POWER

12 SEC. 104. Each national investment company shall have
13 authority to borrow money and to issue its debentures, bonds,
14 promissory notes, or other obligations under such general
15 conditions and subject to such limitations and regulations as
16 the Board may prescribe.

17 ELIGIBLE ENTERPRISES

18 SEC. 105. The Board, after consultation with the Secre-
19 tary of Commerce, shall promulgate standards to determine
20 the eligibility of business enterprises for the purposes of this
21 Act. In promulgating such standards, which may differ
22 according to the types of financing or other relevant factors,
23 the Board shall give consideration to—

24 (a) the policies set forth in section 2; and

1 (b) the extent to which such enterprises have rea-
2 sonable access to facilities for credit and equity financing.

3 LOANS AND INVESTMENTS

4 SEC. 106. (a) Each national investment company shall
5 have authority to make or acquire loans with or without
6 security to business enterprises which are eligible under this
7 Act, or to purchase obligations of such enterprises. Such
8 loans, purchases, or other acquisitions may be made either
9 directly or in cooperation with banks or other lending institu-
10 tions, through agreements to participate or by the purchase
11 of participations, commitments to purchase, or otherwise, as
12 the company may determine.

13 (b) Each national investment company shall have au-
14 thority to acquire, and to resell to the issuer or to others.
15 the income debentures or bonds, common or preferred stocks.
16 or other capital shares of business enterprises eligible under
17 this Act.

18 AGGREGATE LIMITATIONS

19 SEC. 107. Without the approval of the Board, the aggre-
20 gate amount of obligations and securities acquired and
21 for which commitments may be issued by any national in-
22 vestment company under the provisions of this Act which
23 exceed the sum of $1,000,000 for any single enterprise shall

1 not exceed 33⅓ percent of the combined capital and surplus
2 and maximum indebtedness of such national investment com-
3 pany authorized by this Act.

4 EXEMPTIONS

5 SEC. 108. (a) The loans of any national banking asso-
6 ciation which are required by any national investment com-
7 pany, in the making of which such company participates,
8 or for any part of which a commitment to purchase is issued
9 hereunder shall not be subject to the limitations on real-
10 estate loans prescribed in section 24 of the Federal Reserve
11 Act, as amended (12 U. S. C. 371).

12 (b) Section 3 of the Securities Act of 1933, as amended
13 (15 U. S. C. 77 C), is hereby amended by inserting at the
14 end thereof the following new subsection (c):

15 "(c) The Commission may from time to time by its
16 rules and regulations, and subject to such terms and condi-
17 tions as may be prescribed therein, add to the securities
18 exempted as provided in this section any class of securities
19 issued by a national investment company under the National
20 Investment Company Act of 1957, if it finds, having regard
21 to the purposes of that Act, that the enforcement of this
22 Act with respect to such securities is not necessary in the
23 public interest and for the protection of investors."

1 (c) Section 304 of the Trust Indenture Act of 1939
2 (15 U. S. C. 77 ddd) is hereby amended by adding the
3 following subsection (e):
4 "(e) The Commission may from time to time by its
5 rules and regulations, and subject to such terms and condi-
6 tions as may be prescribed therein, add to the securities
7 exempted as provided in this section any class of securities
8 issued by a national investment company under the National
9 Investment Company Act of 1957, if it finds, having regard
10 to the purposes of that Act, that the enforcement of this
11 Act with respect to such securities is not necessary in the
12 public interest and for the protection of investors."

13 TAX PROVISIONS

14 SEC. 109. (a) Section 851 (a) (1) of the Internal
15 Revenue Code of 1954 is amended by inserting before the
16 word "registered" the following: "chartered under the Na-
17 tional Investment Company Act of 1957 as a national invest-
18 ment company or is".
19 (b) Section 851 (b) (2) of the Internal Revenue
20 Code of 1954 is amended by inserting immediately after
21 the words "90 percent" the following: "(75 percent in the
22 case of a national investment company chartered under the
23 National Investment Company Act of 1957)".
24 (c) Section 851 of the Internal Revenue Code of 1954

1 is amended by adding at the end thereof a new subsection as
2 follows:

3 "(f) EXEMPTION OF NATIONAL INVESTMENT COM-
4 PANIES FROM LIMITATIONS OF SUBSECTION (b) (4).—
5 If the Board of Governors of the Federal Reserve System
6 determines that it is necessary and appropriate to accom-
7 plishment of the purposes of the National Investment Com-
8 pany Act of 1957 that any national investment company
9 chartered under such Act be exempt from the requirements
10 of this subsection (b) (4), it shall certify such determina-
11 tion to the Secretary or his delegate and, in such event,
12 the limitations prescribed in subsection (b) (4) shall not
13 apply to such national investment company."

14 (d) (1) Section 852 (a) of the Internal Revenue Code
15 of 1954 is amended by adding at the end thereof the follow-
16 ing: "The investment company taxable income of a regu-
17 lated investment company which is a national investment
18 company chartered under the National Investment Company
19 Act of 1957 shall, for purposes of paragraph (1), be in-
20 creased by the amounts described in subsection (d) (3)
21 (D) and decreased by the amounts described in subsection
22 (d) (5) (B)."

23 (2) Section 852 of the Internal Revenue Code of 1954

1 is amended by adding at the end thereof a new subsection
2 as follows:
3 "(d) NATIONAL INVESTMENT COMPANY RESERVE.—
4 "(1) RESERVE GENERALLY.—A regulated invest-
5 ment company which is a national investment company
6 chartered under the National Investment Company Act
7 of 1957 may, under regulations prescribed by the Secre-
8 tary or his delegate establish and maintain a reserve sub-
9 ject to the limitations provided in this subsection.
10 "(2) LIMITATION ON RESERVE.—The amount of
11 the reserve shall not at any time exceed the lesser of—
12 "(A) 50 percent of the invested capital of the
13 company as defined in paragraph (7), or
14 "(B) the accumulated earnings and profits de-
15 termined as of the close of the taxable year.
16 "(3) CHARGES TO RESERVE.—The reserve shall be
17 charged as of the end of the taxable year (whether or
18 not such charge produces a minus amount in the reserve)
19 with the following:
20 "(A) the net capital loss for the taxable year
21 (as defined in section 1222 (10));
22 "(B) the net operating loss for the taxable
23 year (as defined in section 172 (c));
24 "(C) the Federal income taxes attributable

1 to the amount added to the reserve under paragraph
2 (5); and
3 "(D) such amount as may be necessary by
4 reason of the limitation provided in paragraph (2).
5 "(4) MANDATORY ADDITIONS TO THE RESERVE.—
6 There shall be added to the reserve as of the close of
7 the taxable year the following:
8 "(A) an amount equal to the excess of the net
9 capital gain for the taxable year computed without
10 regard to section 1212 (relating to capital loss
11 carry-over) over the net capital gain for the taxable
12 year; and
13 "(B) an amount equal to the excess of the
14 taxable income for the taxable year computed
15 without regard to section 172 (relating to the net
16 operating loss deduction) over the taxable income
17 for the taxable year.
18 "(5) DISCRETIONARY ADDITION TO THE RE-
19 SERVE.—In any year in which an amount (other than
20 the amount described in paragraph (4)) is added to the
21 reserve; the company shall, in the computation of its
22 investment company taxable income be allowed—
23 "(A) a deduction equal to such amount of the
24 addition to the reserve as does not cause the aggre-

1 gate amount of the reserve (including such addition)
2 to exceed 20 percent of the invested capital of the
3 company as defined in paragraph (7); and
4 "(B) the dividends received credit provided in
5 section 243 but such credit shall not exceed 85
6 percent of the portion of amounts added to the
7 reserve under this subparagraph which is not de-
8 ductible from investment company taxable income
9 under subparagraph (A).
10 "(6) REDUCTION OF TERMINATION OF RESERVE.—
11 In the event of a reduction or termination of the reserve
12 in connection with a partial or complete liquidation of
13 the company (or of any company to which the reserve
14 has been transferred in an exchange upon which gain
15 was not recognized by reason of any provision of this
16 subtitle) the gain realized by a stockholder upon any
17 such liquidation shall, to the extent of the pro rata
18 share of the reserve, be considered as a gain from the
19 sale or exchange of property held for less than six
20 months.
21 "(7) INVESTED CAPITAL.—For purposes of para-
22 graph (2), the term 'invested capital' means the sum,
23 determined as of the close of the taxable year, of—
24 "(A) the amount of money or property (in-
25 cluded in an amount equal to its unadjusted basis

1 without regard to the value of the property as of
2 March 1, 1913, except that if such basis is a substi-
3 tuted basis, it shall be adjusted, with respect to the
4 period before the property was paid in, by an
5 amount equal to adjustments proper under section
6 312 (f) for determining earnings and profits) pre-
7 viously paid in for stock, or as paid-in surplus or
8 as a contribution to capital, reduced by the amount
9 of distributions not out of earnings and profits in
10 the year of distribution and not out of accumulated
11 earnings and profits; and
12 "(B) the amount of the outstanding indebted-
13 ness (not including interest) of the company which
14 is evidenced by a bond, note, bill of exchange, de-
15 benture, certificate of indebtedness, mortgage, or
16 deed of trust, except that indebtedness not repre-
17 sented by a bond or debenture shall not be included
18 in excess of an amount equal to the average daily
19 amount of indebtedness not so represented which
20 was outstanding during the taxable year."
21 (e) Each national investment company established un-
22 der this Act, including its franchise, capital, reserves, and
23 surplus, its income, its real property, its tangible and in-
24 tangible personal property, its obligations (both as in princi-
25 pal and income derived therefrom), shall be subject to taxa-

1 tion, in the same manner and to the same extent as a State-
2 chartered institution of similar character by any State,
3 county, municipality, or local taxing authority or by any
4 Territory, dependency, or possession of the United States;
5 and its real property shall be subject to special assessments
6 for local improvements.

7 MISCELLANEOUS

8 SEC. 110. (a) Wherever practicable the operations of a
9 national investment company shall be undertaken in coop-
10 eration with banks or other financial institutions, and any
11 servicing or initial investigation required for loans or acquisi-
12 tions of securities by the company under the provisions of
13 this Act may be handled through such banks or other finan-
14 cial institutions on a fee basis.

15 (b) Each national investment company may make use,
16 wherever practicable, of the advisory services of the Federal
17 Reserve System and of the Department of Commerce which
18 are available for and useful to industrial and commercial busi-
19 nesses, and may provide consulting and advisory services
20 on a fee basis and have on its staff persons competent to pro-
21 vide such services. Subject to the supervision and direction
22 of the Board, any Federal Reserve bank is authorized to act
23 as a depository or fiscal agent for any company organized
24 under this Act. Such companies may invest funds not rea-
25 sonably needed for their current operations in direct obliga-

1 tions of, or obligations guaranteed as to principal and interest
2 by the United States.

3 (c) The Board is authorized to prescribe regulations
4 governing the operations of national investment companies
5 and to carry out the provisions of this Act in accordance
6 with the purposes of this Act. Each national investment
7 company shall be subject to examinations made by direction
8 of the Board by examiners selected or approved by the
9 Board, and the cost of such examinations, including the com-
10 pensation of the examiners, may in the discretion of the
11 Board be assessed against the company examined and when
12 so assessed shall be paid by such company. Every such com-
13 pany shall make such reports to the Board at such times and
14 in such form as the Board may require.

15 (d) The Secretary of Commerce is authorized to advise
16 and assist in promoting national investment companies.

17 (e) Should any national investment company violate
18 or fail to comply with any of the provisions of this Act or
19 of regulations prescribed hereunder, all of its rights, privi-
20 leges, and franchises derived herefrom may thereby be for-
21 feited. Before any such company shall be declared
22 dissolved, or its rights, privileges, and franchises forfeited,
23 any noncompliance with or violation of this Act shall, how-
24 ever, be determined and adjudged by a court of the United
25 States of competent jurisdiction in a suit brought for that

1 purpose in the district or territory in which the principal
2 office of such company is located, which suit shall be brought
3 by the United States at the instance of the Board or the
4 Attorney General.

5 (f) Whenever in the judgment of the Board any person
6 has engaged or is about to engage in any acts or practices
7 which constitute or will constitute a violation of any provision
8 of this Act or of any regulation thereunder, the Board may
9 make application to the proper district court of the United
10 States, or the United States courts of any Territory or other
11 place subject to the jurisdiction of the United States, for an
12 order enjoining such acts or practices, or for an order en-
13 forcing compliance with such provision, and such courts
14 shall have jurisdiction of such actions and upon a showing
15 by the Board that such person has engaged or is about to
16 engage in any such acts or practices a permanent or tem-
17 porary injunction, restraining order, or other order shall be
18 granted without bond.

19 (g) Any national investment company may at any time
20 within the two years next previous to the date of the ex-
21 piration of its corporate existence, by a vote of the share-
22 holders owning two-thirds of its stock, apply to the Board
23 for approval to extend the period of its corporate existence
24 for a term of not more than thirty years, and upon approval
25 of the Board as provided in section 101 hereof such com-

1 pany shall have its corporate existence extended for such
2 period unless sooner dissolved by the act of the shareholders
3 owning two-thirds of its stock, or by an Act of Congress or
4 unless its franchise becomes forfeited as herein provided.

5 (h) Nothing in this Act or in any other provision of
6 law shall be deemed to impose any liability on the United
7 States or on any Federal Reserve bank with respect to any
8 obligations entered into, or stocks issued, or commitments
9 made, by any company organized under this Act.

10 TITLE II—CHANGES IN FEDERAL RESERVE 11 AUTHORITY

12 REPEAL OF SECTION 13B OF THE FEDERAL RESERVE ACT

13 SEC. 201. Effective one year after the date of enactment
14 of this Act, section 13b of the Federal Reserve Act (12
15 U. S. C. 352a) is hereby repealed; but such repeal shall
16 not affect the power of any Federal Reserve bank to carry
17 out, or protect its interest under, under agreement thereto-
18 fore made or transaction entered into in carrying on opera-
19 tions under that section.

20 RETURN OF FUNDS TO TREASURY

21 SEC. 202. (a) Within sixty days after the enactment
22 of this Act, each Federal Reserve bank shall pay to the
23 United States the aggregate amount which the Secretary of
24 the Treasury has heretofore paid to such bank under the
25 provisions of section 13b of the Federal Reserve Act; and

1 such payment shall constitute a full discharge of any obliga-
2 tion or liability of the Federal bank to the United States or
3 to the Secretary of the Treasury arising out of subsection
4 (e) of said section 13b or out of any agreement thereunder.
5 (b) The amounts repaid to the United States pursuant
6 to section 202, and any remaining balance of the funds set
7 aside in the Treasury for payments under section 13b of
8 the Federal Reserve Act shall be covered into miscellaneous
9 receipts.

10 AUTHORITY TO SELL ASSETS TO NATIONAL INVESTMENT
11 COMPANIES

12 SEC. 203. Any national investment company organized
13 under this Act may purchase from any Federal Reserve
14 bank, and any Federal Reserve bank is authorized to sell to
15 any such company, at such reasonable price as may be
16 agreed upon, any or all of the assets heretofore or hereafter
17 acquired by such Reserve bank under the provisions of sec-
18 tion 13b of the Federal Reserve Act.

19 TITLE III—MISCELLANEOUS PROVISIONS

20 PENALTIES

21 SEC. 301. Title 18, United States Code, section 1014,
22 is amended by inserting the phrase "a national investment
23 company organized under the National Investment Com-
24 pany Act of 1957," after the words "National farm loan
25 association,".

1 GEOGRAPHIC APPLICABILITY

2 SEC. 302. The authority provided in this Act shall be
3 applicable in the United States, including the District of
4 Columbia and the Territories and possessions.

5 RIGHT TO AMEND THIS ACT

6 SEC. 303. The right to amend, alter, or repeal this Act
7 is hereby expressly reserved.

Note:

S.2160 substituted for S. 719 (referred to in Senator Fulbright's letter of May 14)

United States Senate

COMMITTEE ON BANKING AND CURRENCY

May 14, 1957

By Messenger

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

Dear Bill:

As you know, there is considerable interest this year in a bill by Senator Sparkman and others (S. 719), generally known as the National Investment Company bill.

I am very much interested in it for several reasons, not the least of which is a possible alternative to legislation before my Committee to aid "depressed areas." I think the latter is potentially dangerous, and the idea of the Federal government interfering to this degree in the private economy is repugnant to me. As you probably know, under this legislation the Federal government would make loans and grants to relieve local unemployment, as well as to help rural areas of low income. It would also channel procurement into areas of "substantial unemployment."

I am also interested in Senator Sparkman's bill on its own merits. I have re-read Chairman McCabe's testimony in support of similar bills in 1950, and I think he made an excellent case. I was disappointed in your report (dated February 19, 1957) on the Sparkman bill, in that the Board's position is not now so clearly an endorsement of the proposal.

Of course, the policies of the Board have changed in other respects since 1950, and I have supported those changes and have upheld the Board consistently since then. However, I don't understand this one.

The Sparkman bill has been re-drafted to include provision for the conversion of existing State development corporations into "national investment companies." I would appreciate it if you would re-examine this bill, copies of which are enclosed. I should like very much to talk to you about it, as soon as it is convenient to you.

Note: Approved with Senator Fulbright 4 pm 5/23/57

Sincerely yours,

J. W. Fulbright

J. W. Fulbright
Chairman

May 17, 1957.

Chairman Martin

Mr. Hackley

Subject: "National investment company" bill suggested by Senator Fulbright

In his letter to you of May 14, Senator Fulbright indicated that he would like to talk to you about a suggested "substitute" for the Sparkman bill (S. 719) relating to national investment companies. For whatever assistance it may be to you, there follows a brief summary of the provisions of the substitute bill enclosed with Senator Fulbright's letter, and a comparison of this bill with previous bills on the subject.

SUMMARY OF SUBSTITUTE BILL

Organization of companies. - The bill would authorize the organization of "national investment companies" either by private groups or by Federal Reserve Banks, subject to the approval of the Board of Governors. The total number of companies formed by the Reserve Banks could not exceed one in each State, the District of Columbia, the territories and possessions of the United States, and Puerto Rico.

Conversion of State development corporations. - Any State development corporation could convert into a national investment company; and for a period of six months after the date of the Act no Federal Reserve Bank could form a national investment company in any State in which there is such a State development corporation unless that corporation shall have stated in writing to the Board that it does not intend to convert into a national investment company.

Capital stock. - The minimum capital of each company would be $5 million. A Federal Reserve Bank forming a company would be required to purchase stock up to $5 million or so much thereof as might not be subscribed by banks and other private investors. A Reserve Bank could buy stock in companies formed by other Reserve Banks. In no case, however, could a Reserve Bank own an aggregate amount of stock in all such companies equal to more than 4 per cent of the combined capital and surplus of all of its member banks.

Stock could also be purchased by member banks, nonmember banks, and other financial institutions and individuals; and every member bank would be authorized to acquire such stock up to an amount equal to not more than 4 per cent of its capital and surplus. The Reserve Banks would be required to sell their stock in such companies upon demand to private investors. The Board could limit the amount

of stock in any company owned by any single stockholder, and no stockholder (other than a Reserve Bank) could own more than 10 per cent without the Board's approval.

Borrowing power. - Each company would have authority to borrow money and issue its obligations subject only to such general conditions and limitations as the Board might prescribe.

Loans and investments. - Each company would be authorized to make loans and commitments to "eligible enterprises" and to purchase stock and other capital shares of such enterprises. However, the sum total of financing for single enterprises in excess of $1 million could not exceed one-third of a company's capital, surplus, and maximum indebtedness.

Eligible enterprises. - The Board, after consultation with the Secretary of Commerce, would be required to prescribe standards as to the eligibility of business enterprises for purposes of the Act.

Exemptions and tax provisions. - Real estate loans by national banks subject to commitments by the companies would be exempt from the limitations of section 24 of the Federal Reserve Act. The Securities and Exchange Commission would be authorized to exempt securities of the companies from the Securities Act of 1933 and the Trust Indenture Act of 1939. For tax purposes, the companies would be treated as regulated investment companies, but with even more liberal provisions for reserves and for carry-over for losses and some other differences.

Supervision. - The Board would be authorized to prescribe regulations and each company would be subject to examination by the Board and would be required to submit reports to the Board.

Repeal of section 13b. - Section 13b of the Federal Reserve Act would be repealed, effective one year after the date of the bill; amounts heretofore paid to the Reserve Banks under that section would be repaid to the Treasury; and the investment companies would have authority to purchase section 13b assets from the Reserve Banks.

COMPARISON WITH PREVIOUS BILLS

The substitute bill is substantially similar to the bill on this subject which was endorsed by Chairman McCabe in 1950, and with the Sparkman bill (S. 719) on which the Board reported in February 1957, but there are some material differences.

The principal difference between S. 719 and the 1950 bill was that the aggregate limit on large loans to individual enterprises was liberalized by defining large loans as those of over $1 million rather than those of over $300,000. The purpose of this limitation, of course, was to make certain that the funds of the investment companies would be available for loans to small businesses.

The substitute bill enclosed with Senator Fulbright's letter, like S. 719, makes the limitation just referred to applicable to individual loans of over $1 million instead of $300,000. In addition, it differs from both S. 719 and the 1950 bill in the following important respects.

1. The 1950 bill limited the total number of companies that could be formed by the Reserve Banks to 36. The substitute bill would permit at least one company to be formed by a Reserve Bank in each State and the District of Columbia, i.e., 49 in the continental United States.

2. The provision in the substitute bill for the conversion of State development corporations into national investment companies is new.

3. Previous bills limited the amount which a Federal Reserve Bank could invest in all national investment companies to 2 per cent of the combined capital and surplus of the Reserve Bank's member banks, or $5 million, whichever is greater. The substitute bill would increase this limitation to 4 per cent of the combined capital and surplus of member banks, without the alternative $5 million limitation.

4. Similarly, the substitute bill would authorize a member bank to invest in a national investment company up to 4 per cent of the member bank's capital and surplus, whereas previous bills limited such investments to 2 per cent.

5. The substitute bill would place no specific limit on total borrowings by a national investment company, although they would be made subject to limitations and regulations by the Board. Previous bills would have limited the maximum indebtedness of an investment company outstanding at any one time to the amount of its capital stock and surplus.

In brief, the proposed substitute bill would <u>not</u> eliminate participation by the Federal Reserve System in the organization and supervision of the national investment companies, as was recommended in the Board's letter of February 19, 1957, reporting on S. 719. On the contrary, the substitute bill would, to some extent, as above indicated actually increase the System participation by authorizing greater investments by the Reserve Banks in the stock of the investment companies.

Excerpt from Minutes of May 24, 1957:

Suggested bill for the establishment of "national investment companies". At this meeting Chairman Martin reported on the discussion with Senator Fulbright to which he referred at the meeting yesterday. He stated that the Senator appeared deeply interested in the problem of small business financing, was opposed to certain alternative bills which had been introduced, intended to hold hearings on the suggested bill to provide for national investment companies, and would like Vice Chairman Balderston to testify in the absence of Chairman Martin when hearings were held in June. The Chairman also said that Senator Fulbright represented himself as supporting the Board's current credit policy, recognized that the proposed legislation, if enacted at present, might run counter to that policy, but spoke of the legislation as a long-range project with enactment at a later session of the Congress.

Chairman Martin went on to say that he expressed the personal view to the Senator that there was a problem involved. However, he made it quite clear that in his opinion the Board would not be prepared to endorse the proposed bill. He said that he also informed Senator Fulbright of the consideration being given by the Board to a comprehensive study of the availability of credit to small business, that he made it clear that such a study would be expensive, and that he obtained the impression that the Senator might support such a study.

Chairman Martin then suggested that the Board give Vice Chairman Balderston as much latitude as possible in testifying so that he might handle the matter and develop the problem without indicating that the Board had taken a firm position on the suggested bill.

In a discussion based on the Chairman's comments, Governor Mills indicated that he was not satisfied that the expense of a comprehensive study of the financing problems of small business was justified under present conditions. However, if such a study were requested by the Congress, the Board of course would have to undertake it.

On this point Chairman Martin commented that he thought it likely that Senator Fulbright would take steps leading to a request for such a study by the Board. In his personal view, Chairman Martin said, the problem was an important one, and for several reasons he would prefer a study by the Federal Reserve System rather than some other agency. Returning to the requested testimony, he again urged that Vice Chairman Balderston be given maximum latitude, pointing out that the proposed bill was a "trial balloon" which might well be revised considerably in the course of hearings and Congressional debate. In this connection, he commented that, in response to a question by Senator Fulbright, he had agreed to make the Board's legal staff available for advice on technical drafting problems, this being the kind of service that would normally be provided upon request in connection with the drafting of legislation.

Governor Robertson then suggested that Governor Balderston would have to testify on behalf of the Board rather than as an individual, but that he did not think it would be difficult for the Board to reach agreement on a general position which would form a basis for the testimony. First, it seemed clear that the Board saw a need for a basic study by some instrumentality of the Government. Second, he felt that in previous testimony on this subject insufficient emphasis had been given to the point that high-powered Federal Reserve dollars should not be used for the purpose of extending credit to business. This could lead to the positive statement in the course of testimony that, while a need might exist for assistance to small business, the proposed investment companies should be established by some agency using regular taxpayers' dollars.

The question then remaining would be the selection of the organization best suited for such an undertaking. In the case of the Federal Reserve, there would be an inconsistency between the credit control function and an operation involving the extension of credit.

Chairman Martin stated that such an approach would be agreeable to him and apparently would be acceptable to Senator Fulbright also, the Senator's concern being particularly that the Board not express the opinion that there was no problem involved.

Governor Vardaman indicated that the approach suggested by Governor Robertson also would be agreeable to him.

After Mr. Cherry had stated that Governor Balderston would be asked to testify on Tuesday, June 11, or some day later that week, it was agreed that the staff would begin preparing for the Board's consideration a draft of statement which might be presented by Governor Balderston.

8-2 909
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1, M.S. Eccles – 14 yrs
2 W.McChesney Martin 6 months
W.D.G Harding 6 yrs
L.R Crissinger 4 yrs
E. Meyer 3 yrs
T.McCabe 3 yrs
Roy Young 3 yrs
E.R. Black 1 yr
C.S. Hamlin 2

85TH CONGRESS
1ST SESSION

S. 2160

IN THE SENATE OF THE UNITED STATES

MAY 27, 1957

Mr. SPARKMAN (for himself, Mr. FULBRIGHT, Mr. CLARK, Mr. HILL, Mr. O'MAHONEY, Mr. KEFAUVER, and Mr. HUMPHREY) introduced the following bill; which was read twice and referred to the Committee on Banking and Currency

A BILL

To make capital more readily available for financing small business and thus to promote, foster, and develop the domestic and foreign commerce of the United States, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

TITLE

SECTION 1. This Act may be cited as the "National Investment Company Act of 1957."

DECLARATION OF POLICY

SEC. 2. It is the policy of the Congress—

(a) to foster the development and growth of independent small-business enterprises with the objective of

enabling them to make their maximum contribution to productive investment and employment and to the economic stability and growth of the Nation;

(b) to make capital for such enterprises more readily available in adequate amounts and on reasonable terms;

(c) to facilitate maximum participation of private financial institutions and investors in financing these enterprises; and

(d) to supplement the existing facilities of banks and other private financial institutions by providing for the establishment of privately owned national investment companies.

TITLE I—NATIONAL INVESTMENT COMPANIES

ORGANIZATION OF NATIONAL INVESTMENT COMPANIES

SEC. 101. (a) National investment companies may be formed for the purpose of operating under this Act by any number of persons not less than five, who shall subscribe to the articles of incorporation of any such company; except that in the case of any company in whose stock one or more Federal Reserve banks invest, the Federal Reserve bank or banks may alone subscribe to the articles of incorporation. The total number of national investment companies formed by Federal Reserve banks pursuant thereto shall not exceed one in each of the several States, the District of Columbia,

1 the several Territories and the several possessions of the
2 United States, and the Commonwealth of Puerto Rico.
3 (b) The articles of incorporation of any national invest-
4 ment company shall specify in general terms the objects for
5 which the company is formed, the name assumed by such
6 company, the area or areas where its operations are to be
7 carried on, the place where its principal office is to be lo-
8 cated, and the amount and classes of its shares of capital
9 stock; and the articles may contain any other provisions not
10 inconsistent with this Act that the company may see fit to
11 adopt for the regulation of its business and the conduct of its
12 affairs, including provision for cumulative voting in election
13 of directors. Such articles and any amendments thereto
14 adopted from time to time shall be subject to the approval
15 of the Board of Governors of the Federal Reserve System
16 (hereinafter called the "Board").
17 (c) The articles of incorporation and amendments
18 thereto shall be forwarded to the Board for consideration and
19 approval or disapproval. In determining whether to ap-
20 prove the establishment of such a company and its proposed
21 articles of incorporation, the Board shall give due regard,
22 among other things, to the need for the financing of inde-
23 pendent small-business enterprises in the area in which the
24 proposed company is to commence business, the general
25 character of the proposed management of the company, the

1 number of such companies previously organized in the
2 United States, and the volume of their operations. After
3 consideration of all relevant factors, the Board may in its
4 discretion approve the articles of incorporation and issue a
5 permit to begin business.

6 (d) Upon issuance of such permit, the company shall
7 become and be a body corporate, and as such, and in the
8 name designated in its articles, shall have power—

9 (1) to adopt and use a corporate seal;

10 (2) to have succession for a period of thirty years,
11 unless extended as provided in section 110 (g), or unless
12 sooner dissolved by the act of the shareholders owning
13 two-thirds of the stock or by an Act of Congress, or
14 unless its franchise becomes forfeited by some violation
15 of law or regulation issued hereunder;

16 (3) to make contracts;

17 (4) to sue and be sued, complain, and defend in
18 any court of law or equity;

19 (5) by its board of directors, to appoint such of-
20 ficers and employees as may be deemed proper, define
21 their authority and duties, fix their compensation, re-
22 quire bonds of such of them as it deems advisable and
23 fix the penalty thereof, dismiss such officers or em-
24 ployees, or any thereof, at pleasure and appoint others
25 to fill their places;

1 (6) to adopt bylaws regulating the manner in which
2 its stock shall be transferred, its officers and employees
3 appointed, its property transferred, and the privileges
4 granted to it by law exercised and enjoyed;
5 (7) to establish branch offices or agencies subject
6 to the approval of the Board;
7 (8) to acquire, hold, operate, and dispose of any
8 property (real, personal, or mixed) whenever necessary
9 or appropriate to the carrying out of its lawful func-
10 tions;
11 (9) to act as depository or fiscal agent of the United
12 States when so designated by the Secretary of the
13 Treasury;
14 (10) to operate in such area or areas as may be
15 specified in its articles of incorporation and approved by
16 the Board; and
17 (11) to exercise the other powers set forth in this
18 Act and such incidental powers as may be reasonably
19 necessary to carry on the business for which the com-
20 pany is established.
21 (e) The board of directors of each national investment
22 company shall consist of nine members all of whom shall be
23 elected annually by the holders of the shares of stock of the
24 company.

1 CONVERSION OF STATE DEVELOPMENT CORPORATIONS

2 SEC. 102. (a) Any State development corporation in-
3 corporated by special law of any State or organized under
4 the general laws of any State may, by the vote of the share-
5 holders owning not less than 51 percent of the capital stock
6 of such corporation, with the approval of the Board, be con-
7 verted into a national investment company under this Act.
8 For a period of six months following enactment of this Act,
9 or for such longer period as the Board may determine, no
10 Federal Reserve bank or banks shall form a national invest-
11 ment company, except by such conversion, in any State,
12 Territory, possession, the Commonwealth of Puerto Rico,
13 or the District of Columbia in which a State development
14 corporation is in being as of the date of enactment of this Act,
15 unless such development corporation shall have stated in
16 writing to the Board that such corporation does not intend
17 to convert into a national investment company as herein
18 provided.

19 (b) In such case the articles of association and organi-
20 zation certificate may be executed by a majority of the
21 directors of the corporation, and the certificate shall declare
22 that the owners of 51 per centum of the capital stock have
23 authorized the directors to make such certificate and to
24 change or convert the corporation into a national investment
25 company. A majority of the directors, after executing the

1 articles of association and the organization certificate, shall
2 have power to execute all other papers and to do whatever
3 may be required to make its organization perfect and com-
4 plete as a national investment company. The shares of any
5 such corporation may continue to be for the same amount
6 each as they were before the conversion, and the directors
7 regardless of number, may continue to be directors of the
8 corporation until the election of the board of directors is held
9 in accordance with section 101 (e).
10 (c) When the Board has given to such corporation a
11 certificate that the provisions of this Act have been complied
12 with, such corporation, and all its stockholders, owners, and
13 employees, shall have the same powers and privileges and
14 shall be subject to the same duties, liabilities, and regula-
15 tions, in all respects, as shall have been prescribed by this
16 Act for corporations originally organized as national invest-
17 ment companies.
18 CAPITAL-STOCK PROVISIONS
19 SEC. 103. (a) Each company organized under this Act
20 shall have a paid-in capital and surplus equal to at least
21 $5,000,000 before it shall commence business. In order to
22 facilitate the formation of national investment companies,
23 each Federal Reserve bank is hereby authorized, notwith-
24 standing any other provisions of law, to invest in the shares
25 of stock of one or more such companies formed by any Fed-

1 eral Reserve bank under section 101 hereof, but with a view
2 to the ultimate disposal of such stock to banks and other pri-
3 vate investors as herein provided. Each Federal Reserve
4 bank which forms a national investment company shall invest
5 in shares of stock of such company in an amount equal to
6 at least $5,000,000, or an amount which, when added to
7 the amounts, if any, of shares subscribed by other Federal
8 Reserve banks, member banks, nonmember banks, financial
9 institutions, corporations, partnerships, or other persons, shall
10 equal the sum of $5,000,000. In no event shall any Federal
11 Reserve bank invest in shares of national investment com-
12 panies if as a result thereof it will hold an amount of such
13 shares aggregating more than 4 percent of the aggregate
14 amount of the combined capital and surplus of all its member
15 banks.

16 (b) The shares of stock in any national investment
17 company shall be eligible for purchase by member banks of
18 the Federal Reserve System, nonmember banks, financial
19 institutions, corporations, partnerships, or other persons.
20 Each member bank is hereby authorized, notwithstanding
21 any other provision of Federal law, to acquire and hold an
22 amount of such shares equal to not more than 4 percent of
23 the capital and surplus of member bank. Upon the demand
24 of any such eligible purchaser, a Federal Reserve bank
25 which holds shares of stock in a national investment company

1 shall, with the approval of the Board, including approval as
2 to price, sell to such eligible purchaser all or a portion of
3 such shares.

4 (c) The aggregate amount of shares in any such com-
5 pany or companies which may be owned or controlled by
6 any stockholder, or by any group or class of stockholders,
7 may be limited by the Board; and no one stockholder, other
8 than a Federal Reserve bank, shall at any time, without
9 the approval of the Board, own or control more than 10
10 percent of the total outstanding shares of any such company.

11 BORROWING POWER

12 SEC. 104. Each national investment company shall have
13 authority to borrow money and to issue its debentures, bonds,
14 promissory notes, or other obligations under such general
15 conditions and subject to such limitations and regulations as
16 the Board may prescribe.

17 ELIGIBLE ENTERPRISES

18 SEC. 105. The Board, after consultation with the Secre-
19 tary of Commerce, shall promulgate standards to determine
20 the eligibility of business enterprises for the purposes of this
21 Act. In promulgating such standards, which may differ
22 according to the types of financing or other relevant factors,
23 the Board shall give consideration to—

24 (a) the policies set forth in section 2; and

1 (b) the extent to which such enterprises have rea-
2 sonable access to facilities for credit and equity financing.

3 LOANS AND INVESTMENTS

4 SEC. 106. (a) Each national investment company shall
5 have authority to make or acquire loans with or without
6 security to business enterprises which are eligible under this
7 Act, or to purchase obligations of such enterprises. Such
8 loans, purchases, or other acquisitions may be made either
9 directly or in cooperation with banks or other lending institu-
10 tions, through agreements to participate or by the purchase
11 of participations, commitments to purchase, or otherwise, as
12 the company may determine.

13 (b) Each national investment company shall have au-
14 thority to acquire, and to resell to the issuer or to others,
15 the income debentures or bonds, common or preferred stocks,
16 or other capital shares of business enterprises eligible under
17 this Act.

18 AGGREGATE LIMITATIONS

19 SEC. 107. Without the approval of the Board, the aggre-
20 gate amount of obligations and securities acquired and
21 for which commitments may be issued by any national in-
22 vestment company under the provisions of this Act which
23 exceed the sum of $1,000,000 for any single enterprise shall

1 not exceed 33⅓ percent of the combined capital and surplus
2 and maximum indebtedness of such national investment com-
3 pany authorized by this Act.

4 EXEMPTIONS

5 SEC. 108. (a) The loans of any national banking asso-
6 ciation which are required by any national investment com-
7 pany, in the making of which such company participates,
8 or for any part of which a commitment to purchase is issued
9 hereunder shall not be subject to the limitations on real-
10 estate loans prescribed in section 24 of the Federal Reserve
11 Act, as amended (12 U. S. C. 371).

12 (b) Section 3 of the Securities Act of 1933, as amended
13 (15 U. S. C. 77 C), is hereby amended by inserting at the
14 end thereof the following new subsection (c):

15 "(c) The Commission may from time to time by its
16 rules and regulations, and subject to such terms and condi-
17 tions as may be prescribed therein, add to the securities
18 exempted as provided in this section any class of securities
19 issued by a national investment company under the National
20 Investment Company Act of 1957, if it finds, having regard
21 to the purposes of that Act, that the enforcement of this
22 Act with respect to such securities is not necessary in the
23 public interest and for the protection of investors."

1 (c) Section 304 of the Trust Indenture Act of 1939
2 (15 U. S. C. 77 ddd) is hereby amended by adding the
3 following subsection (e):
4 "(e) The Commission may from time to time by its
5 rules and regulations, and subject to such terms and condi-
6 tions as may be prescribed therein, add to the securities
7 exempted as provided in this section any class of securities
8 issued by a national investment company under the National
9 Investment Company Act of 1957, if it finds, having regard
10 to the purposes of that Act, that the enforcement of this
11 Act with respect to such securities is not necessary in the
12 public interest and for the protection of investors."

13 TAX PROVISIONS

14 SEC. 109. (a) Section 851 (a) (1) of the Internal
15 Revenue Code of 1954 is amended by inserting before the
16 word "registered" the following: "chartered under the Na-
17 tional Investment Company Act of 1957 as a national invest-
18 ment company or is".
19 (b) Section 851 (b) (2) of the Internal Revenue
20 Code of 1954 is amended by inserting immediately after
21 the words "90 percent" the following: "(75 percent in the
22 case of a national investment company chartered under the
23 National Investment Company Act of 1957)".
24 (c) Section 851 of the Internal Revenue Code of 1954

1 is amended by adding at the end thereof a new subsection as
2 follows:
3 "(f) EXEMPTION OF NATIONAL INVESTMENT COM-
4 PANIES FROM LIMITATIONS OF SUBSECTION (b) (4).—
5 If the Board of Governors of the Federal Reserve System
6 determines that it is necessary and appropriate to accom-
7 plishment of the purposes of the National Investment Com-
8 pany Act of 1957 that any national investment company
9 chartered under such Act be exempt from the requirements
10 of this subsection (b) (4), it shall certify such determina-
11 tion to the Secretary or his delegate and, in such event,
12 the limitations prescribed in subsection (b) (4) shall not
13 apply to such national investment company."
14 (d) (1) Section 852 (a) of the Internal Revenue Code
15 of 1954 is amended by adding at the end thereof the follow-
16 ing: "The investment company taxable income of a regu-
17 lated investment company which is a national investment
18 company chartered under the National Investment Company
19 Act of 1957 shall, for purposes of paragraph (1), be in-
20 creased by the amounts described in subsection (d) (3)
21 (D) and decreased by the amounts described in subsection
22 (d) (5) (B)."
23 (2) Section 852 of the Internal Revenue Code of 1954

1 is amended by adding at the end thereof a new subsection
2 as follows:
3 "(d) NATIONAL INVESTMENT COMPANY RESERVE.—
4 "(1) RESERVE GENERALLY.—A regulated invest-
5 ment company which is a national investment company
6 chartered under the National Investment Company Act
7 of 1957 may, under regulations prescribed by the Secre-
8 tary or his delegate establish and maintain a reserve sub-
9 ject to the limitations provided in this subsection.
10 "(2) LIMITATION ON RESERVE.—The amount of
11 the reserve shall not at any time exceed the lesser of—
12 "(A) 50 percent of the invested capital of the
13 company as defined in paragraph (7), or
14 "(B) the accumulated earnings and profits de-
15 termined as of the close of the taxable year.
16 "(3) CHARGES TO RESERVE.—The reserve shall be
17 charged as of the end of the taxable year (whether or
18 not such charge produces a minus amount in the reserve)
19 with the following:
20 "(A) the net capital loss for the taxable year
21 (as defined in section 1222 (10));
22 "(B) the net operating loss for the taxable
23 year (as defined in section 172 (c));
24 "(C) the Federal income taxes attributable

1 to the amount added to the reserve under paragraph
2 (5); and
3 "(D) such amount as may be necessary by
4 reason of the limitation provided in paragraph (2).
5 "(4) MANDATORY ADDITIONS TO THE RESERVE.—
6 There shall be added to the reserve as of the close of
7 the taxable year the following:
8 "(A) an amount equal to the excess of the net
9 capital gain for the taxable year computed without
10 regard to section 1212 (relating to capital loss
11 carry-over) over the net capital gain for the taxable
12 year; and
13 "(B) an amount equal to the excess of the
14 taxable income for the taxable year computed
15 without regard to section 172 (relating to the net
16 operating loss deduction) over the taxable income
17 for the taxable year.
18 "(5) DISCRETIONARY ADDITION TO THE RE-
19 SERVE.—In any year in which an amount (other than
20 the amount described in paragraph (4)) is added to the
21 reserve; the company shall, in the computation of its
22 investment company taxable income be allowed—
23 "(A) a deduction equal to such amount of the
24 addition to the reserve as does not cause the aggre-

1 gate amount of the reserve (including such addition)
2 to exceed 20 percent of the invested capital of the
3 company as defined in paragraph (7); and
4 "(B) the dividends received credit provided in
5 section 243 but such credit shall not exceed 85
6 percent of the portion of amounts added to the
7 reserve under this subparagraph which is not de-
8 ductible from investment company taxable income
9 under subparagraph (A).
10 "(6) REDUCTION OF TERMINATION OF RESERVE.—
11 In the event of a reduction or termination of the reserve
12 in connection with a partial or complete liquidation of
13 the company (or of any company to which the reserve
14 has been transferred in an exchange upon which gain
15 was not recognized by reason of any provision of this
16 subtitle) the gain realized by a stockholder upon any
17 such liquidation shall, to the extent of the pro rata
18 share of the reserve, be considered as a gain from the
19 sale or exchange of property held for less than six
20 months.
21 "(7) INVESTED CAPITAL.—For purposes of para-
22 graph (2), the term 'invested capital' means the sum,
23 determined as of the close of the taxable year, of—
24 "(A) the amount of money or property (in-
25 cluded in an amount equal to its unadjusted basis

1 without regard to the value of the property as of
2 March 1, 1913, except that if such basis is a substi-
3 tuted basis, it shall be adjusted, with respect to the
4 period before the property was paid in, by an
5 amount equal to adjustments proper under section
6 312 (f) for determining earnings and profits) pre-
7 viously paid in for stock, or as paid-in surplus or
8 as a contribution to capital, reduced by the amount
9 of distributions not out of earnings and profits in
10 the year of distribution and not out of accumulated
11 earnings and profits; and
12 "(B) the amount of the outstanding indebted-
13 ness (not including interest) of the company which
14 is evidenced by a bond, note, bill of exchange, de-
15 benture, certificate of indebtedness, mortgage, or
16 deed of trust, except that indebtedness not repre-
17 sented by a bond or debenture shall not be included
18 in excess of an amount equal to the average daily
19 amount of indebtedness not so represented which
20 was outstanding during the taxable year."
21 (e) Each national investment company established un-
22 der this Act, including its franchise, capital, reserves, and
23 surplus, its income, its real property, its tangible and in-
24 tangible personal property, its obligations (both as in princi-
25 pal and income derived therefrom), shall be subject to taxa-

1 tion, in the same manner and to the same extent as a State-
2 chartered institution of similar character by any State,
3 county, municipality, or local taxing authority or by any
4 Territory, dependency, or possession of the United States;
5 and its real property shall be subject to special assessments
6 for local improvements.

7 MISCELLANEOUS

8 SEC. 110. (a) Wherever practicable the operations of a
9 national investment company shall be undertaken in coop-
10 eration with banks or other financial institutions, and any
11 servicing or initial investigation required for loans or acquisi-
12 tions of securities by the company under the provisions of
13 this Act may be handled through such banks or other finan-
14 cial institutions on a fee basis.

15 (b) Each national investment company may make use,
16 wherever practicable, of the advisory services of the Federal
17 Reserve System and of the Department of Commerce which
18 are available for and useful to industrial and commercial busi-
19 nesses, and may provide consulting and advisory services
20 on a fee basis and have on its staff persons competent to pro-
21 vide such services. Subject to the supervision and direction
22 of the Board, any Federal Reserve bank is authorized to act
23 as a depository or fiscal agent for any company organized
24 under this Act. Such companies may invest funds not rea-
25 sonably needed for their current operations in direct obliga-

1 tions of, or obligations guaranteed as to principal and interest
2 by the United States.
3 (c) The Board is authorized to prescribe regulations
4 governing the operations of national investment companies
5 and to carry out the provisions of this Act in accordance
6 with the purposes of this Act. Each national investment
7 company shall be subject to examinations made by direction
8 of the Board by examiners selected or approved by the
9 Board, and the cost of such examinations, including the com-
10 pensation of the examiners, may in the discretion of the
11 Board be assessed against the company examined and when
12 so assessed shall be paid by such company. Every such com-
13 pany shall make such reports to the Board at such times and
14 in such form as the Board may require.
15 (d) The Secretary of Commerce is authorized to advise
16 and assist in promoting national investment companies.
17 (e) Should any national investment company violate
18 or fail to comply with any of the provisions of this Act or
19 of regulations prescribed hereunder, all of its rights, privi-
20 leges, and franchises derived herefrom may thereby be for-
21 feited. Before any such company shall be declared
22 dissolved, or its rights, privileges, and franchises forfeited,
23 any noncompliance with or violation of this Act shall, how-
24 ever, be determined and adjudged by a court of the United
25 States of competent jurisdiction in a suit brought for that

1 purpose in the district or territory in which the principal
2 office of such company is located, which suit shall be brought
3 by the United States at the instance of the Board or the
4 Attorney General.

5 (f) Whenever in the judgment of the Board any person
6 has engaged or is about to engage in any acts or practices
7 which constitute or will constitute a violation of any provision
8 of this Act or of any regulation thereunder, the Board may
9 make application to the proper district court of the United
10 States, or the United States courts of any Territory or other
11 place subject to the jurisdiction of the United States, for an
12 order enjoining such acts or practices, or for an order en-
13 forcing compliance with such provision, and such courts
14 shall have jurisdiction of such actions and upon a showing
15 by the Board that such person has engaged or is about to
16 engage in any such acts or practices a permanent or tem-
17 porary injunction, restraining order, or other order shall be
18 granted without bond.

19 (g) Any national investment company may at any time
20 within the two years next previous to the date of the ex-
21 piration of its corporate existence, by a vote of the share-
22 holders owning two-thirds of its stock, apply to the Board
23 for approval to extend the period of its corporate existence
24 for a term of not more than thirty years, and upon approval
25 of the Board as provided in section 101 hereof such com-

1 pany shall have its corporate existence extended for such
2 period unless sooner dissolved by the act of the shareholders
3 owning two-thirds of its stock, or by an Act of Congress or
4 unless its franchise becomes forfeited as herein provided.
5 (h) Nothing in this Act or in any other provision of
6 law shall be deemed to impose any liability on the United
7 States or on any Federal Reserve bank with respect to any
8 obligations entered into, or stocks issued, or commitments
9 made, by any company organized under this Act.

10 TITLE II—CHANGES IN FEDERAL RESERVE
11 AUTHORITY

12 REPEAL OF SECTION 13B OF THE FEDERAL RESERVE ACT

13 SEC. 201. Effective one year after the date of enactment
14 of this Act, section 13b of the Federal Reserve Act (12
15 U. S. C. 352a) is hereby repealed; but such repeal shall
16 not affect the power of any Federal Reserve bank to carry
17 out, or protect its interest under, under agreement thereto-
18 fore made or transaction entered into in carrying on opera-
19 tions under that section.

20 RETURN OF FUNDS TO TREASURY

21 SEC. 202. (a) Within sixty days after the enactment
22 of this Act, each Federal Reserve bank shall pay to the
23 United States the aggregate amount which the Secretary of
24 the Treasury has heretofore paid to such bank under the
25 provisions of section 13b of the Federal Reserve Act; and

1 such payment shall constitute a full discharge of any obliga-
2 tion or liability of the Federal bank to the United States or
3 to the Secretary of the Treasury arising out of subsection
4 (e) of said section 13b or out of any agreement thereunder.
5 (b) The amounts repaid to the United States pursuant
6 to section 202, and any remaining balance of the funds set
7 aside in the Treasury for payments under section 13b of
8 the Federal Reserve Act shall be covered into miscellaneous
9 receipts.

10 AUTHORITY TO SELL ASSETS TO NATIONAL INVESTMENT
11 COMPANIES

12 SEC. 203. Any national investment company organized
13 under this Act may purchase from any Federal Reserve
14 bank, and any Federal Reserve bank is authorized to sell to
15 any such company, at such reasonable price as may be
16 agreed upon, any or all of the assets heretofore or hereafter
17 acquired by such Reserve bank under the provisions of sec-
18 tion 13b of the Federal Reserve Act.

19 TITLE III—MISCELLANEOUS PROVISIONS

20 PENALTIES

21 SEC. 301. Title 18, United States Code, section 1014,
22 is amended by inserting the phrase "a national investment
23 company organized under the National Investment Com-
24 pany Act of 1957," after the words "National farm loan
25 association,".

GEOGRAPHIC APPLICABILITY

SEC. 302. The authority provided in this Act shall be applicable in the United States, including the District of Columbia and the Territories and possessions.

RIGHT TO AMEND THIS ACT

SEC. 303. The right to amend, alter, or repeal this Act is hereby expressly reserved.

85TH CONGRESS
1ST SESSION

S. 2160

A BILL

To make capital more readily available for financing small business and thus to promote, foster, and develop the domestic and foreign commerce of the United States, and for other purposes.

By Mr. SPARKMAN, Mr. FULBRIGHT, Mr. CLARK, Mr. HILL, Mr. O'MAHONEY, Mr. KEFAUVER, and Mr. HUMPHREY

MAY 27, 1957

Read twice and referred to the Committee on Banking and Currency

Subcon ittee on Small Business of the nate
Banking and Currency Committee

Joseph S. Clark Chairman

A. Willis Robertson
John J. Sparkman
Frank J. Lausche
J. Glenn Beall
Frederick G. Payne
Clifford P. Case.

Excerpts from Chairman Martin's Testimony before the Subcommittee on Small Business of the Senate Committee on Banking and Currency, dealing with a Proposed Study of Small Business Financing, June 20, 1957

* * * *

Mr. Martin. While we feel that it is undesirable for the Federal Reserve to provide the capital and participate in management functions in the proposed institutions, this should in no way be taken as minimizing our concern with the financing problems of small business. Despite the fact that available information on the subject is illuminating, some further investigation of the subject might be useful. The time required for such an investigation would preclude its use in the consideration of the pending proposed legislation, but it might provide valuable factual information for future reconsideration of the problem.

A fresh study of the small business financing problem might confirm the existence of gaps in the present financing facilities and techniques, and it might yield important by-products. The pointing out of potentially profitable lending opportunities could stimulate private enterprise to fill the indicated gaps.

I merely point out in my last paragraph that the type of exploration and work that was done in the consumer installment field unquestionably led to the expansion and development of that business and also, all that I am saying here is I think all of us ought to continue to work hard on this problem.

Senator Clark. Thank you very much, Mr. Martin. Senator Fulbright?

Senator Fulbright. I would like to encourage you to make that study. I think there is a great misunderstanding of the significance of recent developments, some of which you have already touched on. I mean, the increased need for capital to carry on the same volume of business.

Mr. Martin. That is right.

Senator Fulbright. And I think this tax angle is extremely important. Yet it is a fleeting thing, and difficult to tie down.

For example, I think the impact of high taxes naturally makes people more cautious and less likely to take a risk in an untried company, because when they lose it they lose it all, and when they make it they can retain so little of it. So that tends to increase, among many other reasons, the attraction of General Motors and similar companies.

Although it is a fine little company, they say they will not invest in it, although it has all of the ingredients of success, because the risk is so great and you cannot keep the money when you make it, and when you lose it you lose it all. That sort of thing is difficult to evaluate, and yet it is there.

Do you not think it is there?

Mr. Martin. I think it is basic, and I make that short comment in the statement.

Senator Fulbright. In your study -- and I hope you will make one -- you can evaluate it in a way that no one else can, I think. Your institution would have the prestige to make such an assertion.

* * * *

Senator Sparkman. * * * * I wonder if you will assure us, as the Chairman of the Board, that the Federal Reserve will make this study. What we need is some kind of leadership in some of the Government agencies, or in the Federal Reserve, to try to work out a program that will be workable. I do not suppose anybody who has introduced one of these bills claims that his plan is perfect, but the purpose of introducing bills is to afford a jumping-off point from which the legislation can be perfected and developed. Can you give us reasonable assurance that the Board will study this carefully, and try to give us recommendations that will effectuate what we are trying to do?

Mr. Martin. I can only give you my personal assurance, Senator, that we will bend our very best efforts to it.

Senator Sparkman. Let me say that nothing is better than that. I would take it at one hundred percent.

Mr. Martin. I will do my very best, Senator.

Senator Sparkman. I certainly will appreciate it. * * * * Senator Fulbright?

Senator Fulbright. I wanted to refer back again to this proposed study. Do you think it would be too much to expect something like an interim report, let us say, next spring? You say on Page 5 of your statement, "The time required for such an investigation would preclude its use in the consideration of the pending proposed legislation,...."

Do you think you could give us something along in the spring of next year, some time around March or April? You see, this is the

first session of this Congress and this bill, if it were not disposed of before we adjourn, will still be before us next spring, and it would be very helpful if we could sort of look forward to some recommendation from your institution by that time.

Mr. Martin. Well, I certainly will try to do it. I cannot commit the Board to a time.

Senator Fulbright. No, but when you made this statement here I thought you might have in mind this session before we adjourn now.

Mr. Martin. That is right, sir.

Senator Fulbright. Where it would be most useful to us. I doubt that under the circumstances which exist here we will complete action on any of these bills before we adjourn now, but I do hope certainly to complete something and get it through here by this time next year.

Mr. Martin. We will work very hard on it and do the best we can.

Senator Sparkman. May I suggest in that line, it seems to me by March 1 you would have ample time, because this is not a new subject with your Board. You people, I imagine, are fairly current on this kind of stuff. You remember, in 1952 the Federal Reserve Board did quite a study for the Small Business Committee somewhat along this line. I remember in one part of that, for instance, you dealt with the cost of capital for small business in the securities market. My recollection is you gave us a 100-page report there, and I think you did it within sixty or ninety days at that time. It was very close to this same subject.

Mr. Martin. I could not put a time limit on it, Senator, on a measure of this scope.

Senator Sparkman. I am not asking you to, but I am just urging that every effort be made to get it in here, and I was suggesting March 1, because that would give you plenty of time to work it out.

Senator Fulbright. You have plenty of money to conduct a study, and you do not need any money or legislation.

Mr. Martin. We do not need the money, but do not want to be criticized.

Senator Fulbright. You have a large staff down there and they have nothing much to do. Everything is very stable and they have no problems.

Senator Sparkman. You do not want to be criticized, you say. Criticism is the healthiest thing there is.

Mr. Martin. I did not mean that criticism.

* * * *

Mr. Chairman:

The Board of Governors concurs in the broad objective of Senate Bill 2160 now before your Committee, namely, to fill an apparent gap in existing credit facilities by providing for a new type of private investment institution to specialize in small business financing.

It seems likely that today the problem of small business financing is in the area of longer term credit and equity capital rather than in that of shorter term credit. This view takes into account the fact that business activities now require a higher investment in tools, machinery, and plant facilities than ever before in our history.

We also base our view in part on information concerning business and credit developments we receive from the twelve Federal Reserve Banks and their twenty-four branches. This information is derived not only from member banks but also from bankers and businessmen through their representation on the boards of directors of the Reserve Banks and branches and through many other established business and financial contacts. In this way it is possible for us at the Federal Reserve Board to obtain a fairly complete picture of the extent to which credit demands in various parts of the country are being met in total and by various categories of borrowers.

In making our appraisal of the credit situation, we combine these observations with careful analysis of a large volume of statistical information on loans by banks and other financial institutions.

From the available information, it is possible to draw certain broad inferences concerning the financing of small business.

We know, for example, that most loans made by commercial banks are to small businessmen. Further insight is obtained by studying the rates of interest charged by commercial banks on various sizes of business loans as reported to us in a quarterly interest rate survey. We are also now in the process of developing information from a recent loan survey on the location of business borrowers in relation to the institutions with which they bank. These and many other current efforts throw light on small business financing and its problems.

This kind of information broadly substantiates the thesis that the problem of small business financing is primarily one of long-term credit and equity capital, and that financing difficulties arise most frequently in the case of ventures where direct financing by commercial banks or other institutions which hold the liquid savings of the public is inadvisable.

There have been a number of attempts in recent years to cope experimentally with the needs of smaller firms for capital and longer term credit. I refer particularly to regional development corporations, organized under State charter with local financing, that have been established in the New England States and in some other areas.

These organizations have as their main objective the removal of impediments and imperfections in the market organization for supplying intermediate and longer term funds to small- and medium-size businesses, particularly those situated away from the main stream of supply. Assuming the potential borrower to be a reasonable credit

risk, sheer lack of knowledge on his part of alternative sources of financing may be the problem; or a lender may lack the skill necessary to arrange the appropriate financial accommodations for him; or insufficient lender competition or facilities in the field may cause the difficulty. By acting as intermediaries, sometimes advancing some funds along with those of participating lenders, at other times merely bringing borrower and lender together, these regional and local financing institutions perform a constructive function.

The efforts of these organizations should certainly be encouraged, and ways and means should be explored to further the participation of private commercial banks in their activities. Commercial banks, because of the demand nature of the bulk of their liabilities, must generally limit the extent to which they make loans outside the field of higher grade, shorter term obligations. They can facilitate the operations of development companies, however, by helping to minimize costs of investigating applicants and by extending loans to these companies in appropriate circumstances.

It strikes us as noteworthy that other private investment companies, organized under general incorporation acts of the various States to specialize in the equity as well as longer term debt financing of promising small business ventures, do not now exist in large numbers. In postwar years, only a few have been established. The privilege of Federal incorporation might offer some advantages and attract the formation of additional companies.

An explanation of the scarcity of private companies in this field may lie in two operating problems. One is the very high cost of original risk appraisal and subsequent supervision; the other relates to taxation. The bill under consideration recognizes the desirability of reducing the tax obstacle.

As to the role of the Federal Reserve with respect to the proposed new financing institutions designed to provide longer term debt or equity financing for small businesses, it would be appropriate, if the Congress sees fit, for the Board of Governors and the Reserve Banks to perform certain functions relating to the activities of such new facilities. These functions relate to chartering, examination, and fiscal agency duties. The performance of such duties is consistent and compatible with the similar functions now performed by the Federal Reserve.

However, the Board would favor neither the financing of such institutions by the Federal Reserve by purchase of stock or otherwise, nor the exercise by the System of any proprietary functions. For example, the Board should not have the responsibility to "promulgate standards to determine the eligibility of business enterprises for the purposes of this Act." Also, it should not be responsible for regulating the borrowing of the investment companies. Such activities should be specifically governed by the Act itself.

Our views on these matters are based on the fundamental objections discussed before this Subcommittee two years ago. Basically, our concern stems from the belief that it is good government as well as good central banking for the Federal Reserve to devote itself primarily

to the objectives set for it by the Congress, namely, guiding monetary and credit policy so as to exert its influence toward maintaining the value of the dollar and fostering orderly economic progress.

While we feel that it is undesirable for the Federal Reserve to provide the capital and participate in management functions in the proposed institutions, this should in no way be taken as minimizing our concern with the financing problems of small business. Despite the fact that available information on the subject is illuminating, some further investigation of the subject might be useful. The time required for such an investigation would preclude its use in the consideration of the pending proposed legislation, but it might provide valuable factual information for future reconsideration of the problem.

A fresh study of the small business financing problem might confirm the existence of gaps in the present financing facilities and techniques, and it might yield important by-products. The pointing out of potentially profitable lending opportunities could stimulate private enterprise to fill the indicated gaps.

Something like this happened as a result of the extensive research directed to consumer lending methods, practices, and experience carried on during the late twenties and the thirties. Dissemination of these research findings did much to spread knowledge of the opportunities of the instalment financing device through the financial community. This research also led to modifications of some State laws governing consumer lending. Wider knowledge of opportunities and broader legislative authority powerfully stimulated the increased provision of consumer credit facilities, which today make up such a large and important segment of our existing structure of private financing institutions.

United States Senate

COMMITTEE ON BANKING AND CURRENCY

June 24, 1957

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

Dear Mr. Chairman:

You will recall that during your testimony before the Small Business Subcommittee of the Committee on Banking and Currency on Thursday, June 20, 1957, it was necessary for me to leave the hearings. I had intended to obtain your views on certain matters affecting the credit needs of small businesses, and I regret that I could not return to the hearing prior to the conclusion of your testimony. Consequently, this letter contains several questions upon which I would appreciate receiving your comments as soon as possible, in order that they be made a part of the record of the hearings held on June 20, 1957.

On page 42 of the Economic Report of the President, transmitted to the Congress on January 23, 1957, there appears the following statement:

> "In the course of the year it became increasingly apparent that tighter credit conditions affected unevenly different sectors of the economy and different types of businesses. New and smaller business firms appeared to find it more difficult to satisfy their financing requirements than established and larger concerns. Also, the changes in the cost and availability of credit exerted especially severe effects on home building."

This statement, together with other observations which have come to my attention, prompt me to ask your reply to or comment upon the following questions:

1. Do you agree that "tighter credit conditions affected unevenly different sectors of the economy and different types of businesses"?

2. Is an uneven effect of credit and monetary policy bad for the economy as a whole?

3. In general, do higher interest rates and a reduced supply of credit in relation to demand pose more serious problems for small businesses than for large businesses?

COPY

4. On the basis of such factual information as may be available to you, what additional volume of credit to small businesses would be necessary to maintain their fair share of the total quantity of credit available?

5. If this additional volume is greater than the lending authority of the Small Business Administration, how can the supply of credit for small businesses be increased?

6. Could the Board of Governors of the Federal Reserve System take steps to increase the supply of credit for small businesses through policy statements or advice to member-institutions?

7. Is it feasible to increase the supply of credit available to small businesses solely through the lending program of the Small Business Administration?

8. When the Congress attempts to alleviate the uneven effects of policies which restrain credit, it is frequently said that such attempts are inflationary. If the Congress decides that such direct lending programs are essential, cannot the Federal Reserve System take action through open-market operations or other means to offset any inflationary tendencies which might otherwise result?

Your early attention to this request will be appreciated.

Sincerely yours,

Joseph S. Clark, U.S.S.

SELECT COMMITTEE ON SMALL BUSINESS
OF THE
HOUSE OF REPRESENTATIVES OF THE UNITED STATES
EIGHTY-FIFTH CONGRESS
WASHINGTON, D. C.

COMMITTEE ROOM:
129 HOUSE OFFICE BUILDING
NATIONAL 8-3120, EXT. 1846

EVERETTE MAC INTYRE
STAFF DIRECTOR AND
GENERAL COUNSEL

WM. SUMMERS JOHNSON
CHIEF ECONOMIST

MRS. MARIE M. STEWART
CLERK

June 25, 1957

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

Dear Mr. Martin:

This is with further reference to your letter of May 10, in which you suggest the possibility of a broad study of small business financing problems which would meet the needs and interest of several other Committees of both the House and the Senate.

Frankly, when Mr. Young brought this letter by my office and presented it as an alternative to my earlier request for information on small business financing, I was not favorably impressed with the suggestion since, among other reasons, it occurred to me that a proposal which hinges upon obtaining cooperation and agreement among so many different Committees would unnecessarily delay matters.

After further reflection on your letter however, and upon rereading it, I am now of the view that your suggestion for a broad fully-rounded study of all aspects of small business financing is one of considerable vision which I did not immediately appreciate.

Consequently, I am now exploring this proposal with some of the other Committees which you mentioned, and it seems to me quite possible that this will eventuate in a later request for a study of the kind that you have suggested.

I am

Sincerely yours,

Wright Patman

May 10, 1957.

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

Dear Mr. Patman:

This is in reply to your letter of April 30 expressing interest in certain data relative to small business financing along the line of material included in the Board's survey of bank loans to business as of October 1955.

There is a very real need for solid information on the financial position and problems of small business that goes far beyond the type of data obtainable by surveying bank loans. That need is for the best and most comprehensive factual and analytical material it is possible to develop on this matter of wide and vital interest.

This is a question with which the Board has been concerned for some time. However, it is not a matter of concern to the Board alone, nor one exclusively in the Board's domain. The matter is of equal concern to a number of committees of the Congress and several departments and agencies of the executive branch.

The problems of small business, in respect to credit and capital and related matters, have, for example, drawn the attention for some years of the Small Business and the Banking and Currency Committees of the House and Senate, the Joint Economic Committee, the Council of Economic Advisers, the Commerce and Treasury Departments, the Small Business Administration, the Federal Trade Commission, the Securities and Exchange Commission, and others. Also, the subject will doubtless be of interest in connection with the study of financial matters that the Senate Finance Committee is planning at this time.

If the true needs for information relative to the financing problems of small business are to be met, it would appear to us highly desirable that an effort be made on the part of all these groups to formulate means of arriving at material that will at once be comprehensive

and broad enough to cover the informational requirements of these groups and be of a scope and quality satisfactory to all. The Board would cooperate to the full in efforts to formulate and carry out such a study. The Board recognizes that such an undertaking would involve a considerable expenditure of time and money. To be worthwhile, such an undertaking would have to be comparable in breadth of coverage to the study of consumer instalment credit undertaken by the Board at the request of the President. As you know, this study required about 12 months' intensive efforts of part of the Board's comparatively small staff, plus the use of several outside survey and research organizations. As you further know, that study entailed direct costs approximating $380,000.

The necessity for such a comprehensive undertaking has been highlighted by efforts in the past, both on our part and on the part of others, to obtain certain limited information by means readily at hand. Recently, for example, we developed what we believed to be revealing data on the trends in bank lending to businesses of various sizes from a quarterly survey on interest rates charged by banks on business loans. The information has been given to members of your staff. This material, while informative as far as it goes, is not sufficient to meet the basic needs which you, as well as we, have in mind.

The same inadequacy is true, unfortunately, for the type of information obtainable in a bank loan survey. Such a survey would be extremely complicated and time consuming, yet would add little to the data on bank financing of small business available from the existing quarterly survey and the regular call reports.

In view of the above, the Board has requested our Director of Research, Mr. Ralph A. Young, to deliver this letter to you personally and to discuss the matter with you.

Sincerely yours,

(SIGNED) WM. McC. MARTIN, Jr.

Wm. McC. Martin, Jr.

ARK:JBE:RAY:

SRC:cd

Miss Muehlhaus

JUL 3 1957

The Honorable Joseph S. Clark,
United States Senate,
Washington 25, D. C.

Dear Senator Clark:

In your letter of June 24 you asked for my comment on a number of questions. I am happy to comment, and hope that my responses will be useful to you and your Committee.

1. Do you agree that "tighter credit conditions affected unevenly different sectors of the economy and different types of businesses"?

2. Is an uneven effect of credit and monetary policy bad for the economy as a whole?

These questions are closely related and I shall try to answer them together.

In an economy as broad and as interdependent as ours, the effects of tighter credit tend to be pervasive--more so, I think, than is commonly realized. One of the immediate effects is to increase the cost of credit thereby tending to reduce the volume of borrowing. It also increases the rewards for savings thereby increasing the amount of loanable funds available. These influences spread throughout the economy in a relatively short time.

To take one example, if individuals decide to save more or borrow less by reducing their purchases of durable goods, these decisions affect several very large and important industries in the country--industries which include both giant manufacturers and relatively small dealers, as well as companies that customarily depend heavily on borrowed funds and those that rely more extensively on internal financing. The decisions also affect the availability of loanable funds to a variety of lenders and hence their ability to meet their customers' demands. In short, these decisions affect in one way or another the countless saving, spending, lending and borrowing activities that make up our daily economic and business life.

One cannot say that every activity, every sector, every member of every sector in the economy is evenly affected by tight credit conditions. Neither can one determine the extent to which one sector is affected relative to another. There is unquestionably some unevenness in the effect of general monetary restraints, but the alternatives--unrestrained inflation or a harness of specific direct controls--would in my opinion be immeasurably more uneven in their discriminatory effects.

3. In general, do higher interest rates and a reduced supply of credit in relation to demand pose more serious problems for small businesses than for large businesses?

It is difficult to say whether, and if so to what extent, tight credit conditions by themselves have a disproportionately adverse effect on small businesses. So far as short-term bank credit is concerned--and small businesses rely heavily on this type of credit--the information we receive from surveys suggests that the supply of such credit has not diminished over the past two and one-half years. While interest rates on small loans of banks generally are higher than rates on large loans, the increase in rates on small loans has been less than that on large loans over this period. Small businesses have also had an increased volume of internal funds and this may have moderated their needs for borrowed funds. According to F.T.C.-S.E.C. data for manufacturing corporations, the profits of small companies increased substantially in 1956, compared with a decline for large companies.

The financing problem of small businesses lies, in our judgment, in the field of long-term debt and equity capital. To some extent, higher interest rates and a supply of credit short of demand for its use may intensify this problem.

It is in boom times that the demands for the goods and services of small, as well as large, businesses are at their peak. It is then that businesses are tempted to overestimate their future growth, to overextend themselves, and to lay the seeds for trouble when final demand is less pressing. Some small businesses, without the research and technical advisory services available to many larger firms, are particularly vulnerable to such miscalculations. The fact that business enterprises may be restrained in their expansion by reluctance on the part of investors to make all of the capital they want available to them is one of the "checks and balances" in our economic system which helps to prevent uneconomic use of our resources.

4. On the basis of such factual information as may be available to you, what additional volume of credit to small businesses would be necessary to maintain their fair share of the total quantity of credit available?

So far as I know, there is no factual information available that would permit a satisfactory judgment as to the amount of credit that represents small business' "fair share"? If one accepts the premise that the impersonal judgment of the market place, while economic in the broadest sense, does not always satisfy desirable social objectives, then one must set up different criteria for allocating available credit. This might result in further involving the Federal Government in financial activities beyond the scope of its ordinary responsibilities. Moreover, these criteria would have to be very general and would have to be geared to the broad social objectives desired rather than to any particular dollar or percentage amounts. This would be a most difficult task and I do not believe it would be as effective as the judgment of the market place.

5. If this additional volume is greater than the lending authority of the Small Business Administration, how can the supply of credit for small businesses be increased?

7. Is it feasible to increase the supply of credit available to small businesses solely through the lending program of the Small Business Administration?

I can also answer these related questions together. Since I feel that it is extremely difficult to determine the "fair share" of the aggregate credit pool that small businesses should receive without the guidance of the market place, I find it equally as difficult to say whether the Small Business Administration can adequately fill any gap that may exist between the "fair share" and the amount of credit currently available to small firms.

As I indicated in my testimony, if there is such a gap, every effort should be made to encourage private organizations to fill it.

6. Could the Board of Governors of the Federal Reserve System take steps to increase the supply of credit for small businesses through policy statements or advice to member-institutions?

The Federal Reserve System has studiously avoided interfering with the operations of its member banks in allocating the available supply of credit to particular sectors or individual members of the economy. This allocation is best left to market forces and to the decisions of our numerous, widely scattered, and locally oriented commercial banks. The Federal Reserve concentrates on influencing the over-all quantity of money and credit and on trying to keep their growth consistent with the maintenance of orderly economic progress.

8. When the Congress attempts to alleviate the uneven effects of policies which restrain credit, it is frequently said that such attempts are inflationary. If the Congress decides that such direct lending programs are essential, cannot the Federal Reserve System take action through open market operations or other means to offset any inflationary tendencies which might otherwise result?

The Federal Reserve would, of course, do everything within its power, through open market operations or other means, to offset any inflationary tendencies that might arise from direct Government lending programs. Such offsetting action is very difficult to accomplish, however, and might prove relatively ineffective, at least in the short-run, due both to the problem of measuring the potential inflationary effects of particular lending programs and the fact that the effects of offsetting action would be delayed. The most appropriate way to counteract this type of inflationary pressure would be through fiscal policy, that is, by financing any new specialized lending programs by taxation.

Sincerely yours,

(Signed) Wm. McC. Martin, Jr.

Wm. McC. Martin, Jr.

ARK:mjk
7/3/57

UNITED STATES SENATE

Committee on Banking and Currency

June 24, 1957.

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

Dear Mr. Chairman:

You will recall that during your testimony before the Small Business Subcommittee of the Committee on Banking and Currency on Thursday, June 20, 1957, it was necessary for me to leave the hearings. I had intended to obtain your views on certain matters affecting the credit needs of small businesses, and I regret that I could not return to the hearing prior to the conclusion of your testimony. Consequently, this letter contains several questions upon which I would appreciate receiving your comments as soon as possible, in order that they be made a part of the record of the hearings held on June 20, 1957.

On Page 42 of the Economic Report of the President, transmitted to the Congress on January 23, 1957, there appears the following statement:

> "In the course of the year it became increasingly apparent that tighter credit conditions affected unevenly different sectors of the economy and different types of businesses. New and smaller business firms appeared to find it more difficult to satisfy their financing requirements than established and larger concerns. Also, the changes in the cost and availability of credit exerted especially severe effects on home building."

This statement, together with other observations which have come to my attention, prompt me to ask your reply to or comment upon the following questions:

1. Do you agree that "tighter credit conditions affected unevenly different sectors of the economy and different types of businesses"?

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Your early attention to this request will be appreciated.

Sincerely yours,

(signed) Joseph S. Clark

Joseph S. Clark, U.S.S.

United States Senate

COMMITTEE ON BANKING AND CURRENCY

July 25, 1957

Small Bus

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

Dear Mr. Chairman:

You will recall our discussions in my office and during your testimony before this Committee on June 20 about the financing problems of small business and the proposed study by the Federal Reserve Board.

This matter was discussed at the meeting of the Committee on July 9. No formal action was taken by the Committee, but I think it is the general consensus, and certainly it is my view, that we welcome the proposed study by the Federal Reserve Board.

You will also recall that the Committee has had before it a number of bills dealing with this problem, including S. 2160 (Senator Sparkman and others) and S. 2286, which I introduced. These bills were the subject of hearings, along with legislation extending and otherwise dealing with the Small Business Administration. The Committee has reported a bill providing for a one year extension of the Small Business Administration on the understanding that the House-passed bill on the same subject and other legislation dealing with the general problem will be considered again early in the next session of Congress. For this reason, it would be very helpful if we could have a report from you on the results of your study by March 1, 1958.

It is my view that there is already in existence a great body of information showing a gap in the credit structure of this country in the availability of equity and long term capital for small- and medium-size business. I would hope, therefore, that the study which you undertake will devote itself primarily to finding a means by which this gap may be filled and that you will be able to recommend to the Committee specific legislation for this purpose. My personal opinion is that S. 2160 and S. 2286 constitute a basis for such legislation.

Sincerely yours,

J. W. Fulbright
Chairman

JWF:yc

Chairman Martin

BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON

OFFICE OF THE VICE CHAIRMAN

August 22, 1957

The Honorable J. W. Fulbright, Chairman,
Senate Banking and Currency Committee,
United States Senate,
Washington 25, D. C.

Dear Senator Fulbright:

As you know, for some time we have been giving consideration to a study of the financing problems of small business. The Board has now authorized such a study in the hope that it will afford a basis for a solution to at least some of the problems in this field that confront the Congress and the financial authorities.

The Board has sent the attached report, which was prepared by a System committee, to the Federal Reserve Banks with a request for their comments and suggestions as to the nature and scope of the study. The report suggests a study which would consist of three parts, (1) an analysis of the existing material on the subject, (2) a study of the operations and policies of the principal types of lenders to small business, and (3) a comprehensive survey of the recent borrowing experiences of small business concerns and their financing practices. Should the nature of the study be changed as a result of the comments of the Federal Reserve Banks you will be informed promptly.

You will note from page five of the attached report that the first two parts of the study will probably be completed by the spring of 1958, but that the third part, the survey of small business borrowing, which the Board regards as the most significant part of the project and which it hopes will be a most useful addition to our understanding of small business financing, cannot be finished before the end of 1958. Even though this part of the study will not be ready for use by your Committee by the time desired, the Board believes it should be made so that the borrower as well as the lender aspects of the subject may be explored thoroughly.

Because of their interest in the problem of small business financing, a copy of this letter is being sent to Chairman Spence, Senators Sparkman and Clark, and Congressman Patman.

Sincerely yours,

C C Balderston

C. Canby Balderston,
Vice Chairman.

Enclosure

C O P Y

Mr. Muehlhaus

AUG 22 1957

The Honorable Brent Spence, Chairman,
House Banking and Currency Committee,
House of Representatives,
Washington 25, D. C.

Dear Congressman Spence:

Because of your interest in the problem of small business financing, you may like to see the attached copy of letter which is going to Chairman Fulbright today. A copy is also being sent to Congressman Patman.

Sincerely yours,

(Signed) C. C. Balderston

C. Canby Balderston,
Vice Chairman.

Enclosure

SRC:dd
8/21/57

Same letter (without last sentence) also sent to:

Senator Sparkman
Senator Clark
Congressman Patman

United States Senate

COMMITTEE ON BANKING AND CURRENCY

August 31, 1957e

Honorable Joseph S. Clark
United States Senate
Washington, D. C.

Dear Joe:

Thank you for copy of your letter of the 30th to Governor Balderston of the Federal Reserve Board. My conclusion is that until the current boom has been stabilized and a definite future trend established any study to be made by the Federal Reserve Board or any other agency on the subject of financing small business would be rather futile.

Recent surveys made by the American Bankers Association indicate that loans to small business have been at a normal rate and that most banks had sufficient money to accommodate small borrowers who were creditworthy risks. The present so-called tight money policy and relatively high interest rates are the smallest problem confronting small business. The problems that really need to be solved are: (1) monopolistic competition, (2) high taxes. The Justice Department and Federal Trade Commission could unite in studying the problem of unfair competition by big industry, while the House Ways and Means Committee will next January start a study of the tax situation.

A third problem which through the years has affected the credit worthiness of small business and which the Government is powerless to control, is management. As you, of course, know many small businesses fail through lack of experienced management but that is the fault of the quality, as the French would say, of our system of private enterprise.

With kind personal regards and best wishes, I am

Sincerely yours,

A. Willis Robertson

Chairman Martin

UNITED STATES SENATE
Committee on Banking and Currency

August 30, 1957

Mr. C. Canby Balderston
Vice-Chairman
Board of Governors of the
Federal Reserve System
Washington, D. C.

Dear Mr. Balderston:

Thank you for sending me a copy of your letter of August 22 to Senator Fulbright relative to the proposed Federal Reserve study of the financing problems of small business. While I am pleased that the Board has finally authorized such a study, I cannot fail to express my keen disappointment at the timing indicated in your letter to Senator Fulbright and the accompanying memoranda.

While an analysis of the existing material on the subject would be of some help to the Subcommittee on Small Business of the Banking and Currency Committee, I doubt whether it would provide much information which has not already been made available to the Subcommittee.

A study of the operations and policies of the principal types of lenders to small business would also be helpful; but again the Subcommittee already has a great deal of material on this subject.

It is the third part of the proposed study: a comprehensive survey of the recent borrowing experiences of small business concerns and their financing practices which would be of immediate and practical help to the Subcommittee in formulating legislation for enactment at the second session of the 85th Congress.

It is for this reason that I am gravely concerned to learn from your letter that this survey cannot be finished until after the 85th Congress has adjourned.

As Chairman of the Subcommittee, my concern at the plight of small business has grown during the last year as evidence mounts to indicate a continuous growth of concentration of economic power in big business and a subsequent diminution of the role of independent

small business in our economy. The social and political implications of this trend are perhaps just as important as the economic.

I fear that the inevitable result of the failure of the Board to produce the third part of its study prior to adjournment of the 85th Congress will be to make it difficult, if not impossible, to consider comprehensive legislation which, in my judgment, is badly needed next year.

Indeed, I would feel that if you cannot complete the study in time to have it available to the Congress no later than the early spring of 1958, it would be wise to consider abandoning it completely. The fact that such a study is under way will inevitably be used by those who have no interest in the plight of small business as an excuse for failing to take action during the 1958 session of the Congress.

Sincerely yours,

(signed) Joseph S. Clark

Joseph S. Clark

cc: Honorable J. W. Fulbright
Honorable A. Willis Robertson
Honorable John J. Sparkman
Honorable Frank J. Lausche
Honorable Homer E. Capehart
Honorable J. Glenn Beall
Honorable Frederick G. Payne
Honorable Clifford P. Case

Chairman Martin

UNITED STATES SENATE
Select Committee on Small Business

September 6, 1957

Mr. C. Canby Balderston
Vice Chairman
Board of Governors of the
Federal Reserve System
Washington 25, D. C.

Dear Mr. Balderston:

Thank you for your courtesy in sending me a copy of your letter of August 22nd addressed to Senator Fulbright concerning the plans of the Federal Reserve Board for studying small-business financing problems.

I am sure that it is unnecessary for me to tell you how keenly disturbed I am by your proposed timetable. I am greatly disappointed that the Federal Reserve Board should now tell us it will take another year and a half before it is able to come up with any help. This seems to constitute a serious abdication of the Board's responsibility.

As you well know, the Board has been aware of the general problem and the specific proposal for many years. Almost ten years ago the Committee for Economic Development supported the establishment of capital banks to help fill a serious gap in the sources of equity financing for small business. Soon thereafter legislative proposals were framed and introduced and the Board was asked for its comments. As long ago as 1950, as I recall, the Chairman of the Board supported this legislation in testimony before the Senate Banking and Currency Committee.

In addition, the Board has never doubted that this inadequacy in fact existed. In a report to the Monopoly Subcommittee of the Senate Small Business Committee in 1952, the Board noted this as the most serious financing problem of small business. Again, several months ago, Mr. Martin testified before the Senate Banking and Currency and stated that he recognized the existence of the problem and expressed sympathy with the aims of the legislation introduced by other Senators and myself to try to meet this problem.

With all this in mind, it obviously comes as a great shock to us who are trying to help small business and who have watched their struggles in the face of inadequate capital financing to hear from the Board that we can expect no help at all from you until 1959. Many of us realize that it may then be too late to help many worthy firms and know that the vigor of our free enterprise system is dependent upon the health of these independent businesses.

I must ask the Board of Governors in all sincerity to reexamine these plans to determine if there is not some means whereby your guidance may be available to us early in 1958, when I predict, the Congress will take some action on the financing problems of small business.

With best personal wishes, I am

Sincerely yours,

(Signed) John Sparkman

John Sparkman
Chairman

Miss Muehlhaus

September 20, 1957

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

Dear Mr. Patman:

On August 22 the Board sent you a report outlining a proposed study of small business financing. The planning staff for this study has now proposed to the Board that a survey of business loans at commercial banks, similar in major respects to the 1955 survey, be added to the program. Such a survey, if undertaken, would be conducted this October and, barring unforeseen delays in compilation, the results should be available by March 1, 1958. Mr. MacIntyre and Mr. Jacques, of the staff of your Select Committee to Conduct a Study and Investigation of the Problems of Small Business, have discussed the proposed business loan survey in detail with the Board's staff.

It is our hope that the survey will provide useful information to the Congress, the Board and others interested in bank lending to small business as well as in bank lending activities generally. Tabulation plans for this survey will be made available to Mr. MacIntyre and Mr. Jacques at an early date in order to obtain the benefit of their suggestions for meeting the interests of your Committee. Special tabulations beyond those originally planned will be provided if such are later felt to be desirable. The machine tabulation procedures planned for the survey make possible considerable flexibility in this respect. You and your staff may be assured of our desire to cooperate as fully as possible in meeting the needs of your Committee for data on bank lending to small business.

Sincerely yours,

(Signed) Wm. McC. Martin, Jr.

Wm. McC. Martin, Jr.

ARK/SSB/RAY:ajm

(33)

July 2, 1957.

Dear Gerhard:

Thank you for sending me a copy of your statement before Congressman Mills' Subcommittee on Fiscal Policy of the Joint Economic Committee which I was very interested to read. It is thoughtful of you to remember me with a copy.

With all good wishes,

Sincerely yours,

Wm. McC. Martin, Jr.

Mr. Gerhard Colm,
National Planning Association,
1606 New Hampshire Avenue, N.W.,
Washington 9, D.C.

Not to be released
before 10:00 a.m.
June 4, 1957

National Planning Association
1606 New Hampshire Ave., N. W.
Washington 9, D. C.

Statement of Gerhard Colm

before the

Subcommittee on Fiscal Policy of the

Joint Economic Committee

June 4, 1957

My name is Gerhard Colm. I am Chief Economist of the National Planning Association, which is a [illegible] organization. I am appearing, however, as an individual, [illegible] representative of my organization. I appreciate the invitation of the Chairman to participate in this panel today, because it comes at a time when the government is faced with important decisions which will affect economic conditions in 1958 and later years.

The Budget Outlook for the Fiscal Years 1958 and 1959

I have been asked [illegible] effect of current Congressional and Executive policies [illegible]. Since the Congress has not yet completed consideration of [illegible] appropriation requests and relevant legislation, only guesses can be made at this time. In the statement attached to this testimony, my associate, Manuel Solomon, and I present such guesses for the fiscal years 1958 and 1959. I would like, at this point, to express my appreciation to the Budget Bureau for making available to us information on current appropriations and expenditures. As for the conclusions, however, we take sole responsibility.

It is our conclusion that both spending and revenue in the fiscal year 1958 will probably turn out to be somewhat higher than estimated last January in the President's Budget. The increase in spending will probably exceed the increase in revenues so that the [illegible] budget surplus would be somewhat smaller than estimated in January, and smaller than the surplus which was realized in the fiscal year 1957, especially if no action should be taken on the proposed increase in postal rates.

My name is Gerhard Colm. I am Chief Economist of the National Planning Association, which is a nonprofit, nonpolitical organization. I am appearing, however, as an individual, rather than as a representative of my organization. I appreciate the invitation of the Chairman to participate in this panel today, because it comes at a time when the government is faced with important decisions which will affect economic conditions in 1958 and later years.

The Budget Outlook for the Fiscal Years 1958 and 1959

I have been asked specifically to evaluate the likely impact of current Congressional and Executive policies on the budget outlook. Since the Congress has not yet completed consideration of all pending appropriation requests and relevant legislation, only guesses can be made at this time. In the statement attached to this testimony, my associate, Manuel Helzner, and I present such guesses for the fiscal years 1958 and 1959. I would like, at this point, to express my appreciation to the Budget Bureau for making available to us information on current appropriations and expenditures. As for the conclusions, however, we take sole responsibility.

It is our conclusion that both spending and revenue in the fiscal year 1958 will probably turn out to be somewhat higher than estimated last January in the President's Budget. The increase in spending will probably exceed the increase in revenues so that the expected budget surplus would be somewhat smaller than estimated in January, and smaller than the surplus which was realized in the fiscal year 1956, especially if no action should be taken on the proposed increase in postal rates.

Federal Budget Outlook - Fiscal Years 1956 - 1959

	Administrative Budget (billions of dollars)			Consolidated Cash Budget (billions of dollars)		
Fiscal year	receipts	expenditures	surplus	receipts	expenditures	surplus
1956 (actual)	68.1	66.5	+1.6	77.1	72.6	+4.5
1957 (revised estimate)	70.7	69.8	+ .9	82.0	80.0	+2.0
1958 (revised estimate)	73.8	72.8	+1.0	87.0	84.5	+2.5
1959 (tentative guess)	76.8	75.3	+1.5	90.8	88.5	+2.3

Note: For assumptions and explanation, see statement attached.

This result may appear shocking if contrasted with the efforts made by the legislative and executive branches to reduce expenditures. It should not come as a surpise to those who read the recent staff report of the Joint Committee on Internal Revenue Taxation, which reached essentially the same conclusion.

Our estimates are explained more fully in the attached statement. I will only summarize the main items which show the results in terms of the administrative budget:

For the fiscal year 1958:	Estimate of Expenditures (billions of dollars)
In President's January Budget Message	71.8
probable underestimate in President's Budget (principally national security)	+ 1.9
impact of reductions in appropriation requests	- 1.6
impact of housing legislation	+ .2
impact of other pending legislation	+ .2

For the fiscal year 1958:	Estimate of Expenditures (billions of dollars)
possible impact of supplemental and deficiency appropriations	+ .3
Revised budget outlook for fiscal year 1958	72.8
impact of failure to increase postal rates	+ .7
Revised budget outlook for fiscal 1958 without postal rate increase	73.5

This is not to say that the estimated level of expenditures suggested here is certain or entirely without control. It is still possible that the Congress will act on the increase in postal rates. It is also not impossible that executive action, such as a reduction in the number of the armed forces, may reduce the increase in expenditures. In addition, measures might be adopted to modify expenditures in a particular year by such devices as the issuance of certificates of interest instead of drawing on Treasury funds for financing the farm price support program. The estimates which I have presented are based primarily on a consideration of budget prospects as of last week and do not presuppose these possibilities. Nevertheless, it appears reasonable to conclude that at least no substantial increase in the surplus either in the administrative or cash budget can be expected for the fiscal year 1958.

The "tentative guess" for the fiscal year 1959 indicates a continuing increase in expenditures almost equal with the increase in revenues which would be expected if favorable business conditions should be maintained. The guess for the year 1959 assumes that expenditures for national security and nondefense areas will be continued under current legislation and present policies. It also assumes some further rise in procurement costs.

This budget outlook may give the impression that the Congress has perhaps not cut the budget sharply enough because the trend of rising expenditures has not yet

been reversed. I would not draw that conclusion. The trend of rising expenditures results basically from causes which are not under the control of the budget makers, either in the executive or the legislative branch. Nor could this trend be reversed simply by adopting a different system of accounting, as has been suggested.

Rather, the rising trend in expenditures primarily reflects the increased responsibilities which the United States has had to assume in this chaotic world. It is the policy of the Government to develop and maintain offensive and defensive weapons which, together with the forces of our allies, make it clear that any attack on the United States or her allies would be a suicidal gamble. In addition, it is the policy of the United States to stand ready to prevent or effectively counteract localized ventures of the Soviet bloc in various parts of the wrld.

These policies require that we provide our armed forces with conventional equipment and at the same time participate in a race for the development of not only more advanced offensive weapons but also more effective defensive measures against these advanced weapons. The costs of production in these areas have risen most severely.

Great Britain was able to reduce her defense expenditures somewhat because she placed increased reliance on U. S. technological developments. We could not do the same without a fundamental revision in the strategy of the Free World. I am not competent to judge whether there is at present any realistic possibility of limiting the international technological armaments race. A limitation of the armaments race -- with or without international agreement -- would be the only event which could reverse the trend of rising government expenditures. As much as I hope that such limitations will become possible, I would be fearful if the Government should lessen needed national security efforts solely in order to permit a reduction in expenditures and taxes.

In the nondefense fields a continued increase in expenditures will follow by necessity from present legislation. Furthermore, I do not believe that present programs are adequate for giving needed support to economic and social development. The National Planning Association just this year issued a Joint Statement on National Investment for Economic Growth signed by many leaders in agriculture, business, labor, and the professions. This statement not only emphasized the need for economy in government and the desirability of tax reduction, but also stated that adequate defense and nondefense programs should have higher priority than tax reduction.

The fact that we can expect only a small surplus in the administrative and cash budgets should not, in itself, make a moderate tax reduction impossible. Indeed, I would see nothing basically wrong if the Federal Government financed some of its outlays by borrowing, similarly as state and local governments or business enterprises do. I would, however, recommend such a policy only if it were necessary in order to promote a better balance in the economy as a whole. Therefore, I fully concur with the plan of this Committee to consider tax and debt policy in the light not only of the budget outlook but also of the economic outlook.

The Economic Outlook

An appraisal of the economic outlook has been assigned to another panel. Therefore, I will only summarize my views as a basis for fiscal policy conclusions. The rate of increase in economic activity -- in real terms -- has been leveling off over the last year. Many observers expect a modest upturn later in the year with the result that the fourth quarter 1957 may show a level of activity above that of the fourth quarter of the preceding year -- again excluding the effect of price increases. However, the increase in activity is less than the rise in the labor force, the expansion in plant and equipment and the advances in technology would permit. We are likely to move along at somewhat below the maximum level of employment and production. At the same time, it is expected that prices will

continue to rise although probably at a reduced rate.

Fiscal Policy Conclusions

Different conclusions have been drawn by various observers from this economic outlook. Stating only the extremes, we find, on the one hand, those who say that because of the upward movement in prices, a continued restrictive fiscal policy is warranted. This would include continued if not greater credit restraint and postponement of tax reduction. On the other hand, some maintain that because the increase in economic activity has been slowing down, if not halted, credit relaxation and tax reduction should be adopted now to give needed support to economic expansion.

I find some merit and some faults in both these views. With respect to the first position, I feel it is necessary to analyze the reasons for the price rise. Price increases resulting from an expansion of demand which presses against scarce resources can most effectively be counteracted by restrictive tax and credit policies. However, it appears that the economy has been expanding at a lesser rate than resources permit. This suggests that the price rise must be attributed, at least in part, to other causes than generally excessive demand. I shall not enter here into the controversy as to whether price increases in industries which may not be fully competitive or whether the rise in labor costs have contributed most to the result. Nor do I wish to raise the question as to what is cause and what is effect in the price-wage spiral. However, if it is true that excessive overall demand is not the primary cause of the price rise, then additional demand restrictions may lead to a further slowdown in the rate of growth and to an increase in unemployment. A continued restrictive policy alone cannot be the full answer to our economic problem.

In spite of this I cannot recommend loosening all the fiscal brakes at the same time. This leads me to a criticism of the second position to which I referred.

Overall demand has not been seriously deficient. I would agree that the recent inflation has originated primarily in a price and cost push rather than in excessive demand. Nevertheless, monetary demand has continued to rise. Otherwise, the increase in prices and the credit restraint would have caused a general decline in economic activity and more widespread unemployment.

The restrictive credit policy has resulted primarily in declines in activities which are particularly dependent on credit, such as residential construction and certain industries in which small businesses are dominant. Therefore, I am not convinced that immediate and simulataneous tax reduction and credit relaxation are called for.

My conclusions from these critical considerations would be the following: I do not think we should adopt tax reduction and credit relaxation at the same time unless a severe slack threatens in the economy. Nor would I recommend immediate tax reduction or a legislative commitment for substantial tax reduction in the near future unless a limitation in the armaments race appears as a realistic possibility and unless our defense strategy can be basically revised. This argument against early and substantial tax reduction is, of course, no argument against tax revision.

To promote economic expansion, I would recommend as a first step credit relaxation and would favor measures which would give increased financial support to residential construction and community development. Such a credit policy would have its greatest impact on those activities which have suffered most. Tax reduction would have a much more general effect and would have to be substantial before it could have an impact on such areas as residential construction. Relaxing credit first also has the advantage that it is more easily reversable than tax reduction and therefore more suitable in a still very cloudy international situation.

At the same time, I would urge that the problem of the price and cost push be

studied for the purpose of developing an effective policy of price stabilization. Only when such stabilization policies have been developed will it be possible to make fuller use of fiscal and credit policies in support of economic growth. Until we have proper devices for dealing with the price and cost push, we should not throw away the fiscal brakes, crude as they are. We should use them, however, gently and should recognize that if used too hard, they may do more harm than good.

If the rise in national security expenditures could be held at the $45 billion level, or if these expenditures could be reduced, substantial tax reduction would not only be feasible but, in my opinion, become an economic necessity in future years. I believe it is premature to adopt such tax reduction now. Nevertheless, it is not too early to prepare for tax reduction now for adoption when the budgetary situation permits it and when the economic situation requires it. I am glad to know that this will be considered by subsequent panels.

STATEMENT ON REVISED BUDGET OUTLOOK

prepared by

Gerhard Colm and Manuel Helzner

submitted in connection with testimony of Gerhard Colm before the Subcommittee on Fiscal Policy of the Joint Economic Committee, June 4, 1957

This statement attempts to reevaluate the budget outlook in the light of more recent developments and in view of the experience of the past fiscal year. Of the two tables included in this statement, one presents revised estimates of budget expenditures and new obligational authority for fiscal year 1958. The other offers a budget outlook for the Federal Government covering the fiscal years 1956 to 1959. In the preparation of these revised budget estimates, we have had the fullest cooperation of the Budget Bureau. They have been helpful in making some of their information on expenditures and appropriations available to us. However, we assume full responsibility for deriving the estimates themselves.

The Congress has not yet completed consideration of the President's Budget or of pending relevant legislation. Hence, we can only estimate what, at this time, the budget outlook for fiscal year 1958 might be. The revised budget estimates which have been prepared in Tables 1 and 2 below are based on the status of legislative action as of May 24th. Estimates have also been prepared regarding the expected budget impact of programs on which Congressional Committees have not yet acted.

Table 1

Revised Estimates of the Federal Budget -- Fiscal Year 1958

	New Obligational Authority		Expenditures	
	In January Budget	Revised Estimates	In January Budget	Revised Estimates
	(billions of dollars)		(billions of dollars)	
Appropriation requests acted upon in some way by either House of Congress or Appropriations Committee: a)				
Independent offices				
Veterans Administration	4.9	4.7	4.9	4.7
Other	.6	.4	.5	.4
General Services Administration	.4	.3	.6	.6
Housing and Home Finance Agency	.1	.1	.1	.1
Department of Agriculture				
Conservation and Acreage Reserve Program (soil bank)	1.4	1.1	1.3	1.0
Commodity Credit Corporation (CCC)	1.2	1.4	1.4	1.6
Other Agriculture	1.1	1.1	1.2	1.0
Department of Commerce	.8	.6	.7	.6
Department of Defense -- military	36.2	33.5	38.0	39.5
Department of Health, Education, and Welfare	2.6	2.5	2.6	2.5
Department of the Interior	.3	.3	.3	.3
Department of Justice	.2	.2	.2	.2
Department of Labor	.4	.3	.3	.3
Post Office	3.3	3.1	b)	b)
Department of State	.2	.2	.2	.2
Treasury Department	.7	.7	.7	.7
Subtotal:	~~54.4~~ 51.1	~~50.5~~ 47.4	53.0	53.7

Table 1 (cont.)

Revised Estimates of the Federal Budget -- Fiscal Year 1958

	New Obligational Authority		Expenditures	
	In January Budget	Revised Estimates	In January Budget	Revised Estimates
	(billions of dollars)		(billions of dollars)	
Other pending programs which affect the budget:				
Mutual security	4.4	3.8	4.4	3.8
Public works	2.3	2.3	2.0	2.0
Increase in veterans disability benefits	---	.2	---	.2
Increase in Federal outlays for housing programs	---	.2	---	.2
Interest on public debt	7.4	7.4	7.4	7.4
All other c)	~~4.8~~ 8.1	~~5.0~~ 8.1	5.0	5.2
With possible allowance for supplemental appropriations	---	1.0	---	.3
Revised Budget Summary	73.3	70.4	71.8	72.8
With no increase in postal rates	---	.7	---	.7
Revised Budget Total	73.3	71.1	71.8	73.5

- -

a) Agency totals may not coincide with budget estimates since some budget items have not yet come up for consideration (for example: mutual security and public works). Also, some legislative items may have a budget impact but may not be considered by the Appropriations Committees.

b) [illegible] than 500 million. Assumes postal rate increase to be enacted. If rates not increased, net expenditures would rise by $ .7 billion.

c) Includes Atomic Energy Commission and Defense Department -- civilian.

Assuming that budget prospects as of May 24th would be sustained by later Congressional action, Table 1 suggests that new obligational authority for fiscal year 1958 would be reduced some $3 billion below January budget estimates. Estimated budget expenditres, however, would show approximately a $700 million increase. There are a number of reasons for this:

1. There appears to be an underestimation of expenditures in the President's 1958 budget in view of recent price and program developments. (E.g. increased costs of defense equipment and a possible increase in expenditures for agricultural price supports beyond what was anticipated explain some of this.)
2. Some of the reductions in new obligational authority apply to program expenditures beyond fiscal year 1958 and may not show up as expenditure reductions until later unless offset by additional appropriations in future years. (E.g. part of the reduction in defense authority affects long lead items and would not affect defense expenditures significantly until fiscal year 1959 or 1960 or beyond.)
3. Some of the Congressional cuts simply involve bookkeeping transactions where the transfer of funds or the use of already approved obligational authority reduces total new authority but has little or no effect on expenditures. (E.g. roughly half of the reduction in Defense Department new obligational authority may be explained as bookkeeping changes).
4. The introduction and consideration of new legislation may add to budget expenditures. (E.g. legislation to increase veterans disability benefits and Federal outlays for housing programs.)

The revised budget total for fiscal 1958 takes into account the reduction in the President's revised estimate for the mutual security programs. Moreover, it also considers the possibility that the increase in postal rates might not be enacted and that requests for supplemental appropriations may be forthcoming at a later stage (particularly this might appear likely in the case of veterans benefit payments which are fixed by law).

Table 2 below examines the budget outlook through fiscal year 1959. It does not consider the possibility or feasibility of a major change in our national defense program in government nondefense activities or in our tax structure.

Table 2

Budget Outlook for the Federal Government

Fiscal Years 1956, 1957, 1958, and 1959
(Billions of Dollars)

	Actual 1956	President's Jan. Budget Estimate 1957	1958	Budget Estimate Revised 1957	Projected 1958	1959
Administrative budget:						
Budget receipts	68.1	70.6	73.6	70.7	73.8	76.8
Budget expenditures	66.5	68.9	71.8	69.8	72.8 a)	75.3 a)
Major national security	40.6	41.0	43.3	43.2	45.2	46.7
Other non-defense programs	25.9	28.9	27.5	26.6	27.6	28.6
Administrative budget surplus	+1.6	+1.7	+1.8	+ .9	+1.0 a)	+1.5 a/
Consolidated cash budget:						
Recipts from the public	77.1	81.7	85.9	82.0	87.0	90.8
Payments to the public	72.6	78.2	82.9	80.0	84.5	88.5
Consolidated cash budget surplus	+4.5	+3.5	+3.0	+2.0	+2.5	+2.3

a) Assumes increase in postal rates. Without this assumed increase in revenue, net expenditures would probably rise by $.7 million in fiscal year 1958 and by $ .8 million in fiscal year 1959.

Both revenues and expenditures for fiscal year 1957 continue to rise above 1956 levels. An economy still operating at relatively high levels of activity would account for most of the increase in revenues. The rise in national security outlays -- primarily defense and atomic energy -- would explain most of the increase in total expenditures. The increase in expenditures, however, will probably exceed the increase in revenues, thereby reducing the conventional administrative budget surplus below January expectations.

Assuming continued full employment levels and high performance in the economy, revenues in fiscal years 1958 and 1959 might be expected to rise by about $3.0 billion per year. The rise in expenditures for 1958, however, as we have already indicated, would offset most of this increase in revenues, thereby preventing any substantial increase in the administrative budget surplus. By fiscal year 1959, the rise in expenditures to meet national security programs may taper off somewhat so that we may experience a moderate increase in the budget surplus.

This budget outlook, however, should be qualified by an additional consideration. The 1958 and projected 1959 budgets presuppose that postal rates will be increased. If increased postal rates and higher postal revenues are not forthcoming, the surplus in both the administrative and consolidated cash budget would be reduced significantly and may even lead to a budget deficit.

The consolidated cash budget takes account of all receipts from and payments to the public and includes the transactions of government trust funds. The outlook for a cash budget surplus or deficit over the next two fiscal years will, therefore, not only reflect activities such as the OASI program and the Federal National Mortgage Association, but will also be determined by the operating

activities of the new Highway Trust Fund. Hence, projections of cash budget receipts and payments must consider the speed with which the new highway program will be implemented. If there is no delay in the highway program, expenditures out of this fund should soon equal or exceed revenues. We have, therefore, assumed that the consolidated cash budget would continue to show a surplus but of a substantially smaller magnitude than in fiscal year 1956.

May 31, 1957
ks

Lehman - 1609

FOR RELEASE: Monday, a.m.
May 6, 1957

CONGRESS OF THE UNITED STATES
JOINT ECONOMIC COMMITTEE

Subcommittee on Fiscal Policy
Hearings on
Fiscal Policy Implications of the
Economic Outlook and Budget Developments

Representative Wilbur D. Mills (D., Ark.), Chairman of the Subcommittee on Fiscal Policy of the Joint Economic Committee, announced today the Subcommittee's plans for hearings, to be held June 3-7, and 13-14, on Fiscal Policy Implications of the Economic Outlook and Budget Developments.

Chairman Mills announced that the hearings will focus on (1) the current economic situation and prospects for the remainder of 1957; (2) the effect of current Congressional and Administration efforts to reduce spending on the prospective budget surplus in fiscal 1958 and on levels of economic activity in 1957-58; (3) types of fiscal action consistent with economic stability and growth if spending reductions are achieved; and (4) the timing of fiscal action in relation to budgetary and economic developments.

In announcing the hearings, Chairman Mills emphasized that the Subcommittee's inquiry is directed toward the broad outlines of fiscal action appropriate to current and foreseeable economic and budgetary conditions rather than toward specific legislative proposals. The Joint Economic Committee, under the Employment Act of 1946, has a continuing responsibility to follow economic developments and to advise the Congress on the adjustments

in public policies which may be needed for steady economic growth. The Fiscal Policy Subcommittee in its current inquiry will apply the fiscal policy principles recommended in the Subcommittee's 1955 study of Federal Tax Policy for Economic Growth and Stability and in other studies by the Joint Economic Committee.

Non-Government experts have been invited by the Subcommittee to participate in a series of panel discussions on June 3-6, and economic interest and research groups on June 7. Government officials have been asked to express their views on June 13-14.

A schedule of the hearings and of witnesses invited to appear is attached. All members of the Joint Economic Committee are invited to participate.

Members of the Subcommittee on Fiscal Policy are:

Representative Wilbur D. Mills, Chairman
Senator Paul H. Douglas
Senator Joseph C. O'Mahoney
Senator Barry Goldwater
Representative Thomas B. Curtis

CONGRESS OF THE UNITED STATES
JOINT ECONOMIC COMMITTEE

Subcommittee on Fiscal Policy

Schedule of Hearings on
Fiscal Policy Implications of the
Economic Outlook and Budget Developments

- -

Monday, June 3, 1957, 10:00 a.m.

The economic outlook.

Panel will review recent developments and suggest prospects for 1957-58 with respect to: plant and equipment outlays; housing; inventories; consumer spending; Federal State and local government expenditures; the money markets; major price movements; employment, production, and productivity. What would be the impact of substantial reductions in Federal appropriations and spending for fiscal 1958 on the level of economic activity during 1957-58?

MR. ROBERT ULIN, Economics Division
McGraw-Hill Publishing Co.

MR. WILLIAM M. TONGUE, Economist
Jewel Tea Co., Inc.

PROFESSOR IRWIN FRIEND, Wharton School
University of Pennsylvania

MR. ROBINSON NEWCOMB
Washington, D. C.

MR. STANLEY RUTTENBERG, Director of Research
American Federation of Labor-Congress of
Industrial Organizations

MR. WALTER E. HOADLEY, Treasurer
Armstrong Cork Co.

Tuesday, June 4, 1957, 10:00 a.m.

Fiscal policy implications
of reductions in appropriations for fiscal 1958.

How will the appropriation reductions proposed to date affect actual Federal spending in fiscal 1958 and subsequent years? In the light of current economic prospects, how would such reductions affect the prospective budget surplus for fiscal 1958? What concept of the public debt is appropriate for assuring that debt management will be consistent with economic stability and growth? What combination of debt reduction, tax reduction, easing monetary restraints, or increase in the Treasury cash balance, would be called for in the interest of economic growth and stability? What considerations should determine the timing of such action?

DR. GERHARD COLM, Chief Economist
National Planning Association

PROFESSOR JAMES TOBIN, Department of Economics
Yale University

PROFESSOR ALBERT G. HART, Department of Economics
Columbia University

MR. EDWIN B. GEORGE, Director of Department of Economics
Dun & Bradstreet

Wednesday, June 5, 1957, 10:00 a.m.

Fiscal action to promote stability and growth in the light of prospective budgetary and economic conditions.

What should be the relative emphasis of fiscal action, in response to expenditure reduction, as between expansion of consumption or investment for continued growth in private sectors of the economy? What type of Federal fiscal action would be appropriate for easing barriers to expansion by State and local governments of services in response to demands of a growing population?

PROFESSOR WALTER W. HELLER, School of Business
University of Minnesota

PROFESSOR WILLIAM J. FELLNER, Department of Economics
Yale University

PROFESSOR PAUL A. SAMUELSON, Department of Economics
Massachusetts Institute of Technology

MR. JOHN K. LANGUM
President, Business Economics, Inc.
Chicago, Illinois

Thursday, June 6, 1957, 10:00 a.m.

Tax changes for steady economic growth.

Should revenue reduction appear desirable in the interests of continuing economic growth, what types of tax changes would enhance the automatic stabilizing capacity of the Federal revenue system? Reduce tax-induced distortions in resource allocation? Improve the competitive climate for new and small businesses, both corporate and non-corporate?

MR. GEORGE TERBORGH, Research Director
Machinery and Allied Products Institute

MR. HARRY J. RUDICK, Attorney
Lord, Day and Lord

PROFESSOR RICHARD A. MUSGRAVE, Department of Economics
University of Michigan

MR. JOHN F. COSTELLOE, Tax Director
Radio Corporation of America

PROFESSOR LAWRENCE H. SELTZER
Department of Economics
Wayne State University

Friday, June 7, 1957, 10:00 a.m.

Views and recommendations
of economic interest and research groups.

The following groups have been invited:

Committee for Economic Development

United States Chamber of Commerce

National Association of Manufacturers

American Federation of Labor-Congress of Industrial Organizations

Railroad Brotherhoods

National Grange

American Farm Bureau Federation

National Farmers Union

Independent and Small Business Coordinating Committee, Inc.

National Federation of Independent Business, Inc.

Thursday, June 13, 1957

The following government officials have been invited:

2:00 p.m. MR. PERCIVAL F. BRUNDAGE, Director
Bureau of the Budget

Friday, June 14, 1957

10:00 a.m. MR. GEORGE M. HUMPHREY
Secretary of the Treasury

2:00 p.m. MR. WILLIAM McC. MARTIN, JR. Chairman
Board of Governors, Federal Reserve System

Journal Title: Washington Banktrends Newsletter

Publisher: U.V. Wilcox, Washington D.C.

Volume and Issues Number: No. 1,045 – 21st Year

Date: May 13, 1957

Pages: 1-4 and supplement (Removed entire issue)

CONGRESS OF THE UNITED STATES

Joint Economic Committee

MEMORANDUM
May 23, 1957

To: Members of the Joint Economic Committee
From: Grover W. Ensley, Executive Director
Subject: The Economic Situation and Outlook

Attached is a summary of the economic situation and outlook for 1957, prepared by the Committee Staff on the basis of extensive discussions with technicians in the Executive agencies of the Federal Government, and economists in business, universities, and research organizations.

This summary is consistent with the moderately optimistic picture presented by the Committee Staff last November, and more recently, in February in connection with the Committee's consideration of the President's Economic Report. A gross national product of about $435 billion still seems likely this year. The misgivings with respect to the immediate economic outlook, which prevailed in many quarters early in the year, now have noticeably lessened.

THE ECONOMIC SITUATION AND OUTLOOK

Summary

Final purchases by consumers, business, and government have continued to rise in 1957 as rapidly as during 1956 (Chart I). Final purchases include all of gross national product except inventory changes. Significantly, real final demand has increased after allowing for rising prices (Chart II). Total output in constant prices, however, has increased little since the fourth quarter of 1956. This leveling out of production despite increasing demand is accounted for by rising prices and the recent shift from substantial inventory accumulation to mild liquidation.

Economic indicators point toward a continued rise in final purchases of goods and services. Business plans to purchase plant and equipment somewhat above the first quarter rate. Housing activity appears to be near the end of the decline which began in 1955. Consumer spending continues to increase, stimulated by rising incomes and population growth. Increases in total government purchases of goods and services (Federal, State, and local) have accounted for a substantial part of the rise in total final purchases since mid-1956 and are expected to continue to do so during the remainder of 1957.

Prices of raw and intermediate products seem to have leveled out, at least temporarily. Prices of finished products, however, are expected to continue to rise.

The trend of total real output in coming months will depend largely on inventory movements. Recent changes appear to be selective adjustments of inventories to particular supply and price situations rather than a general response to disappointing sales. In the aggregate, present inventory-sales ratios are not excessive by historical standards. In view of rising trends in incomes, final purchases, and prices of finished goods, prolonged inventory liquidation seems unlikely. An upturn in real output would result as soon as such liquidation ends.

The economic situation at the end of 1957 and immediately beyond is less clear. This is usual so many months in advance, even though confidence in longer-run prospects is warranted. Temporary let-downs in demand for housing, for business plant and equipment, or for consumer durable goods are not precluded by favorable long-term expectations.

The Committee has repeatedly stated that monetary and fiscal policies should give due consideration to economic conditions and prospects. The hearings on Fiscal Policy Implications of the Economic Outlook and Budget Developments, scheduled by the Subcommittee on Fiscal Policy for June 3-7 and 13-14, will consider the application of this principle in current circumstances.

Total output and employment

(1) Gross national product, according to preliminary estimates, rose $3.3 billion from $423.8 billion in the fourth quarter 1956 to a first quarter 1957 annual rate of $427.1 billion. Rising prices account for almost half of this increase.

(2) While real output changed very little, total purchases of goods and services, exclusive of inventory, continued to expand in real terms in the first quarter as in preceding quarters. These divergent movements resulted from a shift from inventory accumulation at a seasonally adjusted annual rate of about $4.1 billion during the fourth quarter of 1956 to liquidation at an annual rate of $1.2 billion in the first quarter of 1957.

(3) The index of industrial production averaged 146 in the first quarter -- about the same as the preceding quarter. In April the index declined one point to 145.

(4) Changes in employment and unemployment have represented mainly seasonal movements since December. A small decrease in manufacturing employment has been offset by increases elsewhere. Unemployment (new definitions) in April was 2.7 million or 4 percent of the civilian labor force -- about the same as the same month of 1956. In March 1957 there were 19 major areas of substantial labor surplus -- the same as in March 1956.

(5) Total man-hours worked in manufacturing have tended to move down moderately in recent months (allowing for usual seasonal changes), as a result of declines in both hours of work and employment. Since output has been stable, output per man-hour probably has been increasing.

Business investment

The March Commerce-Securities and Exchange Commission survey of business expenditures on plant and equipment shows 1957 plans for outlays about 6.5 percent above those in 1956. About one-half of this rise may be attributable to higher prices. A plateau is indicated for the year, a little above the first quarter record rate of such purchases.

The survey reveals a greater diversity in plans for this year than was true a year ago when all industry groups were scheduling expanding programs. It also shows that large and medium-sized firms account for the anticipated rise in manufacturing investment in 1957, while small companies, in the aggregate, plan a reduction in outlays.

The Commerce-SEC survey is consistent with the 12 percent increase shown by the McGraw-Hill survey, published April 26. The different rates of increase shown by the two surveys result from McGraw-Hill's coverage of only large firms while Commerce-SEC covers small and medium-sized firms as well.

The latest survey of business capital appropriations by the National Industrial Conference Board appears in the May 27 issue of Newsweek. According to this survey, the second half capital expenditures will be slightly higher than the first half -- the same trend assumed on the basis of the other surveys.

Business plans to maintain a high level of capital expenditures during the next four years according to the recent McGraw-Hill survey. Manufacturing companies in this survey reported a 6 percent increase in manufacturing capacity in 1956. They plan another 6 percent increase in 1957 and a further 15 percent increase during the following three years. Manufacturing companies were reported to be operating at 86 percent of capacity at the end of 1956, somewhat below their preferred rate of 90 percent.

As expected, a decline in private residential (nonfarm) construction has been offset by rises in other private construction. Considering the increases in construction costs over the last year, total private construction outlays in real terms during the first four months of 1957 have been below a year ago. Housing starts (seasonally adjusted) rose slightly in April. Contract awards have been rising more than seasonally.

Sales, inventories, and new orders

(1) Total business sales have declined slightly from a peak reached in January (seasonally adjusted) but movements have been small, reflecting, in part, reduction in purchases for inventory.

(2) Inventories declined in the first quarter at an annual rate of $1.2 billion measured in average prices prevailing during the quarter compared to an accumulation of $4.1 billion, annual rate, in the fourth quarter of 1956. In terms of book values which reflect rising prices as well as volume changes, business inventories increased slightly during the quarter as manufacturing inventories rose and those of trade firms declined.

(3) New orders placed with manufacturers during March totaled $27.8 billion on a seasonally adjusted basis. This represented an increase of 3 percent over March 1956 but a decline of about 5 percent from November 1956. The recent decrease has centered in the durable

goods industries. Shipments have equalled or slightly exceeded the flow of new business in manufacturing recently so that backlogs of unfilled orders declined fractionally. At the end of March, however, backlogs of unfilled orders were still $4 billion above those of a year earlier. In the machinery industries backlogs are equal to 5 or 6 months' output at current rates. The decline in new orders reflects both inventory adjustments and a slowing rate of increase in investment in plant and equipment. In the aggregate, present inventory-sales ratios are not excessive by historic standards. In view of increases in incomes, in final purchases, and in prices of finished goods, therefore, prolonged inventory liquidation seems unlikely.

Incomes

Personal income reached $336.5 billion (seasonally adjusted annual rate) in the first quarter, an increase of about 1 percent over the fourth quarter of 1956 and almost 6 percent above the first quarter of last year. In April, personal income rose to $339.3 billion, or almost 1 percent above the first quarter average. After taxes, disposable personal income was $295.4 billion in the first quarter compared to $280.2 billion in the same quarter a year ago. After adjusting for price change, total real disposable personal income was about 2 percent higher than in the first quarter of 1956 but per capita real disposable personal income was about the same in the first quarter as during 1956.

(1) Increases in total wages and salaries in current dollars reflect sustained high levels of employment and a rise in wage rates sufficient to offset shorter hours of work. Average hourly earnings have increased 5 percent over the past year. The work-week declined almost one-half hour.

The purchasing power of spendable weekly earnings of the average factory worker (weekly earnings after deduction of Federal income and social security taxes, adjusted for price changes), however, did not gain over the past year for the first time since mid-1954. Income taxes took a slightly larger share of wages. Consumer prices rose 3.7 percent. The rate of social security deductions increased.

(2) According to BLS data, about 1,400,000 workers will soon receive escalation wage increases as a result of recent rises in consumer prices. At least 5 million workers will receive wage increases some time during 1957 on the basis of contracts concluded in 1955 and 1956.

(3) According to preliminary estimates, first quarter corporate profits, after adjustment for usual seasonal changes, were about the same as in the fourth quarter of 1956, and about 6 to 7 percent above

the first quarter of last year. For the year 1957, profits before taxes are likely to average at least as high as the first quarter level.

(4) Farmers' realized net income is estimated at a seasonally adjusted annual rate of about $12 billion in the first quarter compared to $11.6 billion a year earlier. According to the Agricultural Marketing Service of the Department of Agriculture, a further increase in farm operators' realized net income in 1957 seems likely, perhaps as much as the 4 percent increase that occurred in 1956.

Consumption

(1) Personal consumption expenditures, under the stimulus of higher incomes and population growth, advanced $4.1 billion to a new record rate of $275 billion in the first quarter, rising slightly faster than disposable income. The rate of personal savings declined to 6.9 percent of disposable income in the first quarter of 1957, although it was at a rate slightly higher than the same quarter of 1956. From the fourth quarter to the first quarter, durable goods purchases rose about $1.1 billion, nondurable goods $1.7 billion, and services $1.3 billion.

(2) Preliminary findings of the Twelfth Annual Survey of Consumer Finances confirm earlier indications that consumers, with financial positions improved during 1956, continue to be optimistic about the future.

International

Net foreign investment increased during the first quarter to a seasonally adjusted annual rate of $4 billion. The average for 1956 was $1.4 billion. The high first quarter rate reflects effects of the Suez crisis; succeeding quarters may be expected to show more modest figures.

There are further indications of renewed economic expansion in Western Europe during the first quarter of 1957. Output advanced in these months in such countries as Germany, France, Sweden, and The Netherlands, and remained unchanged in Great Britain.

Prices

Consumer prices have continued to rise. March was about 2.3 percent above the average of 1956 and 3.7 percent above March 1956.

The rise in the wholesale price index has slowed. Prices of raw materials have declined slightly, prices of intermediate products have been stable, and prices of finished consumer and producer products continue to rise.

Construction costs have also continued to rise, though a little more slowly than the 5 percent annual rate prevailing during most of 1956. Recently, transportation rates were increased. There is widespread discussion of a steel price hike by mid-year.

State and local government expenditures

State and local governments purchased goods and services in the first quarter at an annual rate of $35 billion, an increase of $1.3 billion over the rate in the fourth quarter of 1956 and $2.9 billion over the first quarter a year ago. The current rate is above earlier expectations.

Federal fiscal developments

Reports through April suggest that the administrative budget will show a surplus of about $1 billion for this fiscal year, ending June 30, 1957. For fiscal 1958, the administrative budget surplus seems likely to fall within the range of $1-2 billion. Estimates by the Staff of the Joint Committee on Internal Revenue Taxation do not differ materially from these.

(1) Receipts are running slightly ahead of the estimates for fiscal 1957 in the President's January 1957 budget. On the basis of present economic trends, receipts may exceed the January estimates for fiscal 1958 by about a billion dollars.

(2) Budget expenditures for the fiscal years 1957 and 1958 may exceed the January estimates by $1 to $1.5 billion in each year. This reflects higher prices than assumed in the January budget estimates. Government purchases are largely concentrated among goods and services for which private demand has been and continues to be heavy.

(3) The long lead-times between appropriations and expenditures suggest that reductions in appropriations now probably would not reduce expenditures significantly before fiscal 1959. Total new and old (unspent from previous years) obligational authority available for expenditure in fiscal 1958 was estimated at $143.3 billion in the January budget. Of this total, it was anticipated that nearly half, or $70 billion, would be unspent balances carried forward from 1957 and prior fiscal years.

Monetary developments

(1) Apart from meeting week-to-week and seasonal needs, the Federal Reserve System, acting on its own initiative through the Open Market operations, has supplied no additional reserves to the banking system

during the past year or, indeed, for the past two years. Government security holdings of the Reserve System at $23,169 million on May 1, 1957 were, for all analytical purposes, unchanged from a year ago. They averaged about $400 million less during April 1957 than in April 1955.

(2) While, in contrast to the preceding year, member bank borrowings for reserves tended to decline somewhat during late 1956, by April 1957 member banks as a group continued to be net borrowers at roughly the same rate as a year ago. What for several months gave an appearance of a growing trend to return to a position of balance or modest excess reserves seems to have been reversed in January 1957 with an increased willingness to borrow for reserves and a return to a deficiency reserve position level of some $300-600 million.

(3) On the other hand, loans adjusted at weekly reporting member banks in leading cities declined about $700 million in the first four months of this year compared to an increase of almost twice that amount in the corresponding period last year.

(4) It is yet too early to tell whether the lessened demand for business loans this spring is a precursor to generally easier credit and a softening of interest rates. The tight bank reserve position inherited from an expansion of 33-1/2 percent in bank loans in the two years 1955-56 tends to prevent any immediate easing of interest rates. Under present policies, whether there is to be any relaxation in the terms and price of money in the months ahead will depend upon the trend in the demands of business for inventory and capital expenditures and the demand for home building funds.

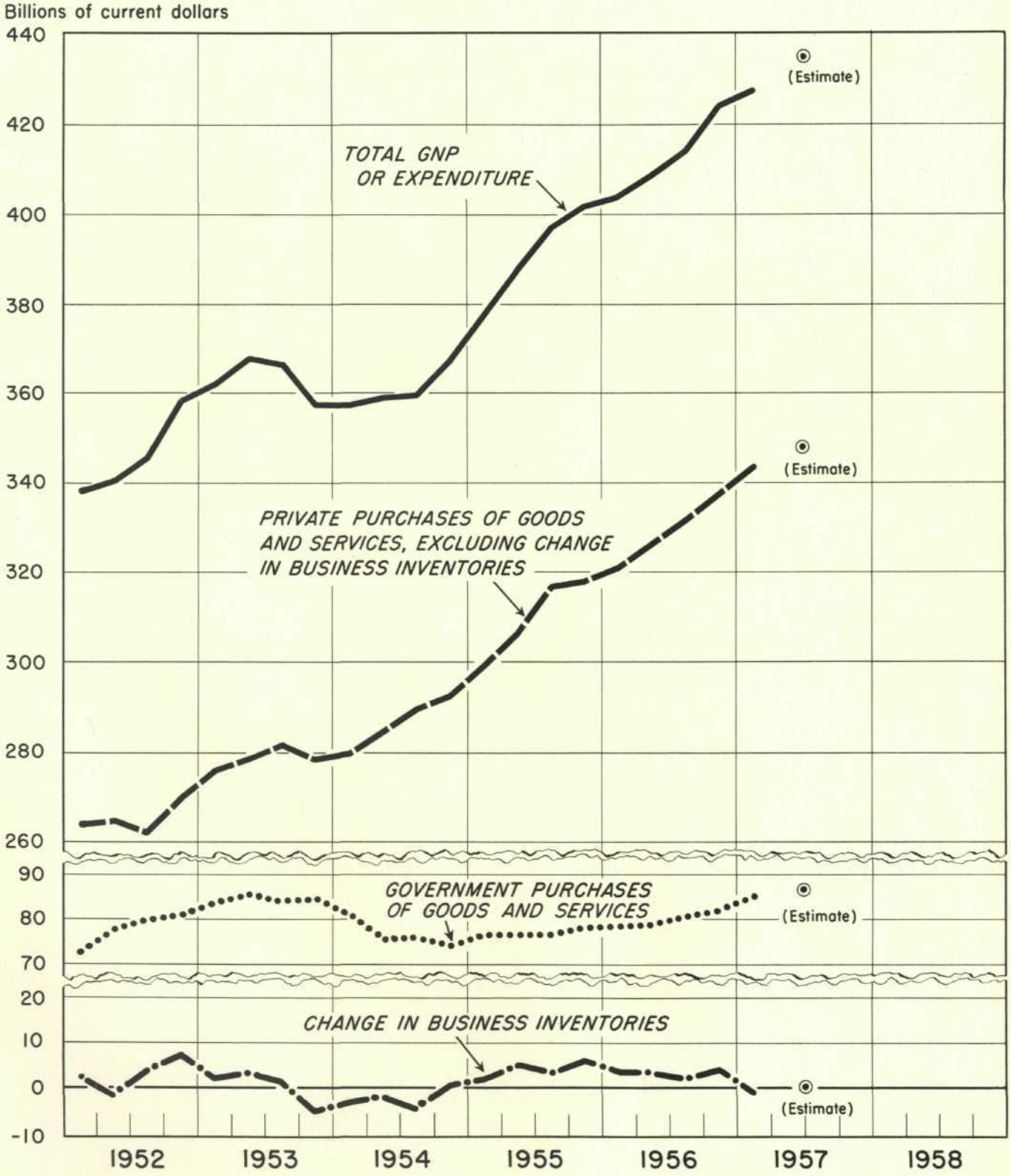
(5) With the recurrent need to raise new money to meet expenditures, to cover attrition on refunding issues, and the redemption of E, F, and G bonds, the Treasury Department has thus far found little respite from the tight money pressures. Some modest softening has developed in the Treasury bill rate. In the recent refunding, carrying a May 1 date, however, the Treasury offered a certificate with a rate of 3-1/2 percent. This is the highest rate paid by the Treasury on such paper since 1933. Similarly, the 3-5/8 percent rate on a 4-3/4 year note in the same offer is the highest rate offered by the Treasury since 1923 for a note carrying a term of 4 to 5 years.

(6) While maturities in August total $15.8 billion and those in October $8.1 billion, $15 billion of these are held by the Federal Reserve and government accounts. In addition to maturing weekly bills, the Treasury will thus have the problem of refunding about $9 billion of publicly held debt and the raising of perhaps an additional $5-6 billion of seasonal new money before the end of the year.

Chart I

GROSS NATIONAL PRODUCT OR EXPENDITURE

QUARTERLY 1952-'57

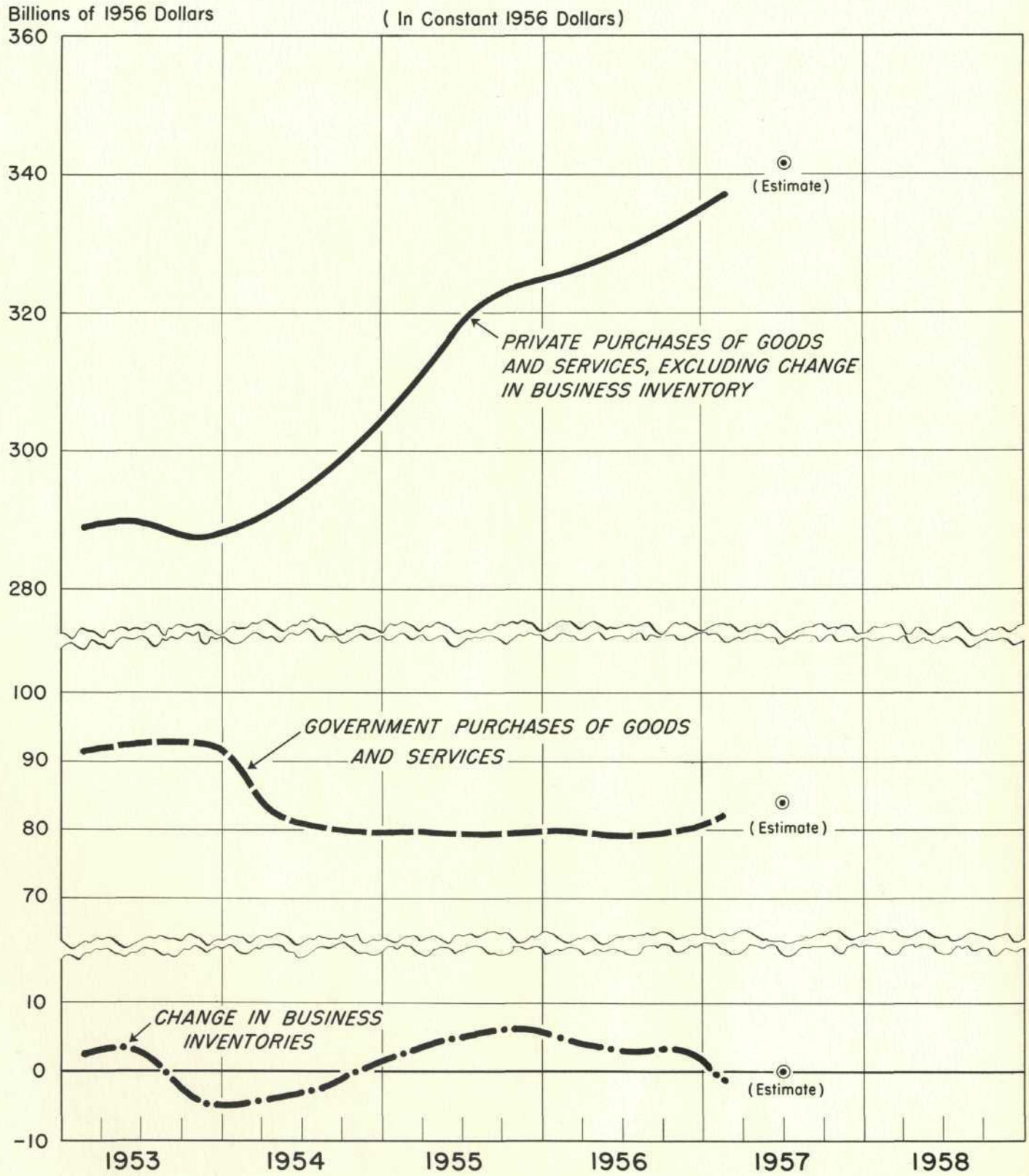


Source: Department of Commerce, Office of Business Economics.
1957 Estimate Staff, Joint Economic Committee.

Chart II

GROSS NATIONAL PRODUCT OR EXPENDITURE

QUARTERLY 1953-'57



Source: Staff, Joint Economic Committee.

Table 1.--Gross National Product or Expenditures, quarterly, 1952-57
(Billions of current dollars)

Period	Purchases of GNP			Change in business inventories	Purchases of GNP excluding change in business inventories	
	Total	Government	Private		Total	Private
1952:						
1st quarter	338.4	72.2	266.2	2.7	335.7	263.5
2d quarter	340.1	77.4	262.7	-1.9	342.0	264.6
3d quarter	345.2	79.8	265.4	3.7	341.5	261.7
4th quarter	358.1	80.5	277.6	7.4	350.7	270.2
1953:						
1st quarter	361.6	83.6	278.0	2.0	359.6	276.0
2d quarter	367.4	85.5	281.9	3.1	364.3	278.8
3d quarter	366.3	83.8	282.5	1.1	365.2	281.4
4th quarter	357.5	84.5	273.0	-5.2	362.7	278.2
1954:						
1st quarter	357.6	80.8	276.8	-3.1	360.7	279.9
2d quarter	358.5	75.5	283.0	-1.7	360.2	284.7
3d quarter	359.4	75.6	283.8	-4.5	363.9	289.3
4th quarter	367.1	74.2	292.9	.2	366.9	292.7
1955:						
1st quarter	377.3	76.3	301.0	1.9	375.4	299.1
2d quarter	387.4	76.2	311.2	4.9	382.5	306.3
3d quarter	396.8	76.5	320.3	3.7	393.1	316.6
4th quarter	401.9	78.1	323.8	6.1	395.8	317.7
1956:						
1st quarter	403.4	78.5	324.9	4.1	399.3	320.8
2d quarter	408.3	78.7	329.6	3.5	404.8	326.1
3d quarter	413.8	80.2	333.6	2.0	411.8	331.6
4th quarter	423.8	82.0	341.8	4.1	419.7	337.7
1957:						
1st quarter	427.1	84.9	342.2	-1.2	428.3	343.4
1957:						
Cal.Yr.*	435.0	87.0	348.0	0	435.0	348.0

* Estimate, Staff, Joint Economic Committee.

Source: Department of Commerce, Office of Business Economics, except as noted.

ESTIMATES OF FEDERAL RECEIPTS FOR FISCAL YEARS 1957 AND 1958

PREPARED BY THE

STAFF OF THE JOINT COMMITTEE ON INTERNAL REVENUE TAXATION

MAY 21, 1957

UNITED STATES
GOVERNMENT PRINTING OFFICE
92190 WASHINGTON : 1957

CONGRESS OF THE UNITED STATES

JOINT COMMITTEE ON INTERNAL REVENUE TAXATION

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ESTIMATES OF FEDERAL RECEIPTS FOR THE FISCAL YEARS 1957 AND 1958

TABLE 1.—*Receipts, expenditures, and surplus of the Federal Government, actual for fiscal 1956, estimates for fiscal years 1957 and 1958*

[In billions of dollars]

	Actual, 1956	Estimated, 1957		Estimated, 1958	
		January budget estimates	May staff estimates	January budget estimates	May staff estimates
Receipts	68.2	70.6	70.7	73.6	74.3
Expenditures	66.5	68.9	69.5	71.8	73.0
Surplus	1.6	1.7	1.2	1.8	1.3

The staff of the Joint Committee on Internal Revenue Taxation estimates that the surplus for the fiscal years 1957 and 1958 will be approximately $1.2 billion and $1.3 billion, respectively. This is shown in table 1, which also compares the staff estimates with the January budget estimates.

1. Budget receipts.—Based upon currently available information, the staff estimates that Federal net budget receipts will amount to $70.7 billion in the fiscal year 1957 and $74.3 billion in the fiscal year 1958. The receipt estimate for the fiscal year 1957 is about $100 million above that presented in the budget this last January, while the receipt estimate for the fiscal year 1958 is about $700 million above that appearing in the January budget document. The staff estimates are based upon the assumptions regarding personal income and corporate profits described later. The receipt estimates in table 1, since they are net budget estimates, do not include receipts earmarked for the highway trust fund, the Federal OASI trust fund, or the various other trust funds. However, information presented below shows receipt estimates without reduction for the amounts earmarked for the trust funds.

2. Budget expenditures.—In the budget presented last January, it was estimated that Federal net budget expenditures in the fiscal year 1957 would amount to $68.9 billion. The staff does not attempt to make any detailed analysis of budget expenditures but experience to date makes it appear that expenditures for the fiscal year 1957 may be something like a half a billion above this estimate of last January. The increase reflects the fact that it now appears that military expenditures for the fiscal year 1957 may be considerably above the January estimates and that, although these may in part be offset by decreases in other categories, the net result is still likely to represent an increase. As a result, the staff has concluded that $69.5 billion now appears to be a more reasonable estimate of net budget expenditures for the fiscal year 1957.

The January budget expenditure estimate for the fiscal year 1958 is $71.8 billion. The staff believes that actual budget expenditures in

the fiscal year 1958 are more likely to be in the neighborhood of $73 billion, or approximately $1 billion above the January budget figure. The staff has reached this conclusion primarily on the grounds that there already have been, and are likely to continue to be, significant price rises which will necessitate increases in approved expenditure programs. It is believed that these price rises which have already occurred, or can be expected in the future, will be of special significance in raising the military expenditure totals. It is believed that the expenditure totals would be still higher if it were not for the substantial appropriation cuts being made by Congress. While these cuts are expected to reduce expenditure totals for the fiscal year 1958 below the levels which would otherwise prevail, it is believed that the reductions currently being made in appropriations by Congress will have their greatest impact on expenditure levels in the fiscal year 1959 and later years.

3. Assumptions as to income levels.—In estimating receipts for the fiscal years 1957 and 1958, the staff has assumed a personal income level for the calendar year 1957 of $342 billion and for the first 6 months of the calendar year 1958, a personal income level of $350 billion.[1] The personal income level for the first quarter of 1957, according to data available at the present time, averages about $336.5 billion, and the most recent monthly figure, that for April, indicates a personal income level of $339.3 billion. Thus, the $342 billion personal income level assumed by the staff for the calendar year 1957 and the $350 billion personal income level assumed for the first 6 months of the calendar year 1958, represents an assumption that personal income levels will continue to rise but represents a conservative estimate of the increase likely to occur.

For the calendar year 1957, the staff assumed that corporate profits before taxes will amount to $44.5 billion.[2] The published corporate profits figure for the calendar year 1956 is $43.7 billion. Thus, the staff estimate of $44.5 billion for the calendar year 1957 is nearly $1 billion above the 1956 level. Corporate income tax collection experience to date suggests that the 1956 profits figure now available may be somewhat overstated. This figure is based on a limited sample and has been subject to significant revision in the past. The level assumed by the staff for the calendar year 1957 may eventually prove to be somewhat more than a billion dollars above the actual level for 1956.

It should be made clear that any downward trend of personal income and corporate profits, or any sharp increase, would necessitate a revision of the revenue estimates presented in this pamphlet.

4. Details of receipt estimates.—Table 2, which follows, shows by major sources the actual 1956 and the estimated 1957 and 1958 fiscal year receipts. This table also indicates by major receipt sources the difference between the January budget estimates and the staff estimates. It also shows receipts before and after reduction for amounts earmarked for various trust funds and amounts payable as refunds. The staff estimates of excise and corporate income tax collections take

[1] The Treasury Department has announced (in a release on the press conference of January 15, 1957) that the January budget estimates were based on a personal income level of $340 billion for the calendar year 1957.

[2] The Treasury Department has announced (in a release on the press conference of January 15, 1957) that the January budget estimates were based on a corporate profit level of $44 billion for the calendar year 1957.

into account the fact that the Tax Rate Extension Act of 1957 extended the existing corporate income tax rates and also the existing rates of certain excise taxes to July 1, 1958. The estimates appearing in the January budget assumed that these rates would be extended, as recommended in the budget message, to April 1, 1958. These rate continuations for an additional 3 months account for about $200 million of the excess of the staff excise tax estimates for the fiscal year 1958 over those in the budget for that year.

TABLE 2.—*Receipts of the Federal Government, actual for fiscal 1956, estimates for the fiscal years 1957 and 1958*

[In billions of dollars]

	Actual, 1956	Estimated, 1957			Estimated, 1958		
		January budget estimates	Staff estimates	Difference	January budget estimates	Staff estimates	Difference
Individual income taxes	35.3	38.5	38.8	+0.3	41.0	41.5	+0.5
Corporation income taxes	21.3	21.4	21.4	----------	22.0	21.9	−.1
Excise taxes	10.0	10.7	10.7	----------	11.1	11.5	+.5
Estate and gift taxes	1.2	1.4	1.4	----------	1.5	1.5	----------
Employment taxes	7.3	7.8	7.8	+.1	8.4	8.4	----------
Customs	.7	.8	.8	----------	.8	.8	----------
Miscellaneous receipts	3.0	3.0	2.8	−.2	3.3	3.2	−.1
Total	78.8	83.5	83.7	+.2	88.0	88.8	+.8
Deduct:							
Transfers to Federal old-age and survivors insurance and disability trust funds	6.3	6.8	6.9	+.1	7.4	7.4	----------
Transfer to railroad retirement account	.6	.7	.7	----------	.7	.7	----------
Transfer to highway trust fund	----------	1.5	1.6	+.1	2.2	2.3	+.1
Refunds of receipts	3.7	3.9	3.9	----------	4.2	4.2	----------
Net budget receipts	68.2	70.6	70.7	+.1	73.6	74.3	+.7

NOTE.—Detail may not add to total because of rounding.

CONGRESS OF THE UNITED STATES

JOINT ECONOMIC COMMITTEE

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MEMORANDUM

May 24, 1957

To: Witnesses participating in Fiscal Policy Subcommittee hearings, June 1957.

From: Norman B. Ture, Economist

Attached is a memorandum, "The Economic Situation and Outlook," prepared by the staff of the Joint Economic Committee and released on May 23. The memorandum has been examined in close detail by the Committee.

The subject matter of this memorandum has an obvious bearing on the forthcoming hearings on Fiscal Policy Implications on the Economic Outlook and Budget Developments, by the Subcommittee on Fiscal Policy, in which you are participating. You may, therefore, find this material useful in your preparation for the hearings.

NBT:EW

Enclosures

Lehman - 1609

FOR RELEASE: Friday, a.m.
May 31, 1957

CONGRESS OF THE UNITED STATES
JOINT ECONOMIC COMMITTEE

Subcommittee on Fiscal Policy
Hearings on
Fiscal Policy Implications of the
Economic Outlook and Budget Developments

Representative Wilbur D. Mills (D., Ark.), Chairman of the Subcommittee on Fiscal Policy of the Joint Economic Committee, today issued the completed list of witnesses invited to participate in the Subcommittee's hearings, June 3-7 and 13-14, on Fiscal Policy Implications of the Economic Outlook and Budget Developments. The hearings are open to the public.

Chairman Mills stated that the hearings have taken on new significance in light of recent estimates of Federal budget results for the fiscal years 1957 and 1958. These estimates, prepared by the staffs of the Joint Economic Committee and of the Joint Committee on Internal Revenue Taxation, point to smaller budget surpluses than presented in the President's January budget message. A major factor in the revision is the rising price of many goods and services purchased by the Federal Government.

In view of these prospects, Chairman Mills stated, there is a greater need than ever before for a careful appraisal of the fiscal policy implications, particularly prospects for tax changes, in the current economic and budget outlook. The Subcommittee's hearings will,

therefore, focus on: (1) the current economic situation and prospects for the remainder of 1957; (2) the effect of current Congressional and Administration efforts to reduce spending on the prospective budget surplus in fiscal 1958 and on levels of economic activity in 1957-58; (3) types of fiscal action consistent with economic stability and growth if spending reductions are achieved; and (4) the timing of fiscal action in relation to budgetary and economic developments.

In announcing the hearings, Chairman Mills emphasized that the Subcommittee's inquiry is directed toward the broad outlines of fiscal action appropriate to current and foreseeable economic and budgetary conditions rather than toward specific legislative proposals. The Joint Economic Committee, under the Employment Act of 1946, has a continuing responsibility to follow economic developments and to advise the Congress on the adjustments in public policies which may be needed for steady economic growth. The Fiscal Policy Subcommittee in its current inquiry will apply the fiscal policy principles recommended in the Subcommittee's 1955 study of Federal Tax Policy for Economic Growth and Stability and in other studies by the Joint Economic Committee.

Non-Government experts have been invited by the Subcommittee to participate in a series of panel discussions on June 3-6, and economic interest and research groups on June 7. Government officials have been asked to express their views on June 13-14.

The schedule of the hearings and of witnesses invited to appear is attached. All members of the Joint Economic Committee are invited to participate.

Members of the Subcommittee on Fiscal Policy are:

Representative Wilbur D. Mills, Chairman
Senator Paul H. Douglas
Senator Joseph C. O'Mahoney
Senator Barry Goldwater
Representative Thomas B. Curtis

CONGRESS OF THE UNITED STATES
JOINT ECONOMIC COMMITTEE

SUBCOMMITTEE ON FISCAL POLICY

Schedule of Hearings on
Fiscal Policy Implications of the
Economic Outlook and Budget Developments

- -

Monday, June 3, 1957, 10:00 a.m.

Senate Interstate and Foreign Commerce Committee Room
G16, Senate Wing, U. S. Capitol

The economic outlook.

Panel will review recent developments and suggest prospects for 1957-58 with respect to: plant and equipment outlays; housing; inventories; consumer spending; Federal, State and local government expenditures; the money markets; major price movements; employment, production, and productivity. What would be the impact of substantial reductions in Federal appropriations and spending for fiscal 1958 on the level of economic activity during 1957-58?

MR. ROBERT ULIN, Economics Division
McGraw-Hill Publishing Co.

MR. WILLIAM M. TONGUE, Economist
Jewel Tea Co., Inc.

PROFESSOR IRWIN FRIEND, Wharton School
University of Pennsylvania

MR. ROBINSON NEWCOMB
Washington, D. C.

MR. PETER HENLE, Assistant Director of Research
American Federation of Labor-Congress
of Industrial Organizations

MR. WALTER E. HOADLEY, Treasurer
Armstrong Cork Co.

Tuesday, June 4, 1957, 10:00 a.m.

Senate Interstate and Foreign Commerce Committee Room
G16, Senate Wing, U. S. Capitol

Fiscal policy implications
of reductions in appropriations for fiscal 1958.

How will the appropriation reductions proposed to date affect actual Federal spending in fiscal 1958 and subsequent years? In the light of current economic prospects, how would such reductions affect the prospective budget surplus for fiscal 1958? What concept of the public debt is appropriate for assuring that debt management will be consistent with economic stability and growth? What combination of debt reduction, tax reduction, easing monetary restraints, or increase in the Treasury cash balance, would be called for in the interest of economic growth and stability? What considerations should determine the timing of such action?

DR. GERHARD COLM, Chief Economist
National Planning Association

PROFESSOR JAMES TOBIN, Department of Economics
Yale University

PROFESSOR ALBERT G. HART, Department of Economics
Columbia University

MR. EDWIN B. GEORGE, Director, Department of Economics
Dun & Bradstreet

MR. WILLIAM BUTLER, Vice President
Chase Manhattan Bank

DR. JOHN D. CLARK

Wednesday, June 5, 1957, 10:00 a.m.

(Room to be announced.)

Fiscal action to promote stability and growth in the light of prospective budgetary and economic conditions.

What should be the relative emphasis of fiscal action, in response to expenditure reduction, as between expansion of consumption or investment for continued growth in private sectors of the economy? What type of Federal fiscal action would be appropriate for easing barriers to expansion by State and local governments of services in response to demands of a growing population?

PROFESSOR WALTER W. HELLER, School of Busines
University of Minnesota

PROFESSOR WILLIAM J. FELLNER, Department of Economics
Yale University

PROFESSOR PAUL A SAMUELSON, Department of Economics
Massachusetts Institute of Technology

MR. JOHN K. LANGUM, President
Business Economics, Inc.
Chicago, Illinois

MR. WILLIAM C. FLAHERTY, Director of Business Research
Chrysler Corporation

Thursday, June 6, 1957, 10:00 a.m.

Senate Interior Committee Room
224, Senate Office Building

Tax changes for steady economic growth.

Should revenue reduction appear desirable in the interests of continuing economic growth, what types of tax changes would enhance the automatic stabilizing capacity of the Federal revenue system? Reduce tax-induced distortions in resource allocation? Improve the competitive climate for new and small businesses, both corporate and non-corporate?

MR. GEORGE TERBORGH, Research Director
Machinery and Allied Products Institute

MR. HARRY J. RUDICK, Attorney
Lord, Day and Lord

PROFESSOR RICHARD A. MUSGRAVE, Department of Economics
University of Michigan

MR. JOHN F. COSTELLOE, Tax Director
Radio Corporation of America

PROFESSOR LAWRENCE H. SELTZER
Department of Economics
Wayne State University

MR. E. G. COLLADO, Treasurer
Standard Oil Company (N. J.)

MR. STANLEY RUTTENBERG, Director of Research
American Federation of Labor-Congress
of Industrial Organizations

Friday, June 7, 1957, 10:00 a.m.

Senate Interior Committee Room
224, Senate Office Building

Views and recommendations
of economic interest and research groups.

The following groups have been invited:

COMMITTEE FOR ECONOMIC DEVELOPMENT
Frazar B. Wilde, Chairman
Research and Policy Committee

UNITED STATES CHAMBER OF COMMERCE
Walter D. Fackler, Assistant Director
Department of Economic Research

NATIONAL ASSOCIATION OF MANUFACTURERS
Ralph Robey, Economic Adviser

AMERICAN FEDERATION OF LABOR-CONGRESS
OF INDUSTRIAL ORGANIZATIONS
Nathaniel Goldfinger, Economist
Research Department

NATIONAL GRANGE
Roy Battles, Assistant to the Master

AMERICAN FARM BUREAU FEDERATION
W. E. Hamilton, Director of Research

NATIONAL FARMERS UNION
John A. Baker, Coordinator of
Legislative Services

INDEPENDENT AND SMALL BUSINESS COORDINATION COMMITTEE, INC.
Miles Pennybacker, President
Voltarc Tubes, Inc.

NATIONAL FEDERATION OF INDEPENDENT BUSINESS, INC.
George J. Burger, Vice President

Thursday, June 13, 1957, 2:00 p.m.
House Caucus Room
362, Old House Office Building

The following Government officials have been invited:

MR. PERCIVAL F. BRUNDAGE, Director
Bureau of the Budget

Friday, June 14, 1957

House Caucus Room
362, Old House Office Building

10:00 a.m. MR. GEORGE M. HUMPHREY
Secretary of the Treasury

2:00 p.m. MR. WILLIAM McC. MARTIN, Jr., Chairman
Board of Governors, Federal Reserve System

Date: June 1[illegible] 1957

TO: Mr. Martin

Here is copy of Secretary's statement to be delivered this morning.

FROM: W. RANDOLPH BURGESS

Room 3326 Ext. 2352

TREASURY DEPARTMENT
Washington

Statement by Secretary Humphrey before the Subcommittee on Fiscal Policy of the Joint Economic Committee, 10:00 A.M. EDT, Friday, June 14, 1957.

Chairman Mills and members of the Subcommittee on Fiscal Policy of the Joint Economic Committee: I appreciate this opportunity to appear before you on the subject of current budgetary and fiscal policy developments, a subject on which you have already heard from numerous witnesses.

Before responding to questions I want to repeat my conviction that although present tax rates are too high and the present heavy tax burden will, in the long-run, seriously hamper necessary economic growth, no general tax reduction should be considered at the present time. The most effective tax cut that can be made to promote healthy economic development is a reduction which will bring benefit to all taxpayers -- when our fiscal situation permits. By this, I mean when we can see ahead a sufficient surplus of income over outgo to pay for such a tax reduction. We should and will keep working vigorously for the day in the not too distant future when we can see such a surplus. Such a surplus does not exist at the present time.

In this connection we must keep a close watch of our budget position and make certain that government spending is conducted as efficiently as is humanly possible. There is nothing new in this goal. We must continue to follow the principles that have guided this Administration for the past four years. We must make every effort to live within our means and to get a dollar's worth for every dollar that we spend.

In watching our budget we must constantly guard against ill-considered, or dangerous, or so-called meat-axe slashing of the budget.

As the President said in his April 18 letter to the Speaker of the House of Representatives, actual spending in the coming fiscal year cannot be cut by multi-billion dollar amounts without danger to the national safety or interest or the modification of some of the existing programs herefore authorized by the Congress. It is not the size of any particular budget which is our paramount concern. It is control of the upward march of total government spending which is of greatest importance to all of us on a long-run basis.

H-1382

The biggest budget problem, as I see it, is one of seeking out long-term savings. The problem of how much and for what we should spend in the fiscal year 1959 -- which will not end until two years from now -- is already upon us. What we must continue to do vigilantly is to keep up not only the everlasting search for possible reductions but the drive to make them real. We must do this while being ever mindful of our position of leadership in the world and the obligations which we must necessarily bear in that regard to protect our national security.

We must balance the necessary costs of our national responsibilities with the equally necessary maintenance of a strong and vigorous economy.

The Administration's fiscal record is a good one. The budget in effect when we took office in 1953 produced a $9.4 billion deficit, and the budget proposed by the prior administration for fiscal year 1954 called for a $9.9 billion deficit. Our Administration, with the help of the Congress, cut spending, reducing the projected deficit for 1954 by two-thirds, or to a final minus figure of $3.1 billion.

But for the largest tax cut in history (a $7.4 billion cut in 1954) the budget would have been balanced in 1955. A balanced budget was delayed for one year because it was then apparent that the savings we then had in prospect would be sufficient before the end of the next year not only to cover the amount of the tax cut but to give us a balanced budget at the same time.

By fiscal 1956 we had eliminated deficits and had a balanced budget with a surplus of $1.6 billion. We will have a surplus in the fiscal year ending this month and the budget proposed for fiscal 1958 also is balanced. This means that we have in prospect a balanced budget for three consecutive years for the first time in more than 25 years.

Federal spending was reduced from the rate of $74.3 billion in the inherited budget of 1953 to $67.8 billion in 1954 and $64.6 billion in 1955. Spending moved up to $66.5 billion in 1956, to an estimated $68.9 billion in the January budget for the present fiscal year, and to a proposed $71.8 billion for 1958. Even with the recent increases the budget for the current fiscal year is $5.4 billion below the budget we inherited in 1953 and is 16% of our gross national product as compared with 21% taken by federal spending in 1953.

If we are successful in properly controlling the size and spending of government, we can look forward to a continuing period of high prosperity for our country. A major ingredient in this high prosperity is the confidence of the American people -- confidence in themselves, in each other and, of fundamental importance, confidence in their government.

The greatest hope for major reductions in government spending lies in a better world situation. Some day the nations of the world must arrive at some better and insured form of understanding which will make it possible to reduce the large amounts of money and energy and resources now going into making things for killing. I confidently believe that such a better day will come.

The relationship between monetary and credit restraint and our present high prosperity is worthy of brief comment.

One thing that can destroy not only our present prosperity but even jeopardize our way of life is runaway inflation.

The record of this Administration in helping control inflation has been good. The value of the dollar, which dropped from 100 to 52¢ between 1939 and January 1953, has changed only 2-1/2¢ in the past four and one-half years, compared with a total drop of almost 48¢ in the thirteen years prior to this Administration.

The credit policy of the Federal Reserve System is an important factor in sustaining the purchasing power of the dollar in this time of very high use of and demand for both labor and materials. The alternative of easy money would mean that there would be more dollars bidding for the available supply of labor and materials. This could only result in sharp increases in the cost of goods. The dollar would buy less.

Mounting increases in the cost of living would bring cruel hardship to millions of our citizens least able to protect themselves. There would be less saving which is the source of investment in plants and equipment which make the ever-increasing jobs that we must have for our growing population. Without increased savings -- without the confidence that money saved would retain its value -- we would have fewer of these new jobs. Over a period of time, growing unemployment would result.

It is essential that the inflationary pressures arising from the high prosperity that we have enjoyed for the past many months be controlled to the greatest possible extent. Restraints on credit involving some increases in the cost of money and the maintenance of taxes at the present levels, at least until such time as we have a substantial excess of income over expenditures, are important factors which will assist in restraining a substantial increase in the cost of living.

Thank you for the opportunity to present these observations to your Committee.

TREASURY DEPARTMENT

TO: Dear Bill

This may be of interest.

NAL

Nils A. Lennartson
Assistant to the Secretary
Room 3420

TREASURY DEPARTMENT
Washington

Statement by Secretary Humphrey before the Subcommittee on Fiscal Policy of the Joint Economic Committee, 10:00 A.M. EDT, Friday, June 14, 1957.

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Before responding to questions I want to repeat my conviction that although present tax rates are too high and the present heavy tax burden will, in the long-run, seriously hamper necessary economic growth, no general tax reduction should be considered at the present time. The most effective tax cut that can be made to promote healthy economic development is a reduction which will bring benefit to all taxpayers -- when our fiscal situation permits. By this, I mean when we can see ahead a sufficient surplus of income over outgo to pay for such a tax reduction. We should and will keep working vigorously for the day in the not too distant future when we can see such a surplus. Such a surplus does not exist at the present time.

In this connection we must keep a close watch of our budget position and make certain that government spending is conducted as efficiently as is humanly possible. There is nothing new in this goal. We must continue to follow the principles that have guided this Administration for the past four years. We must make every effort to live within our means and to get a dollar's worth for every dollar that we spend.

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The Administration's fiscal record is a good one. The budget in effect when we took office in 1953 produced a $9.4 billion deficit, and the budget proposed by the prior administration for fiscal year 1954 called for a $9.9 billion deficit. Our Administration, with the help of the Congress, cut spending, reducing the projected deficit for 1954 by two-thirds, or to a final minus figure of $3.1 billion.

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Mounting increases in the cost of living would bring cruel hardship to millions of our citizens least able to protect themselves. There would be less saving which is the source of investment in plants and equipment which make the ever-increasing jobs that we must have for our growing population. Without increased savings -- without the confidence that money saved would retain its value -- we would have fewer of these new jobs. Over a period of time, growing unemployment would result.

It is essential that the inflationary pressures arising from the high prosperity that we have enjoyed for the past many months be controlled to the greatest possible extent. Restraints on credit involving some increases in the cost of money and the maintenance of taxes at the present levels, at least until such time as we have a substantial excess of income over expenditures, are important factors which will assist in restraining a substantial increase in the cost of living.

Thank you for the opportunity to present these observations to your Committee.

For release on delivery

Statement of

William McChesney Martin, Jr.,

Chairman, Board of Governors of the Federal Reserve System

before the

Subcommittee on Fiscal Policy
of the
Joint Economic Committee

June 14, 1957

Mr. Chairman:

This Committee and the Board of Governors share a common concern: that the operations of both monetary and fiscal policy be directed--in the words of a report issued by your Committee in January 1956--to "maintaining a steady and sustainable rate of economic progress."

On behalf of the Board of Governors, I should like to outline some measures which we believe would contribute to the achievement of this common objective.

Events have moved swiftly since passage of the Employment Act of 1946. Congressional debate and expert opinion preceding passage of that Act were in close agreement in pointing to unemployment of men and machines as the primary threat to the national economy. The history of the period since the war, both in this country and abroad, however, has demonstrated that the primary danger was not one of idle men but was one of too much money.

Almost everywhere in the world, pressure on resources has been intense. The necessity of preventing competing claims for scarce resources from resulting in general price increases has been a major problem. Defense needs have been a major claimant. Other demands on resources have been bolstered by pressing individual and community needs, on the one hand, and by large financial assets, strong liquidity positions, and rapidly rising current incomes on the other. Even so, the opportunities for vigorous growth and accelerated technological progress resulting in sharply rising standards of living and increased security, especially for those in the lower and middle income groups, have been very great. Even

greater opportunities lie ahead, ready to be realized if the threat of international conflict can be reduced and the insidious inroads of inflation curbed.

Inflation is never harmless, even in its mild or "creeping" form. Neither is it inevitable. Given appropriate monetary and fiscal policies, reasonable restraint by consumers and businesses in their spending decisions, and continuing keen competition, price stability with a rising standard of living can reasonably be expected. On the other hand, acceptance of the gradually rising price theory carries with it a widening expectation of further rise. This leads in turn to financial overcommitments, speculation, misdirected expansion of capacity, slackened efficiency, erosion of existing savings and discouragement of new savings, and an ultimate reaction of a serious nature.

For about two years we have been experiencing an intensified demand for funds and, although the supply of savings and the volume of bank credit have both increased, expanding demands have outpaced their availability to potential users except at rising interest rates. Consequently, the price of money has risen. If bank credit had been allowed to increase more rapidly under these circumstances, prices of goods and services, including those purchased by Federal, State and local governments, would have risen further under the stimulus of inflationary credit pressures. How much further no one can say, but the strength of inflationary forces has been and is still formidable.

An increase in the volume of savings is the most effective way to deal with a situation whose inflationary potential would only be aggravated by an excessive use of credit. As these savings are made available to meet demands for more housing, schools, and other public improvements,

as well as expansion of new business plant and equipment, they provide the resources for stable economic growth. To the extent that fiscal policy results in a budgetary surplus and the Federal debt is reduced, the supply of savings is increased and the need for monetary restraint lessened. This is because maintenance of a surplus permits funds to be channeled through Government debt retirement into the capital markets where they would be available to meet private demands and demands of State and local governments for funds to carry through their projects for needed community facilities.

A reduction in taxes would bring welcome relief to millions of taxpayers. Such action, however, without a corresponding curtailment in Federal expenditures, would reduce or eliminate the budget surplus, and tend to stimulate increased total spending in the economy. At the same time the supply of funds made available to the capital markets through Federal debt retirement would be reduced.

As a number of witnesses who appeared before this Committee have pointed out, the general economic situation is still one of very active demands, intensive utilization of resources and continuing pressure toward higher prices for goods and services. They have also noted the declines in residential building and some consumer durable goods, the slight falling off in total industrial production and the drop in prices of some sensitive commodities. However, the general economy is still being stretched by record levels of plant and equipment outlays, rising demands for State and local government projects, further increases in consumer buying, and continued need for large-scale defense spending. On balance, the situation

does not seem to us to reflect a basic weakening that would call for relaxation in efforts to curb inflationary pressures.

Your Committee has indicated an interest in the consideration given to current and prospective economic trends in the formation of Federal Reserve policy. Since Federal Reserve System operations reflect to some degree all phases of the nation's economic life and have a pervasive influence on it, they must be adjusted on a day-to-day basis to the ever changing situation. Hence, the System has need for as much current and background economic information as it can assemble.

Efforts are directed toward bringing together, and combining as background for our decision-making the best available statistical information and the best informed impressions and judgments that can be obtained from businessmen, bankers, agricultural experts, labor leaders, and from others both in and out of government. We also depend on information collected and compiled by other agencies of the Federal Government. For this reason it is important to the proper formulation of monetary policy that the statistical facilities of the Federal Government be well manned.

In our appraisal of economic developments maximum use is made of the decentralized structure of the Federal Reserve System. Through the 12 Federal Reserve Banks and their 24 branches, in business and financial centers all over the United States, and especially because of the caliber and experience of men who serve as the directors and officers of these institutions, the Federal Reserve is in close touch with current and prospective developments throughout the country.

In accordance with provisions of the Federal Reserve Act the Board meets frequently with Presidents of the Federal Reserve Banks, who serve as members and alternates, on the Federal Open Market Committee. The Act also provides for quarterly meetings with the Federal Advisory Council, composed of representatives of the member banks in each district. These occasions make it possible to study continuously underlying developments in all parts of the country and all sectors of the economy.

Much of the statistical data and other information we collect for our own policy decisions is also made available to the public in general. We believe this is as important as its internal use, because it helps to provide a basis for better public understanding and more accurate appraisal of credit and monetary problems and of policy actions designed to deal with them.

Article Title: Reserve Board Plans No Easing on Credit Curbs Now Martin States

Journal Title: Dow Jones News Wire

Date: June 14, 1957

Article Title: Reserve Wont Relax Credit Curbs Now, Martin Testifies

Journal Title: American Banker

Date: June 17, 1957

July 1, 1957.

The Honorable Wilbur D. Mills,
Chairman,
Subcommittee on Fiscal Policy,
Joint Economic Committee,
Washington 25, D. C.

Dear Mr. Mills:

This is to thank you for your letter of June 27 enclosing a copy of your Subcommittee's report on Fiscal Policy Implications of the Economic Outlook and Budget Developments and also a copy of your letter to the members of Congress.

The Subcommittee's report, and particularly your letter, are most heartening and reassuring. The final sentence of your letter, "Inflation and the means of preventing it bear no party labels," is most felicitous and fortunate.

Sincerely yours,

Wm. McC. Martin, Jr.

ET:mnm

Congress of the United States

JOINT ECONOMIC COMMITTEE

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

June 27, 1957

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

Dear Mr. Martin:

Enclosed is a copy of the report by the Subcommittee on Fiscal Policy entitled "Fiscal Policy Implications of the Economic Outlook and Budget Developments." On behalf of the Subcommittee I would like to take this opportunity to thank you for your participation in the Subcommittee's inquiry. Your efforts contributed materially to an objective appraisal of the fiscal policy problems facing the Nation today.

Sincerely yours,

Wilbur D. Mills, Chairman
Subcommittee on Fiscal Policy

Enclosure

June 28, 1957

Congress of the United States
Washington, D. C.

Dear Member:

The attached report on fiscal policy implications of the economic outlook and budget developments by the Subcommittee on Fiscal Policy of the Joint Economic Committee was presented to the Congress on June 26, 1957. The purpose of this report was to set forth in the clearest possible language, the Subcommittee's findings concerning the broad outline of a sound, responsible fiscal policy in fiscal 1958 which would best contribute to the setting in which our free enterprise economy can achieve continuing growth without further inflation.

These findings, prepared and reviewed with the greatest care by all members of the Subcommittee, are based on the testimony presented to the Subcommittee in public hearings by 33 non-Government experts from industry, labor, agriculture, and universities. These hearings were conducted in an objective and non-partisan spirit in which all members of the Subcommittee sought to develop, with the assistance of these experts, the facts concerning the prospects for easing fiscal and monetary restraints. The Subcommittee was also greatly benefitted by the full and candid testimony of the Director of the Bureau of the Budget, the Secretary of the Treasury, and the Chairman of the Board of Governors of the Federal Reserve System.

Each day's hearings was opened by a statement from the chair which emphasized the objective, non-partisan approach of the Subcommittee to the fiscal policy problems with which we were concerned. These problems are of the gravest moment. The ability of this Nation to enjoy continuing economic growth without the inequitable burden of inflation, depends on the answers provided to these problems. The responsibility for finding these answers is an awesome one. It can be properly discharged only by level-headed, searching scrutiny of facts, in which all those participating keep partisan considerations subservient to the interests of the country as a whole.

I very much regret that the Subcommittee's report has not been received in all quarters in the non-partisan spirit in which it was offered. I particularly regret that the major emphasis of the report has been overlooked. I want to restate that emphasis in unmistakably clear terms now.

The Subcommittee's basic finding, clearly stated in its report and surely by now appreciated by every member of this Congress, is that there is only one way in which taxes can be reduced and monetary restraints eased without resulting in further inflation, so long as the economy continues to operate at high and rising levels. That one way is by stopping the increases in Federal Government spending.

The report states that barring an economic downturn, which seems unlikely at this time, tax reductions or easing monetary restraints in fiscal year 1958 should be based on substantial reductions in actual Federal spending if further inflation is to be avoided. The report states that such reductions have not yet been provided. The report states that merely continuing present spending programs will not curb rising Federal spending over the next several years. The report states that substantial reduction in Federal spending will require cuts in present spending programs as well as forgoing new expenditures. The report states that to reduce present spending programs, the Congress and Administration will have to go beyond merely eliminating waste and inefficiency and will have to make basic revisions in these programs. The report states that if we can find the way to check the rise in Federal spending, the growth in our economy will permit substantial tax reductions over the coming years. The report states that the basic problem underlying present inflationary trends is an inadequate level of real savings out of current income. The report states that until higher levels of voluntary real savings are achieved, we must rely on general fiscal and monetary restraints to curb inflation. The report recognizes that the burdens of high taxes and tight money do not fall evenly throughout the economy. The report states what all of us know, that the burden of inflation is far more unfairly distributed. The report states that the alternative to these general fiscal and monetary restraints is direct Government control over wages and prices, which would be even worse than inflation. The report states that both the Congress and the Administration must be constantly attentive to changes in the tax system to keep it in line with the needs of our dynamic economy, but that the timing of such changes must give due consideration to the Government's revenue requirements.

Will any one take issue with any one of these statements in the Subcommittee's report?

The report does <u>not</u> endorse tight money nor high taxes. <u>Every</u> member of the Subcommittee on Fiscal Policy, <u>every</u> member of the Joint Economic Committee, <u>every</u> member of the Congress wants to see substantial reductions in taxes and easing of monetary restraints. But, <u>no</u> member of the Subcommittee on Fiscal Policy, <u>no</u> member of the Joint Economic Committee, <u>no</u> member of the Congress wants further inflation.

The report states that restraining inflation never has been and never will be an easy job. The report states that public policies cannot duck the problem of inflation and honestly serve the interests of the American people. The report states that these problems must be faced squarely and will be solved by appraising the findings of objective and dispassionate inquiries.

I cannot see a single partisan issue in this report. Inflation and the means of preventing it bear no party labels.

Sincerely yours,

/s/ WILBUR D. MILLS

Union Calendar No. 228
85th Congress, 1st Session - - - - - - House Report No. 647

FISCAL POLICY IMPLICATIONS OF THE ECONOMIC OUTLOOK AND BUDGET DEVELOPMENTS

REPORT

OF THE

JOINT ECONOMIC COMMITTEE

TO THE

CONGRESS OF THE UNITED STATES

JUNE 26, 1957.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

UNITED STATES
GOVERNMENT PRINTING OFFICE
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JOINT ECONOMIC COMMITTEE

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

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NORMAN B. TURE, *Economist*

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Union Calendar No. 228

85TH CONGRESS, 1st Session | HOUSE OF REPRESENTATIVES | REPORT No. 647

FISCAL POLICY IMPLICATIONS OF THE ECONOMIC OUTLOOK AND BUDGET DEVELOPMENTS

JUNE 26, 1957.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

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

REPORT

[Pursuant to sec. 5 (a) of Public Law 304 (79th Cong.)]

The following report of the Joint Economic Committee prepared by the Subcommittee on Fiscal Policy was approved for transmission to the Congress by the full committee. The subcommittee is composed of Representative Wilbur D. Mills, chairman, Senators Paul H. Douglas, Joseph C. O'Mahoney, and Barry Goldwater, and Representative Thomas B. Curtis. The report sets forth the subcommittee's findings with respect to the broad outlines of fiscal action during the fiscal year 1958, which on the basis of both economic and budget prospects would be consistent with the Employment Act objectives of economic growth and stability.

INTRODUCTION

The Subcommittee on Fiscal Policy of the Joint Economic Committee conducted hearings on June 3–7, 13–14, 1957, on the fiscal policy implications of the economic outlook and budget developments. The purpose of these hearings was to examine the facts concerning current and prospective economic and budget developments upon which sound, responsible fiscal policy, consistent with the economic growth objectives of the Employment Act, should be based.

Discussion with 33 non-Government experts and with the Director of the Bureau of the Budget, the Secretary of the Treasury, and the Chairman of the Board of Governors of the Federal Reserve System focused on: (1) the current economic situation and prospects for the remainder of 1957 and for 1958; (2) the effect of current congressional and administrative efforts to reduce spending on the prospective budget surplus in fiscal 1958 and on levels of economic activity in 1957–58; (3) types of fiscal action consistent with economic stability and growth if spending reductions are achieved; and (4) the timing of fiscal action in relation to budgetary and economic developments. These discussions were directed toward the broad outlines of fiscal action which would best contribute to the setting within which our enterprise economy can proceed on a steady and noninflationary course of economic growth. Responsible fiscal policy calls for revenues adequate to finance Government activities, including debt management, in a manner which will contribute to economic stability and growth.

FINDINGS OF THE SUBCOMMITTEE ON FISCAL POLICY

Inflation is a grave economic problem facing the American economy today. Failure to deal with it forthrightly will result in increasing hardships for millions of Americans. It will impose the costs of economic instability on future generations by making achievement of steady economic progress increasingly difficult.

The rapid expansion of Federal Government spending in recent years, coming on top of sharp increases in consumption and investment in the private sectors of the economy, has contributed significantly to current inflationary pressures. Present fiscal and monetary restraints, such as the extension of tax rates otherwise scheduled for reduction, the application of modest surpluses to debt retirement, and general controls for restricting increases in the supply of credit, have not been fully effective in curbing pressures for widespread price increases.

Public policies must face up squarely to the problem of inflation. Restraining inflation never has been and never will be an easy job. It requires making hard decisions in public policies to contend with problems which may become increasingly complex. The current difficulties in management of the Federal debt offer an impressive example. Demands for immediate and substantial tax reduction and for more freely available credit are others. Steady economic growth and stable prices, however, will not be achieved unless we are guided by appraisal of the findings of objective and dispassionate inquiries.

The subcommittee's findings are:

(1) The economic outlook for the remainder of 1957 and early 1958 suggests continued increases in output and income. Although somewhat less buoyant than in 1956, total demand shows sufficient strength in widespread sectors of economic activity to point to continuing upward pressures on prices. Modest, e. g., $1 billion to $2 billion, reductions in Federal spending, with corresponding increases in the budget surplus in fiscal 1958, would not significantly affect these prospects.

At the same time, a number of soft spots in the economy emphasize the need for continuing alertness to possible changes in overall levels

of economic activity which may require revisions in current public policies.[1] A downturn in economic activity would call for easing restraints. If relaxation of present general credit controls should prove inadequate to prevent a continuing decline in employment and output, general tax reduction should be provided.

(2) Barring an economic downturn, which seems unlikely at this time, tax reductions or easing monetary restraints in fiscal year 1958 should be based on realization of substantial, e. g., $3 billion to $5 billion, reductions in Federal expenditures during the year, if renewed acceleration of widespread price increases is to be avoided. The achievement in fiscal 1958 of such reductions in actual Federal spending below the January 1957 estimates would call for tax reductions effective with respect to a part of fiscal 1958, certainly not later than the beginning of fiscal 1959. Present prospects indicate a somewhat smaller surplus in fiscal 1958 than the $1.8 billion estimated in the President's January 1957 budget message. Rising prices, particularly for defense goods and services, appear to be largely responsible for the downward adjustment in the estimated surplus.

Under present conditions of high levels of employment and output, any modest surplus in the Federal budget should be applied to debt reduction. In addition to facilitating public debt management, this use of a budget surplus will reduce the demands imposed on monetary policy as a means of restraining inflationary pressures.

(3) In order to justify tax reduction under conditions of steady economic growth, more remains to be done by the Congress and the administration with respect to actual Federal spending in fiscal 1958 than has been accomplished to date. Actions so far undertaken by the Congress and the administration with respect to the President's 1958 budget proposals hold little promise for reduction in actual Federal spending in fiscal 1958. In several cases, these actions represent revisions of the estimated costs of specific programs presented in the President's January 1957 budget message. In other cases, appropriations have been cut without changing existing program obligations of the Federal Government, so that supplemental or deficiency appropriations will subsequently be necessary. Moreover, reductions in appropriations for fiscal 1958 may, in a number of cases, have little effect on actual expenditures during the year because of the carryover from fiscal 1957 of existing but unused obligational authority. In their efforts to reduce Federal spending, the Congress and the administration should recognize that decreases in budget estimates do not necessarily result in decreases in actual Government outlays.

(4) Several Federal spending programs appear to contain built-in expansion features. Federal Government commitments for old-age assistance, social-security benefits, and highway expenditures are but a few examples of Federal programs which will increase under present law provisions. Refunding maturing issues of the public debt may be expected to result in increases in interest costs, so long as the present tight money conditions persist. In addition, cost and price increases tend to result in increasing levels of Federal spending, even when no change in real terms is made in existing programs. Merely continuing

[1] Senator O'Mahoney wishes to add:
"Notable soft spots are present in the areas of agriculture and small business. Huge Government appropriations to take agricultural surpluses out of the market, instead of a constructive legislative solution that would make agriculture a self-supporting segment of the economy, and the rising rate of bankruptcy in the field of small business, are warning signals that cannot safely be ignored. In these two areas taxpayers who ought to be contributing to the tax receipts of the Government are not earning incomes upon which taxes can be paid."

present programs, therefore, may well result in rising levels of Federal spending over the next several years.

(5) Substantial reductions in Federal spending in fiscal 1958 and subsequent years will require downward revision of existing programs as well as forgoing new expenditures. Rising prices and costs, particularly in defense spending, suggest that such revisions may well be necessary even to hold fiscal 1958 expenditures to the level estimated in the President's budget message of January 1957.

(6) Many important considerations, other than those of maintaining stability in the general price level and a high rate of economic growth, enter into decisions about the kind and magnitude of Federal spending programs. It should be recognized, however, that under present economic conditions, widespread demands for tax reductions cannot be met without inflationary consequences unless Government spending is prevented from rising as rapidly as revenues. The Congress and the administration, therefore, should increase their efforts to find means for reducing the scope of present Federal spending programs. These efforts will have to go beyond elimination of waste and inefficiency. Close review of the substance of present programs, prospects for their future expansion or contraction, and their contributions to the Nation's economic progress compared with private uses of the resources they demand will be necessary to effect major reductions in Federal expenditures.

More than 60 percent of estimated budget expenditures for fiscal 1958, as proposed in the President's January 1957 budget message, is for major national security programs, including expenditures abroad. The Joint Economic Committee repeatedly has pointed out that our economy can support such heavy defense programs while increasing productive capacity and living standards in the private sectors of the economy. Nevertheless, national security expenditures require the use of large amounts of resources which might add significantly to the rate of economic growth. A prime objective of the Congress and the administration, therefore, should be to achieve the highest possible level of military competence at the least possible cost in terms of resources used.

Reductions in Federal spending should be carefully determined to avoid weakening our national security preparations and those Federal Government activities which contribute most to developing the material and human resources essential for economic growth. On the other hand, there need be little concern about possible adverse effects on the level of total economic activity resulting from imposing effective restraints on expansion of Federal expenditures. Appropriate tax and credit policy changes can provide adequate increases in private demand to afford employment for additions to the labor force and to plant and equipment, and also for any resources released through decreased Federal spending. Indeed, since continuation of the postwar average rate of growth in gross national product may be expected to produce about $3 billion annually in additional revenue, preventing further growth in Federal spending will permit substantial tax reductions contributing to a growing level of private demand.

(7) Present inflationary pressures frequently are attributed to the so-called cost-price push, as distinct from the traditional inflation resulting from excessive demand. Whether or not this distinction is valid, it is evident that general price increases can occur without

increasing unemployment only if demand is adequate to support the higher price level. The basic problem is an inadequate level of savings out of current income. An ever-increasing volume of real savings is needed to meet the economy's requirements for replacement of plant and equipment under inflated prices and for growth based upon full exploitation of rapid technological advances. Fiscal and monetary policies should be directed toward encouraging a higher level of voluntary real savings under the present conditions of inflationary pressure.

Since these objectives have not been fully accomplished, public policies to cope with increases in the price level must take the form of general fiscal and monetary restraints on the expansion of total spending. It is recognized that the burden of such restraints may not be evenly distributed throughout the economy. The burden of inflation, however, is far more inequitably distributed. The alternative to general fiscal and credit controls is some form of direct Government control over wage and price determination. The use of this type of control would produce results as bad, if not worse, than the inflation against which it would be directed, and should be avoided.

(8) The long-run growth conditions of our dynamic economy call for constant attention to revision of the Federal revenue structure. Structural changes which broaden the tax base and improve the fairness of our tax laws would permit substantial reductions in tax rates while maintaining necessary revenues and would contribute to steady economic growth. Such revision is a continuing responsibility of the administration and of the tax committees of the Congress. The timing of such revisions must give due consideration to the Government's revenue requirements and to economic conditions. Ill-timed structural changes may defeat their long-run objectives by promoting economic instability.

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85th Congress
2d Session

COMMITTEE PRINT

FEDERAL EXPENDITURE POLICIES FOR ECONOMIC GROWTH AND STABILITY

REPORT

OF THE

SUBCOMMITTEE ON FISCAL POLICY

TO THE

JOINT ECONOMIC COMMITTEE

CONGRESS OF THE UNITED STATES

JANUARY 23, 1958

Printed for the use of the Joint Economic Committee

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NORMAN B. TURE, *Economist*

LETTER OF TRANSMITTAL

JANUARY 23, 1958.

Hon. WRIGHT PATMAN,
Chairman, Joint Economic Committee,
House of Representatives, Washington, D. C.

DEAR SIR: Transmitted herewith is a report by the Subcommittee on Fiscal Policy on Federal Expenditure Policies for Economic Growth and Stability. The report presents the subcommittee's findings and conclusions based upon its hearings and study undertaken pursuant to the recommendation of the full committee in its February 28, 1957, Report on the January 1957 Economic Report of the President.

Representative Thomas B. Curtis and Senator Barry Goldwater join me in presenting this report. Senators Paul H. Douglas and Joseph C. O'Mahoney also participated in the planning and formulation of the study and hearings. They have approved the transmission of this report to the committee but could not participate in its preparation.

Sincerely,

WILBUR D. MILLS,
Chairman, Subcommittee on Fiscal Policy.

FEDERAL EXPENDITURE POLICIES FOR ECONOMIC GROWTH AND STABILITY

INTRODUCTION

The Joint Economic Committee, in its February 28, 1957, report to the Congress (H. Rept. No. 175, 85th Cong., 1st sess.) suggested the desirability of a study of Federal expenditure programs in terms of their impact on the level of economic activity and the standards for public expenditures to promote overall economic growth in the long run. In June 1957, the Subcommittee on Fiscal Policy undertook an examination of the fiscal policy implications of the economic outlook and budget developments in fiscal 1958. The subcommittee's report (H. Rept. No. 647, 85th Cong., 1st sess.) pointed up the need for a thorough inquiry into the substance of current Federal expenditure policies in order to appraise their consequences for the economy's growth and stability.

On the basis of these suggestions, the subcommittee initiated its study of Federal expenditure policies and their relationship to the attainment of the Employment Act objectives. In the course of its study, the subcommittee invited and received the assistance of experts from business, labor, research groups, universities, and Government. These participants prepared papers on various aspects of the subcommittee's inquiry, which were printed and distributed to subcommittee members, participants, and the general public in early November. Hearings were held November 18–27, during which participants and the subcommittee developed more fully the problems and issues raised in the printed papers.

The subcommittee has not attempted to make specific recommendations with respect to particular Federal spending programs. Determination of these programs is the function of various legislating committees of the Congress. This statement, instead, sets forth broad principles to assist in the formulation of Federal expenditure policies in the light of the Employment Act objectives.

FINDINGS AND CONCLUSIONS

Meeting the challenge presented by Soviet advances in science and technology emphasizes but does not alter this Nation's basic economic policy objectives. Clearly we must improve our defense efforts. The more fundamental test, however, is to demonstrate our capacity to provide the military competence needed to deter war and the economic competence needed to maintain and improve our standards of living. A high rate of economic growth, unhindered by inflation or recession, is the principal requisite for successfully meeting this challenge.

Increasing emphasis on economic growth necessarily focuses attention on Federal expenditure policies. The Federal Government is the largest industry in the United States. Its direct purchases of goods and services account for a substantial share of the economy's total output; its effects on the amount and character of economic activity are even greater than can be indicated by any such statistic.

In part, these influences stem from the means by which the Federal Government's activities are financed. This subject was extensively investigated in 1955 by the Subcommittee on Tax Policy of the Joint Economic Committee in its study of Federal tax policy for economic growth and stability. The character and extent of the Federal Government's spending activities, however, may be of even greater consequence.

The Joint Economic Committee and its subcommittees, under the mandate of the Employment Act of 1946, must be concerned primarily in all of their inquiries with the impact of Government activity on attainment of the Nation's basic economic policy objective: A high rate of growth in productive capacity with minimum fluctuations in the rate of resource use and in the general price level. The Subcommittee on Fiscal Policy recognizes that many other considerations enter into determination of the scope and character of the Federal Government's activities, and that in many instances such considerations must be ruling. Nevertheless, we cannot ignore the economic consequences of any Government spending policy if we are to be sure that Government will most greatly enhance or least interfere with the conditions requisite for steady economic progress.

1. Increasing the effectiveness of our national defense in the years ahead very likely will result in rising defense expenditures

Developments since mid-1957 once more dramatically point up the extremely rapid rate of obsolescence of military plant and equipment. Weapons regarded as highly advanced today become conventional tomorrow and outmoded the day after. Indeed, since considerable time necessarily must elapse between the stages of conception, planning, and production of new weapons systems, the lag between recognition of the type and amount of preparations required to maintain our national security and actual accomplishment always must be substantial. A lag reflecting continuing, rapid progress in science and technology and alertness to the military implications of such advances is evidence of the fundamental strength and soundness of the Nation's efforts to deter war. On the other hand, any lag between conception and achievement stemming from rigidity in planning and programing defense efforts must be regarded as a serious weakness in the Nation's defense preparations.

The Soviet Union has demonstrated not only its capabilities in science and technology but its determination to exploit achievements in these fields for military purposes, regardless of the costs involved in terms of material living standards and amenities for the Russian people. Moreover, the rapid rate of Soviet economic growth (as shown in the study, Soviet Economic Growth: A Comparison with the United States, prepared for the Subcommittee on Foreign Economic Policy of the Joint Economic Committee by the Legislative Reference Service of the Library of Congress, July 5, 1957) indicates that such costs may be reduced significantly in the future. Soviet progress in the military applications of scientific and technological advances, rather than domestic considerations, determines the floor under defense efforts in the United States.

Maintaining the superiority, or at least equality, in military capacity upon which the Nation's survival well may depend precludes settling upon any given complex of weapons systems as ultimately satisfying our defense requirements. Research must be expected continually to reveal the obsolescence of weapons even before their production, and indeed should be directed toward that end. To the extent that such research is successful, it should be expected to accelerate the rate of obsolescence and to result in an increasingly complex defense technology. These factors underlie the prospect of rising defense outlays.

2. The prospect of higher levels of defense spending raises no serious questions about the capacity of the economy to meet these demands

In the broadest sense, the amount of resources we can afford to devote to national defense depends on the benefits to be derived compared with the real output for nondefense purposes which must be given up in order to achieve them. The benefits of an adequate defense program lie in prevention of the loss of life and property which would result if a lack of military capability by the United States led to the outbreak of war. Since such benefits are incalculably great, there can be little question that whatever level of defense effort, attainable in real terms, is required to deter aggression is clearly economical.

It is virtually impossible, on the basis of objective standards, to determine the specific limits of defense spending which can be accommodated without major adverse consequences. Our experience during World War II, the Korean crisis, and the entire postwar period has demonstrated the enormous flexibility of the economy and the tremendous reserves of resources which can be mobilized to meet extraordinary demands.

Present defense expenditures, in fact, are absorbing about 10 percent of the Nation's total output. A mere continuation of the postwar trend of growth in real output would alone make possible substantial annual increases in our defense program without materially increasing the proportion of total resources allocated to this end. A 20-percent increase in annual defense outlays, for example, would require less than two-thirds of the annual increase in the economy's total output which we can expect if the postwar rate of growth is maintained. The extent to which our defense preparations can be enlarged and made more effective will be limited, if at all, by difficulties in reallocating resources rather than by inadequate economic capacity.

Maintaining and accelerating our economic growth is thus the basic step required for minimizing over the long run the real costs of increasingly effective defense preparations. An expanding and increasingly diversified productive capacity affords the best assurance that the rapidly changing requirements of national security can be satisfied promptly. The skills and achievements in science and technology upon which our national security depends are also the basis for an increasing capacity to produce a greater volume of more widely diversified nondefense goods and services. Efforts to strengthen the foundations of rapid economic growth and to enhance our defense capabilities are not only consistent, but serve to reinforce each other.

3. National-defense requirements should guide rather than depend upon decisions concerning the level and composition of other Federal spending programs and the evaluation of revenue prospects and requirements

Considerations of economy in our defense programs must originate in the continually changing requirements growing out of our own accomplishments and those of a potential aggressor. Determining defense preparations on this basis calls for a high degree of flexibility in planning and programing which may be seriously impaired by rigid budgetary ceilings on defense outlays.

A flexible budget approach to defense spending does not imply relaxation of efforts to increase efficiency in defense preparations. The prospect of rising defense costs, on the contrary, emphasizes the necessity for (1) eliminating superfluous activities of the Defense Department, particularly those which private enterprises can as efficiently undertake; (2) improving the organization of defense activities, particularly in the research and development areas in order to eliminate wasteful duplication of effort and competition for highly specialized research resources and to assure greater continuity in effort; (3) improving procurement practices to assure minimum-cost production of defense materiel; and (4) revision of personnel policies to minimize costly turnovers. Specific positive efforts along these and similar lines offer far greater assurance of achieving greater efficiency in the defense program than do rigid budget ceilings on outlays.

4. Proposals for fiscal action to offset currently developing slack in employment and plant and equipment use should take account of the possibility of a delayed increase in defense outlays

Under present circumstances, expansion and improvement of the Nation's defense efforts may not be fully and immediately reflected in estimated budget expenditures for fiscal 1959. Development of new weapons, upon which we increasingly must concentrate, requires a substantial investment of time as well as of the most highly skilled and specialized human and material resources. The bulk of the rise in actual defense spending, therefore, may be delayed, but should not be disregarded in formulating fiscal policy.

Although present economic conditions appear to call for relaxation of fiscal and monetary restraints, the effects in 1958 of expansion of defense efforts and defense-associated activity in the private sectors of the economy on total employment and production cannot yet be clearly ascertained. Moreover, the overall budgetary effect of the changes to be made in other Federal spending programs, in response to changing defense demands, is similarly unclear at this time.

Until these trends can be appraised more clearly, economic stabilization policy should rely on expansionary monetary and credit actions which can be quickly reversed should inflationary pressures again become dominant. Tax reductions enacted prior to determination of budgetary and economic trends well might require at a subsequent date tax increases or reimposition of severe monetary restraints to prevent further sharp rises in the general price level. Should it appear, upon appraisal of these trends, that monetary action alone is inadequate to contain persistent recessionary pressures, tax reduction would be in order. The extent of any such reduction should give due consideration to revenue needs to meet projected outlays, and to provide some surplus, at income levels which may be expected when the present slack in employment and production is eliminated.

5. *Whether or not tax reduction will be called for, tax revision always is timely.*

Emphasis in any tax-revision program should be on eliminating or restricting those provisions of the tax laws which tend to offset the resource-allocating signals of the market mechanism. Preferential provisions in the Internal Revenue Code which substitute tax considerations for those of the market place result not only in inefficient resource use, but also in increasing complexity and unfairness in assignment of tax burdens. Constructive tax revision aimed at greater neutrality in the impact of our revenue laws on the ways in which taxpayers use the resources at their disposal has become more urgent than ever in light of the new challenges currently confronting the Nation.

Improvements in the Federal tax system, along the lines suggested by the Subcommittee on Tax Policy of the Joint Economic Committee in its report, Federal Tax Policy for Economic Growth and Stability (S. Rept. No. 1310, 84th Cong., 2d sess.), should be one major objective of fiscal policy aimed at improving the conditions for economic growth. An equally important objective should be revision of Federal spending programs in light of the demands originating in changing defense and defense-related activities and the changing conditions and opportunities for economic growth. Whether or not nondefense spending by the Federal Government can or should be reduced to match increases in defense outlays is of secondary importance compared with efforts to attain the greatest possible economy in Government.

6. *In view of the increasing importance of expanding productive capacity as the foundation for more effectively meeting our requirements for national security and leadership of the free world, economic growth consequences should be a major criterion in the formulation of Federal expenditure policies*

The impact of Federal spending programs on the availability of resources to other sectors of the economy has significant consequences for the rate and direction of overall economic growth. In applying the economic-growth criterion, therefore, the basic test is whether some or all of the resources required by a Federal expenditure program would contribute more to the economy's total product in some alternative use. Since not all of the products, benefits, and costs of many Federal spending programs are immediately and directly realized, the long-run and indirect consequences of these programs, as

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well as the more immediately observable effects, should be carefully evaluated.

7. Economy in Government should be measured by the relative benefits and costs of each program rather than by reference merely to amounts spent

The subcommittee has found no necessary relationship between the amount of Federal expenditures and the rate of economic growth over the long run. A far more important factor appears to be the character of Federal activities and their impact on the setting in which private economic activity must take place. Economy in Government, therefore, involves changing priorities in Federal Government activities, at times requiring expansion of some Federal programs while reducing others, in response to changing circumstances. Based on the test of alternative-resource use, this is a major means through which the Federal Government can contribute to the Nation's economic growth.

Evaluation of many Federal spending programs aimed at broadly expressed social and political objectives on the basis of their comparative benefits and costs is admittedly difficult. The distinguishing characteristics of these programs is that their benefits cannot be fully measured by objective standards such as those provided by the market mechanism. While the costs of these programs can be readily ascertained, their relative values must be determined through the political process by those invested with responsibility for formulating and enacting Federal spending programs. These value judgments should be based on as full awareness as possible of the indirect as well as direct economic effects of the programs, whether or not these effects are immediately related to the program's objectives, and to the greatest extent possible should be arrived at in the light of the comparative costs of all expenditure programs. Broad social objectives frequently are referred to as "needs," but it should be clear that needs are relative rather than absolute. Determining the priority of programs to meet these objectives must give careful consideration to their relative costs.

Other Federal programs, such as those in public works and natural-resource and regional development, should present far less difficulty in measuring benefits. Such programs long ago were established as appropriate activities of the Federal Government where their objective is to eliminate barriers to or provide the stimulus for fuller, more effective resource use and where the means required for realizing these objectives exceed the financial capacity of immediate beneficiaries. Whether any specific project is to be undertaken, however, should be determined by appraisal of measurable economic benefits in comparison with the project's cost. A project which does not promise a rate of return at least equal to that available on the average throughout the economy cannot be justified on economic grounds. The use of lower interest rates in benefit-cost analysis results in a higher level of Federal public works expenditures than would be justified on the basis of most effective resource use. Uneconomical use of resources also results from including in expected benefits those which represent merely transfers from existing facilities, rather than net additions to total productivity.

8. Federal programs aimed at supporting or improving the economic position of particular groups or industries should be constantly reevaluated in the light of changing circumstances

Whatever their initial justification, subsidy programs should be so contrived as to eliminate the necessity for their continuation. The broad changes which must be expected in our economy require frequent revision in the scope and character of these programs if they are to achieve their purposes. Failure to adapt the substance of subsidies to changing demands and opportunities may be expected to prevent most efficient use of resources in the subsidized activities as well as in other types of economic endeavor. Where this is the case, the subsidy not only fails of its immediate objective but also imposes real costs on the entire economy over the long run.

Preferential tax provisions and provision of Government services at less than cost, no less than direct Federal outlays, serve to subsidize the activities involved. Frequently, however, neither the cost nor the benefits sought by this type of subsidy can be readily determined. An important basic step for improving these programs, therefore, is to provide for the clearest possible exposition of their purpose and substance.

9. The alternative-resource-use test also should be applied to Federal programs which involve no significant Federal expenditures

Federal enterprise activities and programs for insurance and guaranty of private loans generally involve very little net budget expenditures but may, nevertheless, exert a powerful influence on the ways in which resources are used in the private and State and local government sectors of the economy. Rigorous analysis and appraisal of these influences is all the more important in determining the scope and character of this type of Federal program since they are not significantly subject to the budgetary discipline.

Elaboration and refinement of statistical materials and procedures can make a major contribution in improving the accuracy and completeness of benefits and cost measurement. In this respect, favorable action on the recommendations made to the Joint Economic Committee's Subcommittee on Economic Statistics in its hearing October 29 and 30, 1957, on the national economic accounts of the United States, would represent a low-cost investment promising a very high rate of return measured in greater economy in the Federal Government.

10. Recognizing that economic considerations may not always prevail in determining Federal expenditure programs emphasizes the need for carrying out these programs at minimum real cost

Maximizing efficiency provides assurance that, whatever the grounds upon which its priority depends, any Federal spending program will impose the least possible limitation, in terms of availability of resources, on activity in other sectors of the economy. In the interests of increasing efficiency, Federal programs should be channeled, wherever possible, through the market mechanism to take advantage of the objective tests of efficiency in resource use provided thereby. In many cases, more extensive application of operations research and analysis may return substantial dividends in the form of resource-saving methods and improved performance standards.

Greater efficiency in Government operations, however, should not be regarded as a substitute for improvement in the formulation of

programs and their objectives. Highly efficient performance of uneconomical programs will not contribute to the Nation's economic development.

11. Federal expenditure policies closely geared to the Nation's economic growth objectives must provide for as rapid adjustment as possible in spending programs in response to changing demand and supply conditions

The essence of a dynamic economy is frequent and rapid change in demands and in methods of production. Such changes result in shifts in the relative value of alternative uses of productive resources. Impediments to prompt change in resource use in response to changing economic opportunities result in loss of efficiency and of total product for the economy as a whole. Rigidities in Federal spending programs may limit significantly the economy's growth potentials.

A considerable volume of evidence showing the inflexibility of many major Federal spending programs was presented to the subcommittee in its hearings in June 1957 on fiscal policy implications of the economic outlook and budget developments and in its November 1957 hearings on Federal expenditure policy for economic growth and stability. A number of these programs have an upward bias as a result of specific features in their statutory authorization, which result in their continuing expansion even under conditions in which decreasing importance is attached to them. Even more adverse consequences result from a fiscally perverse spending program which increases or decreases directly with increases or decreases in earmarked revenues. This type of program adds to inflationary pressures when boom conditions swell tax receipts and accelerates declining demand when receipts shrink under recessionary conditions.

12. Flexibility in Federal expenditure programs has important implications with respect to the stabilization objectives of the Employment Act

Periods of boom and recession generally are characterized by changes in the relative economic and social priorities accorded by the economy as a whole to alternative resource uses. Greater flexibility in spending programs, therefore, would permit more expeditious reduction in those public functions of decreasing priority in periods of rapid expansion of economic activity. By the same token, it would more readily permit expansion of those public services and functions subject to increasing demand should a decline in private expenditures serve to free the required resources.

Across-the-board changes in Federal expenditures in response to changing levels of overall economic activity, on the other hand, can be expected to contribute to economic stability only at the cost of misallocation of resources. Changing demand and supply conditions will not uniformly affect the desirable level of every Federal spending program. While minimizing inflationary pressures well may require some—possibly substantial—reduction in Federal spending, it does not follow that each Federal spending program should bear a proportionate part of any overall reduction. By the same token, increasing all Federal expenditures in the same proportion to offset recessionary pressures would result in highly uneconomical or wasteful uses of productive services. The extent to which the Federal Government changes the level of spending for any program during a recession or a

boom, therefore, should be determined on the basis of changes in economic and social priorities.

13. Tax and monetary policy should be relied upon to bear the major brunt of achieving economic stabilization objectives

The effects of many Federal spending programs on levels of total economic activity do not necessarily coincide closely in time with actual expenditures. While adjustments in Federal spending programs are essential in response to long-run changes in economic conditions, they are much less suited to leveling out short-run fluctuations. The subcommittee's hearings in June and in November 1957 confirmed the view that economic stabilization efforts should rely initially on general monetary and credit actions. For major, long-term growth and stabilization requirements, changes in tax rates should be related to changes in levels of Government expenditures by the need for full utilization of growing productive resources and stability in the general price level.

14. The scope and character of Federal spending programs should reflect, wherever possible, the comparative economic advantages of the Federal, State, and local governments and of private enterprise in achieving program objectives

The dynamic qualities in the Nation's political and economic development have resulted in frequent changes in the relationships among the Federal, State, and local governments, and between the public and private sectors of the economy. No clearly established division of responsibility for satisfying changing demands has emerged in this development. This flexibility, while possibly posing the danger of undue concentration of power at the Federal level, also may be a major source of strength in the economy, since it affords assurance that changing demands for services in response to changes in conditions required for economic growth need not be frustrated by institutional barriers.

The nature of the problems and objectives giving rise to many Federal programs precludes substantial and effective non-Federal participation. On the other hand, many types of activities performed by the Federal Government also can be and are performed by State and local governments and in the private sectors of the economy. Apart from the generally recognized social and political virtues in minimizing Federal responsibility for such functions and activities, considerations of the economy's growth potential also require Federal programs to be so formulated as to give non-Federal organizations every opportunity to determine whether they can efficiently participate in achieving the desired objectives.

15. Failure of State and local governments and private enterprise to recognize and to respond quickly to new demands must be expected to result in public pressure for the Federal Government to expand its activities

The historical record shows that the public has turned readily to the Federal Government when other agencies failed to meet new or expanded demands, and that the Federal Government has not been able to defer very long taking the action demanded of it. Revision and expansion of educational programs and of basic research efforts are the most important cases in point at the present time. The signifi-

cance of these programs for the Nation's defense preparations and for economic growth has suggested to many the occasion for Federal Government action. The prospect for such pressures was stressed by the Subcommittee on Economic Stabilization of the Joint Economic Committee in its 1955 study of automation and technological change. The subcommittee pointed out, however, that first responsibility for meeting the demands for technical and scientific skills should fall upon local communities and upon the individuals and businesses interested in such competence.

These and similar programs are those in which a major role of the Federal Government, in the past, has been to stimulate activity in the non-Federal sectors of the economy. Whether that role now is to be substantially expanded well may depend on the speed with which agencies other than those of the Federal Government respond to the new and rapidly increasing demands.

16. Federal participation in activities shared by State and local governments and private enterprise should be aimed primarily at improving the effectiveness of these activities and should avoid merely transferring responsibility for them to the Federal Government

In the field of education, for example, the basic objective is to improve the quality of curriculum and instruction at all grade levels as well as to increase the number of teachers, classrooms, and enrollments in advanced institutions.

Achieving this objective will require reappraisal and revision of the basic substance of educational programs at the elementary, secondary, and advanced levels. Although these revisions will not be achieved merely by increasing expenditures, they should be expected to result in rising costs, since they will require relatively more and better resources than now are available. In view of this prospect, efforts to improve education programs should seek every possible opportunity to exploit technological advances. The use of television as a means of supplementing present instructional techniques, for example, suggests numerous other low-cost, high-return capital outlays which might well be made, particularly at the secondary and advanced levels of education. More intensive use of existing school plant and equipment may also serve to reduce the real costs of expansion and improvement of the Nation's education programs.

There is no evidence that the extent of the increase in these costs depends significantly on whether responsibility for improving educational programs is assigned to the Federal, State, or local governments or to the private sector of the economy. The role of the Federal Government in this effort, therefore, should be determined on other grounds.

Some of the participants in the subcommittee's study urged greater Federal responsibility for educational programs on the basis that the extra demands on resources in education arise from national rather than local requirements. Whether the national interest in education is greater than, or even different from, that of the States and localities cannot be objectively determined. In any case, since the real costs of the desired improvements will not be materially affected by shifting responsibility, greater financial participation by the Federal Government, if deemed necessary, should avoid obscuring these costs lest

States and localities be encouraged to divert their resources to programs of lower social priority, with a consequent loss to the economy as a whole.

Statutory and constitutional provisions limiting their financial resources may inhibit States and localities from promptly assuming increasing responsibility for public functions. Such limitations cannot be realistically ignored in the formulation of Federal expenditure policies. Where these are the principal constraints faced by State or local governments, however, the efforts of the Federal Government should be directed primarily toward the development of an expanded fiscal capacity at the State and local level.

Very much the same considerations are involved in the case of improving and expanding research activities. The subcommittee's hearings brought out the fact that a major obstacle to more effective research programs is the difficulty in establishing criteria for the allocation of highly limited and specialized research skills and equipment. It is agreed generally that a significant expansion of research efforts is required. Success in this respect, however, depends at the outset on improving the organization of research resources and their allocation into more productive lines of inquiry. Merely providing substantial increases in Federal outlays for these programs may serve only to transfer available research skills and facilities from the private sectors of the economy to the Federal Government, without materially improved results. Such competition may, in fact, disrupt current research efforts in which the Federal Government has a major interest.

The subcommittee's study brought out clearly the importance of expanding activity in pure research as the basis for continued technological advance and, therefore, economic growth. The study also revealed the limitations on present knowledge concerning the conditions and incentives necessary for long-run expansion of pure research efforts. It seems clear that over much of the period of this Nation's industrial development, the complex of patent laws, the tax system, and other institutional arrangements provided a setting highly conducive to rapid exploitation of applied research and developmental activity. Further study and analysis is required to determine the adequacy of these arrangements under today's conditions, and more particularly, to determine whether these arrangements are consistent with the growing requirements for pure research.

A number of the participants in the subcommittee's study maintained that, in view of the highly uncertain results, it is unlikely that private enterprise can be expected to undertake of its own initiative a major part of these pure research activities. However significant this limitation may be, it does not necessarily follow that merely enlarging research establishments within the Federal Government will achieve the desired objective. A necessary first step is determining the present availability and use of research talent and facilities in business, the universities, private research organizations, and at all levels of government. Federal research programs should seek closer integration and better organization of research activities. Such improvements are fundamental in assuring the greatest possible productivity from any increase in Federal research outlays.

17. Business-type activities of the Federal Government should be subjected to frequent review to determine the possibilities of their effective performance by private enterprise

The subcommittee's hearings brought out an extensive inventory of Federal Government activities of an essentially private-enterprise character. The dollar total of the net costs of such programs may be regarded as relatively insignificant when measured against total budget expenditures. The implications of these activities concerning the appropriate relationship between the Federal Government and the private sectors of the economy, however, warrant their careful consideration.

Some of these Federal enterprises were originated during the depression of the 1930's in order to stimulate economic recovery by developing new markets, often through subsidies of a particular type of production or consumption, and by reducing risks for a wide variety of private enterprises. The relative importance of these Federal activities should be assumed to have been significantly affected by the substantial changes in economic conditions occurring during World War II and the postwar period and should be frequently reappraised in light of the Nation's continuing economic development and progress.

Some business-type enterprises of the Federal Government are intended to prevent private monopolization of activities for which the most efficient scale of operation precludes a profitable multifirm industry. Federal responsibility in such cases permits the economy as a whole to realize the benefits of optimum-size enterprise without the dangers inherent in private monopolies. Since these conditions are difficult to determine objectively in advance of actual experience, and since Federal enterprise well may preclude subsequent private participation, Federal ventures in this area should assume the burden of proving their necessity on the grounds of basic economic obstacles to successful, competitive private enterprise.

Another category of Federal enterprise includes those which developed from pilot projects for product or resource development in which private enterprise, either because of lack of knowledge or because of alternative investment opportunities, was not interested. Continuation of Federal participation in such activities after substantial private development has occurred may be justified on the grounds of protecting the public interest, particularly from the danger of undue private concentration of production and distribution control. In such cases, the possibilities of developing a broader private market for the disposition of the facilities or effective regulatory practices which do not require continuation of the Federal enterprise should be explored.

Whether or not the Federal Government should continue or withdraw from any enterprise activity must be determined on the basis of the considerations relevant to each case. The Employment Act objective of promoting vigorous private enterprise, however, calls for continuing reexamination of these Federal functions to minimize any constraints they may impose on opportunities for private enterprise.

18. Budget procedures should be revised to show more clearly the economic effects and costs of Federal Government programs

The Federal budget is more than an accounting statement of proposed outlays and anticipated receipts. It is the principal instrument which those responsible for formulating and enacting expenditure policy must use to: (1) evaluate and compare alternative public programs on the basis of a wide range of criteria, including that of promoting economic growth and stability; (2) determine the type of program best suited to meeting public demands; and (3) make sure that those programs which are adopted are carried out in the most efficient manner possible. The extent to which real economy and efficiency can be achieved in the Federal Government, therefore, depends on the effectiveness of the budgetary process.

19. Effective budgetary procedures should provide adequate information concerning the objectives and substance of the expenditures to be made by the Federal Government

The regular course of the legislative process very often suffices to develop the salient features of new spending proposed for the Federal Government. In the case of continuing expenditures, however, issues concerning their basic substance and purpose may be obscured by concern with details. Without a clear analysis of the purposes to be served by such expenditures and their past effectiveness in achieving these purposes, there is no basis for informed judgment about their relative value and the consequent priority in command over resources to be accorded them.

20. The budgetary process should show how the various activities of the Federal Government are related to each other on a program basis, and how these programs are related to similar activities outside of the Federal Government

Responsible decisions about the desirability of specific expenditures or appropriations requested by any agency of the Federal Government hardly can be made in the absence of information about similar activities elsewhere in the economy. Instances of Federal agencies working at cross-purposes or in duplication of each other's efforts or those of private enterprises, the States, or localities, continually are brought to the attention of the Congress. While considerations of effective administration call for presentation of expenditures on an organizational basis, considerations of economy in Government, calling for budgetary exposition on a program basis, are at least equally important.

Moreover, program analysis should include Federal activities which lie outside the budget. Activities of Federal corporations, trust funds, and those financed by counterpart funds may have important consequences for other Federal programs more explicitly set forth in the budget. Failure to relate these extrabudgetary activities to budget programs can impair the effectiveness of both.

21. Budget decisions should be based upon a clear recognition of the longer range prospects for Government programs in terms of their costs and objectives

Current procedures concentrate attention on the single fiscal year covered by the budget despite the fact that most Federal expenditure programs are designed to continue over substantially longer periods

of time. Economy in Government, in the sense used throughout this report, requires evaluation of the long-run resource requirements and benefits of spending programs. The initial-year requirements of many programs may appear to be insignificantly small, although their eventual cost may substantially exceed the benefits to be derived. In the absence of analysis of these long-run prospects, there can be little assurance that alternative programs will be properly weighed.

Greater emphasis in the budgetary process on the long-run costs and objectives of Federal programs would also facilitate determination of the conditions under which programs can be reduced or terminated. Relatively explicit statutory provisions to this effect would, at the least, provide the basis for thorough periodic appraisals of the substance of Federal Government activities.

22. Budgetary procedures should provide an objective analysis of the likely effects of Federal programs on the overall level of economic activity, employment, prices, and opportunities for and limitations upon investment and other growth-generating activities in the private and State and local sectors of the economy

The budget should set forth clearly the types of adjustments which may have to be made if the basic continuing objectives of the Employment Act are to be achieved. It is recognized that economic effects may be of minor significance in determining the relative importance of specific programs. Nevertheless, these factors cannot be ignored in the budgetary process if economic policies of the Federal Government are to be mutually consistent and are to contribute to a high rate of economic growth with minimum fluctuations in the rate of resource use and in the general price level.

In many cases, particularly where long lead-time items are involved, the economic impact of Federal programs is not clearly or accurately reflected by estimates of budget expenditures. In such cases, budget expenditures represent the culmination of the economic activity set in motion by the placing of a Government contract. In the current situation, for example, substantially expanded efforts in the missiles and other technologically advanced defense programs will be reflected only partially in proposed defense expenditures for fiscal 1959, although such efforts may have major immediate consequences for the level and type of activity in important sectors of the economy. Accurate and complete analysis of the economic effects of such Federal programs requires information concerning levels of contract activity as well as expenditures. Budgetary procedures, therefore, should provide data concerning the proposed rate of use of obligational authority. Development of statistical series on the use of obligational authority would materially aid evaluation of the influence of Federal programs on the economy.

23. Budget procedures should describe the plans and methods which are to be used to achieve greater efficiency in carrying out the functions proposed in budgeted programs

In the absence of fairly explicit, positive proposals to this end, there is a tendency to seek greater efficiency through blanket reductions in the amount of funds made available. Such actions, however, run a considerable risk of undermining the effectiveness of spending programs without eliminating the basic sources of inefficiency.

24. *Finally, achieving the economies and increased efficiency in the Federal Government required to meet the challenges now facing the Nation demands vigorous leadership by the executive branch and cooperation by the Congress and the public*

Explicit proposals for revision of specific spending programs should be presented to the Congress in the President's budget message and supporting statements. Such proposals should be supported by a detailed appraisal of the relative merits of existing and proposed programs.