William McChesney Martin, Jr., Papers

Box 27/Folder 3

Series V, Subseries D

Hearings, August 1957-April 1958

HEARINGS FRB August 13-19, 1957
April 22 - 23, 1958

(36) SENATE FINANCE COMMITTEE
Senator Harry Flood Byrd, Chairman .... Examination of fiscal and monetary policies

1957

...... Prepared statement; first-half Richmond Bank's flannel board presentation (Messrs. Wayne, McKinney and Fentress) 10 a.m. - 11:30 a.m. .... August 13

...... Second-half flannel board presentation; Questioning by Senator Martin (Pa.), 10 a.m. - noon .... August 14

...... Questioning by Senator Long (La.) and Senator Williams (Delaware) 10 a.m. - 12:35 p.m. .... August 15

...... Questioning by Senator Long. 10:30 a.m. - 12:45 p.m. .... August 16

...... Questioning by Senator Carlson (Kansas) and Long, 10 a.m. - 12:30 p.m. .... August 19

AND

Questioning by Senator Malone (Nevada) 2 p.m. - 8:35 p.m. ..... August 19

HEARING RECESSED--to be reconvened on call of the Committee Chairman.

1958 On reconvening of Committee, Mr. Martin testified as follows:

.... Prepared statement. Questioning by Senators Byrd, Frear, Flanders, Jenner and Carlson. 10 a.m. - 12:30 p.m. .... April 22

...... Questioning by Senators Kerr, Bennett, Martin, and Malone 10 a.m. - 1 p.m. and 2:30 p.m. - 5:30 p.m. .... April 23

Schedule of Witnesses

1957

SENATE FINANCE COMMITTEE

Harry Flood Byrd, Chairman (Va.)
Robert S. Kerr (Okla.)
J. Allen Frear, Jr. (Dela.)
Russell B. Long (La.)
George A. Smathers (Fla.)
Clinton P. Anderson (New Mex.)
Paul H. Douglas (Illinois)
Albert Gore (Tennessee)

Edward Martin (Pa.)
John J. Williams (Dela.)
Ralph E. Flanders (Vt.)
George W. Malone (Nevada)
Frank Carlson (Kansas)
Wallace F. Bennett (Utah)
William E. Jenner (Indiana)

Schedule of Senate Finance Committee
Hearings
1957

Chairmaned by Senator Byrd of Virginia.

Opening Statement by Chairman Byrd .... June 18

First Witness: Secretary of the Treasury George M. Humphrey

Prepared Statement .... June 18
Questioning by Senator Byrd .... June 19
Questioning by Senators Byrd and Kerr .... June 20
Questioning by Senator Kerr .... June 21
Questioning by Senator Kerr .... June 25
Questioning by Senators Martin and Frear .... June 26
Questioning by Senators Frear and Williams .... June 27
Questioning by Senators Long and Flanders .... July 1
Questioning by Senator Smathers .... July 2
Questioning by Senator Malone .... July 8
Questioning by Senator Malone .... July 9
Questioning by Senators Malone and Anderson .... July 10
Questioning by Senators Carlson and Gore .... July 11
Questioning by Senators Bennett & Jenner .... July 12
(14 days of testimony)

Second Witness: Under Secretary of the Treasury W. Randolph Burgess

Prepared Statement .... July 29
Questioning by Senator Byrd .... July 30
Questioning by Senator Kerr .... July 31
Questioning by Senator Kerr .... August 1
Questioning by Senator Kerr .... August 2
Questioning by Senators Kerr and Malone .... August 3
Questioning by Senators Martin and Williams .... August 6
Questioning by Senators Long and Flanders .... August 7
Questioning by Senators Flanders and Anderson .... August 8
Questioning by Senators Byrd and Carlson .... August 9
(10 days of testimony)

Third Witness: Chairman Martin of the Federal Reserve Board

Statement by Senator Byrd at opening of Mr. Martin's testimony ..... August 13
Prepared statement - Mr. Martin .... August 13
Richmond Bank's flannel board presentation (first half) .... August 13
10 a.m. – 11 30

Second-half flannel board presentation; questioning by Senator
Martin (Pennsylvania) .... August 14
10 a.m. – 12

Schedule of Senate Finance Committee
Hearings
(Page 2)

Mr. Martin (continued)

Questioning by Senators Long (La.) and Williams (Delaware) .... August 15 $10-12^{35}$
Questioning by Senator Long .... August 16 $10^{30}-12$
Questioning by Senators Carlson (Kansas) and Long .... August 19 $10-12^{30}$
Questioning by Senator Malone (Nevada) .... August 19 $2-8^{35}$

Hearing recessed--to reconvene on call
of the Chairman.

1958

SENATE FINANCE COMMITTEE

Harry Flood Byrd (Va.) CHAIRMAN
Robert S. Kerr (Okla.)
J. Allen Frear, Jr. (Del.)
Russell B. Long (La.)
George A. Smathers (Fla.)
Clinton P. Anderson (New Mex.,)
Paul H. Douglas (Ill.)
Albert Gore (Tenn.)

Edward Martin (Penn.)
John J. Williams (Del.)
Ralph E. Flanders (Vt.)
George W. Malone (Nev.)
Frank Carlson (Kan.)
Wallace F. Bennett (Utah)
William E. Jenner (Ind.)

Chairman Martin
M

COPY

FOR RELEASE BY THE SENATE FINANCE COMMITTEE FOR THE MORNING PAPERS, MONDAY, MARCH 31, 1958

Senator Harry F. Byrd, Chairman of the Senate Finance Committee announced today that Bernard M. Baruch will be the first witness as the hearings on the Financial Condition of the United States are resumed tomorrow, Tuesday, April 1st. The famous financier and advisor to Presidents is expected to comment on the present economic difficulties.

Other witnesses scheduled to appear after the Easter Recess include Marriner S. Eccles, former Chairman of the Board of Governors of the Federal Reserve System, on Wednesday, April 16th; Dr. Sumner Slichter, Lamont University Professor, Harvard University, on Thursday, April 17th; William McChesney Martin, Chairman of the Board of Governors of the Federal Reserve System, on Tuesday and Wednesday, April 22nd and 23rd; and Dr. Seymour Harris, Chairman, Department of Economics, Harvard University, on Thursday, April 24th.

This is a continuation of the hearings commenced by the Finance Committee last year to make a complete study of the financial condition of the United States including matters relating to Federal revenue and debt, tariff and trade, and social security and pensions.

Humphrey and
Burgess Statements

to Burgess

SENATOR KERR'S QUESTION

I. Beginning in January 1953 and thereafter,

(a) State the policy directives adopted by Federal Open Market Committee. Indicate whether each marked a change in previous monetary policy and the direction of the change.

(b) Describe each Treasury financing action, other than the regular weekly bill offerings, but including regular weekly bill offerings where the Treasury increased the amount in order to raise additional cash.

(1) Give the amount of each offering taken by the Federal Reserve; the Treasury for the trust funds and other Government investment accounts; and the commercial banks.

(2) Identify those Treasury financing actions which in your judgment were supported by the Federal Reserve either through (1) open market operations, or, (2) reductions in reserve requirements.

CHART PRESENTATION ON

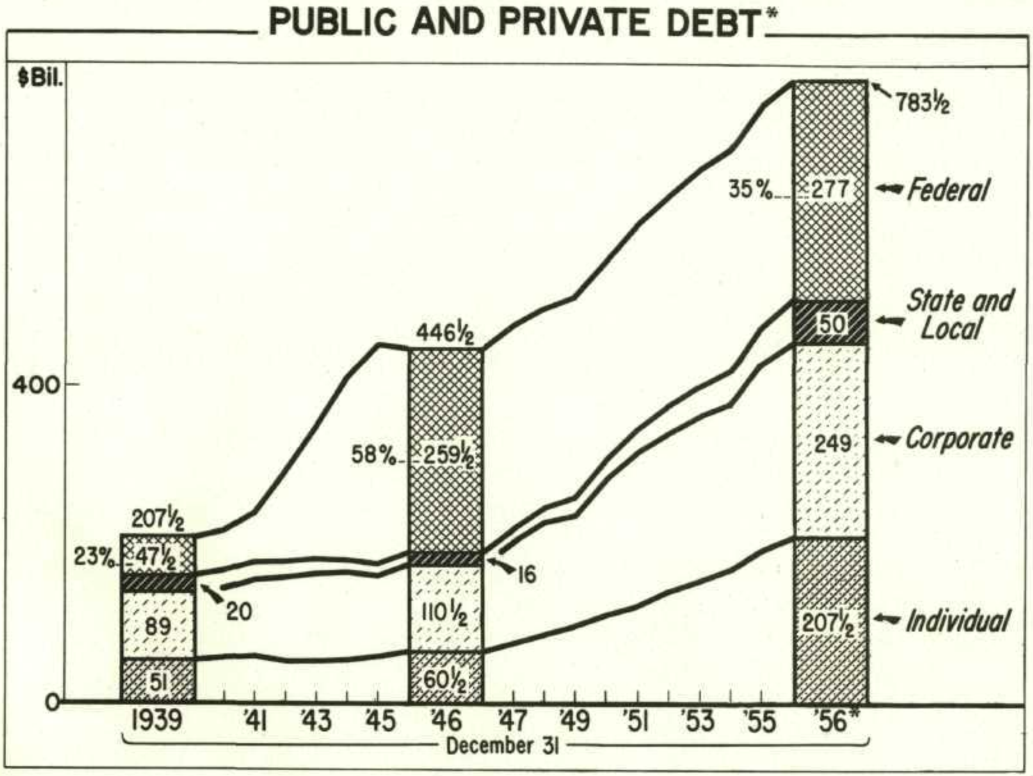
TECHNICAL ANALYSIS OF THE PUBLIC DEBT

Before the Senate Finance Committee

July 1957

OFFICE OF THE SECRETARY OF THE TREASURY
ANALYSIS STAFF - DEBT DIVISION

Chart I



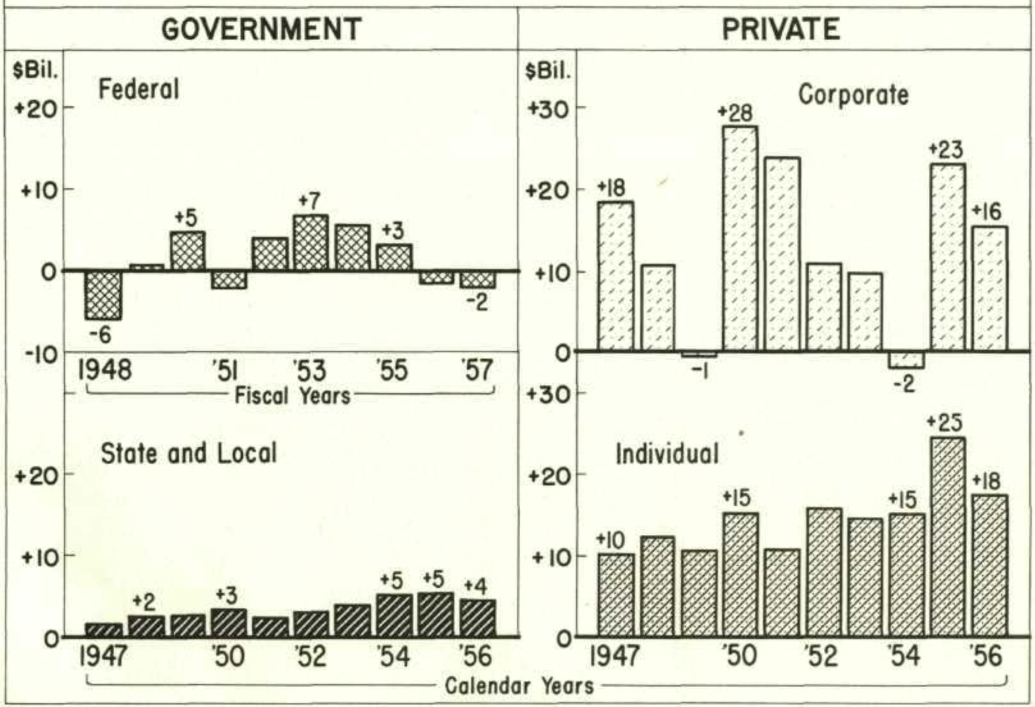
*Gross debt.

Office of the Secretary of the Treasury

B-1172-A-10

Chart 2

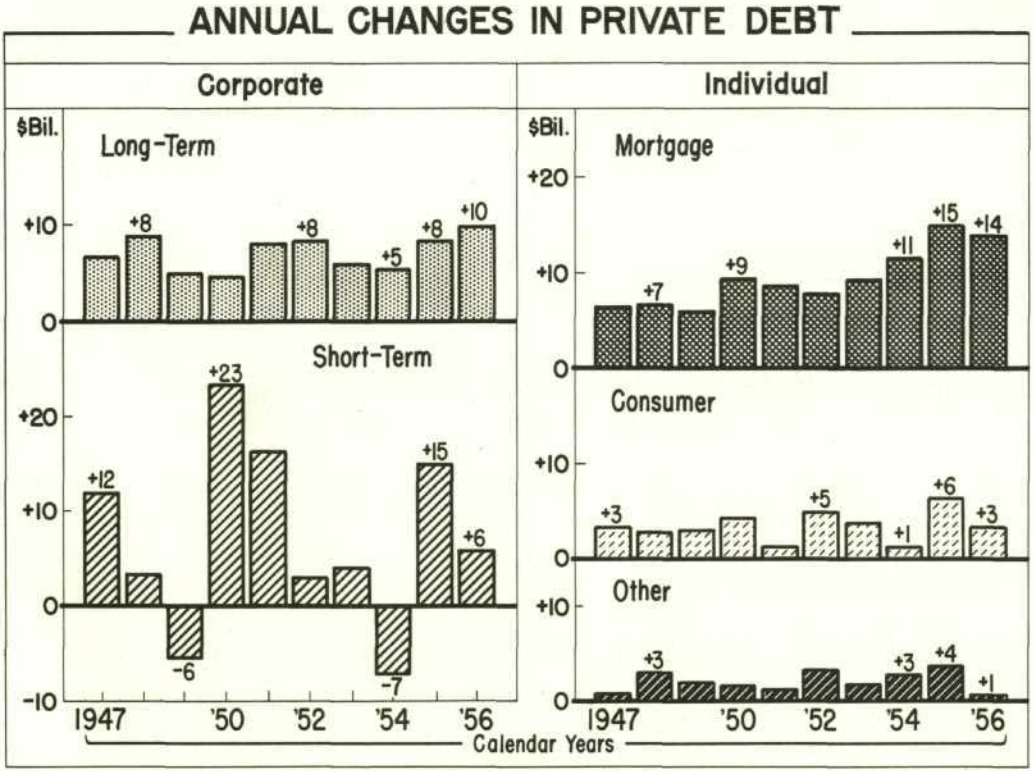
ANNUAL CHANGES IN PUBLIC AND PRIVATE DEBT



Office of the Secretary of the Treasury

B-1320-1

Chart 3



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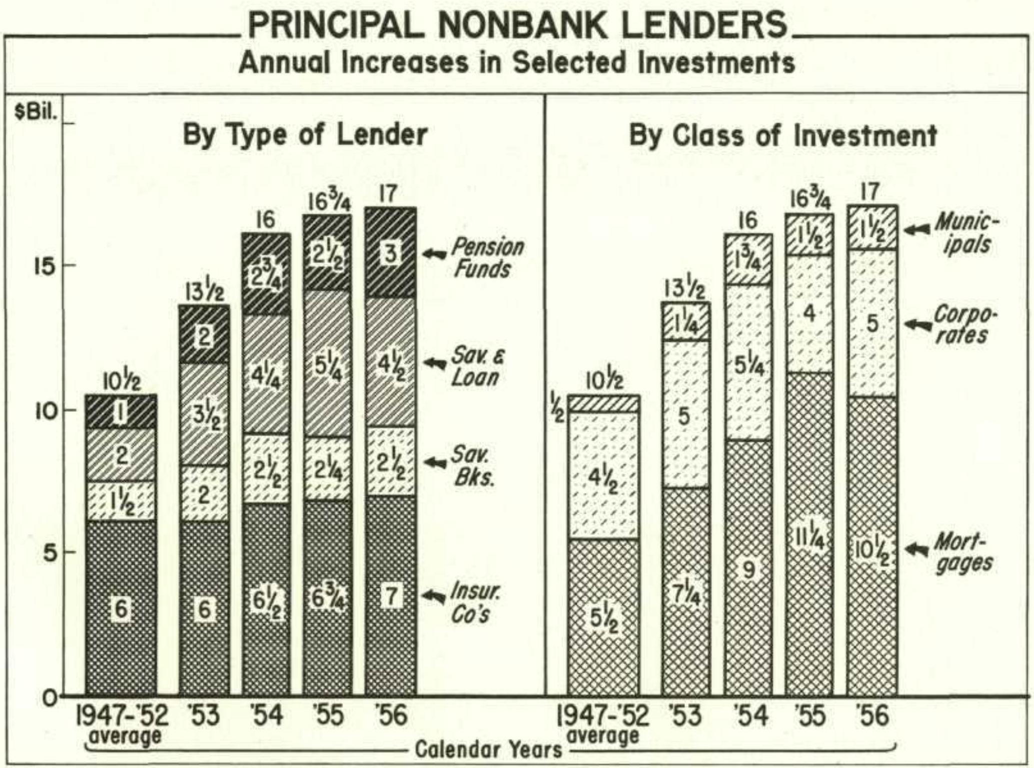

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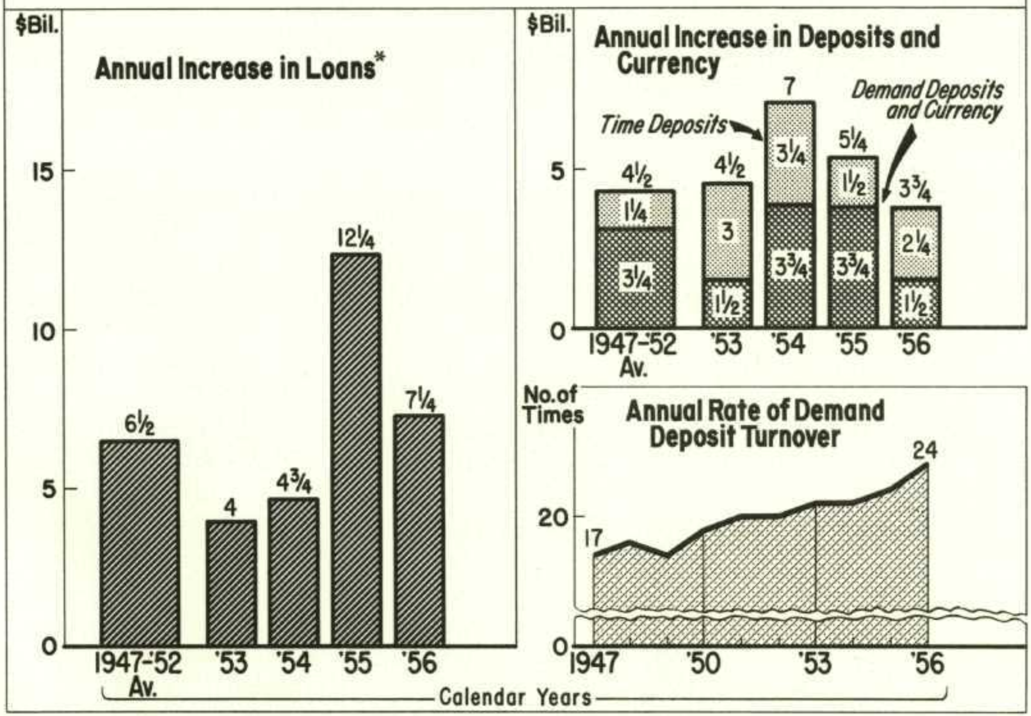
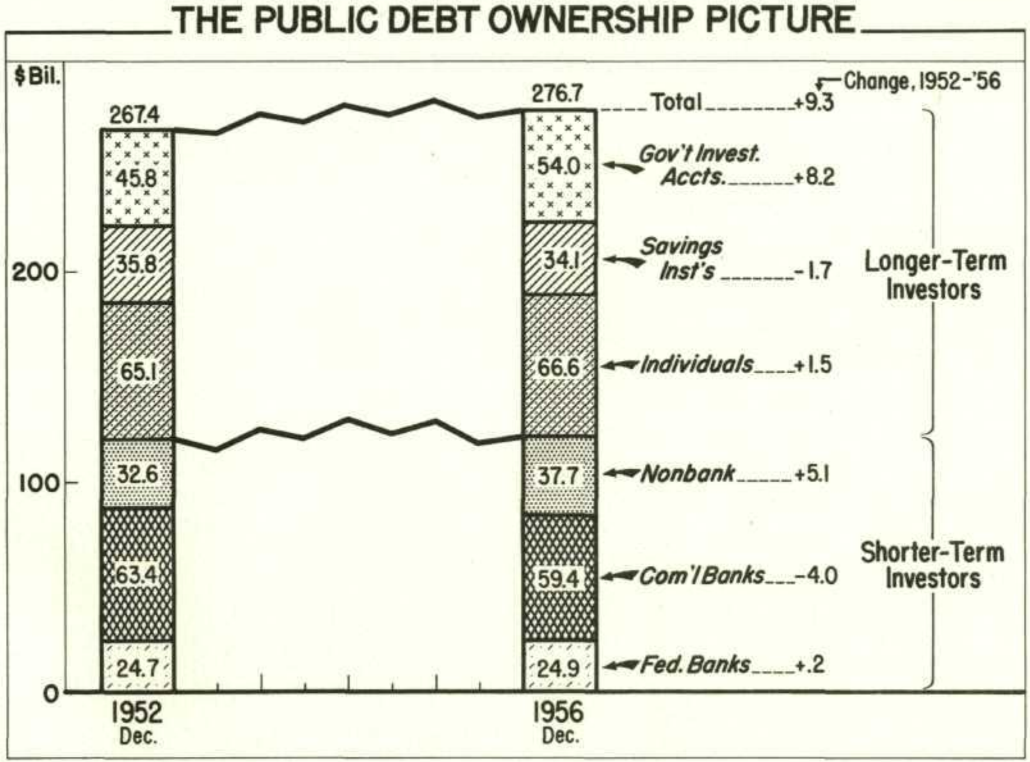
G-1030

COMMERCIAL BANK LENDING AND THE MONEY SUPPLY



*Including investments other than Governments.

Chart 6

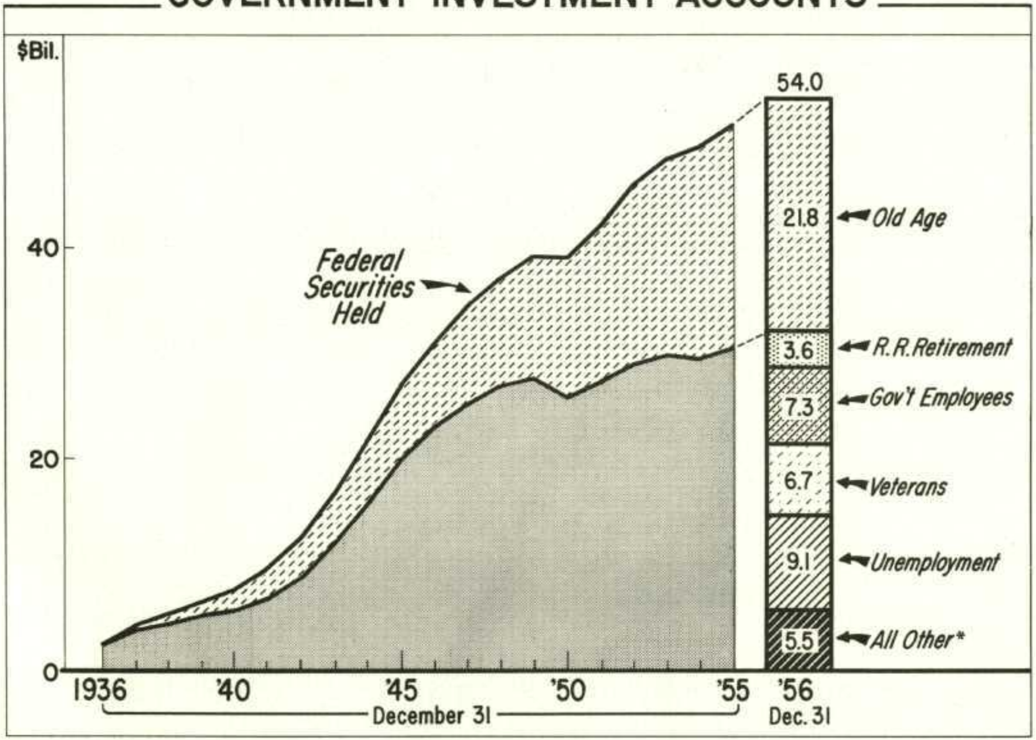


Office of the Secretary of the Treasury

B-1322

Chart 7

GOVERNMENT INVESTMENT ACCOUNTS



*Principally F.D.I.C. and Postal Savings.

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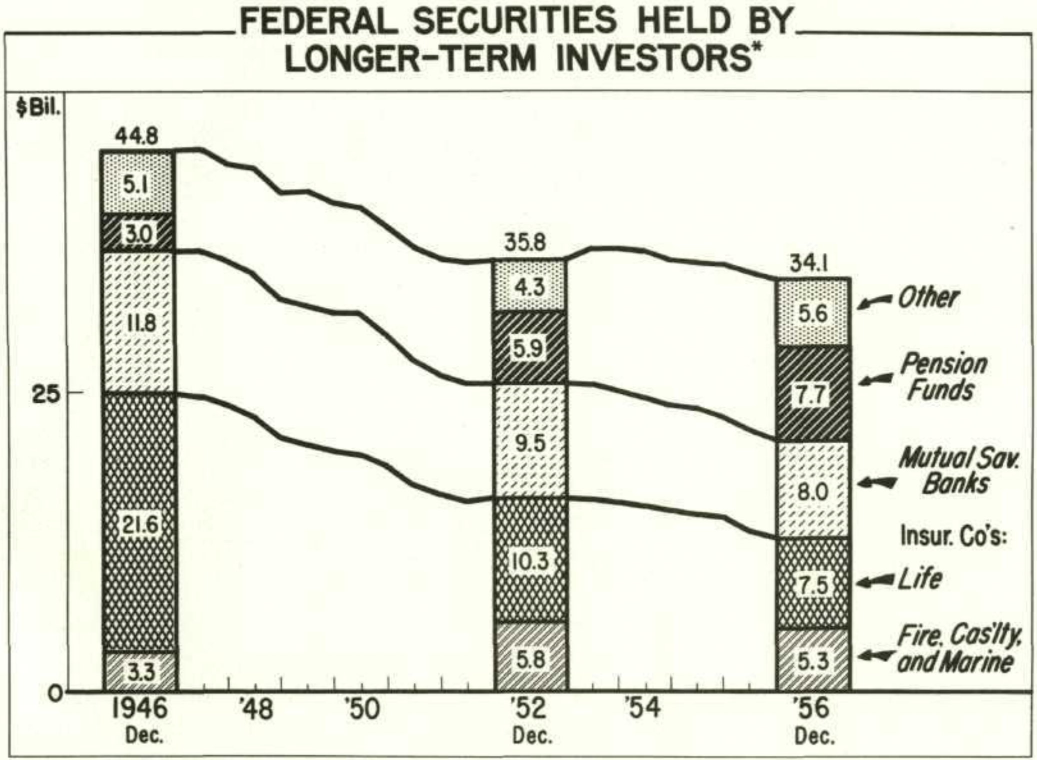
B-1283-2

Chart 8



*Nonbank excluding individuals.

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B-1280-4

Chart 9

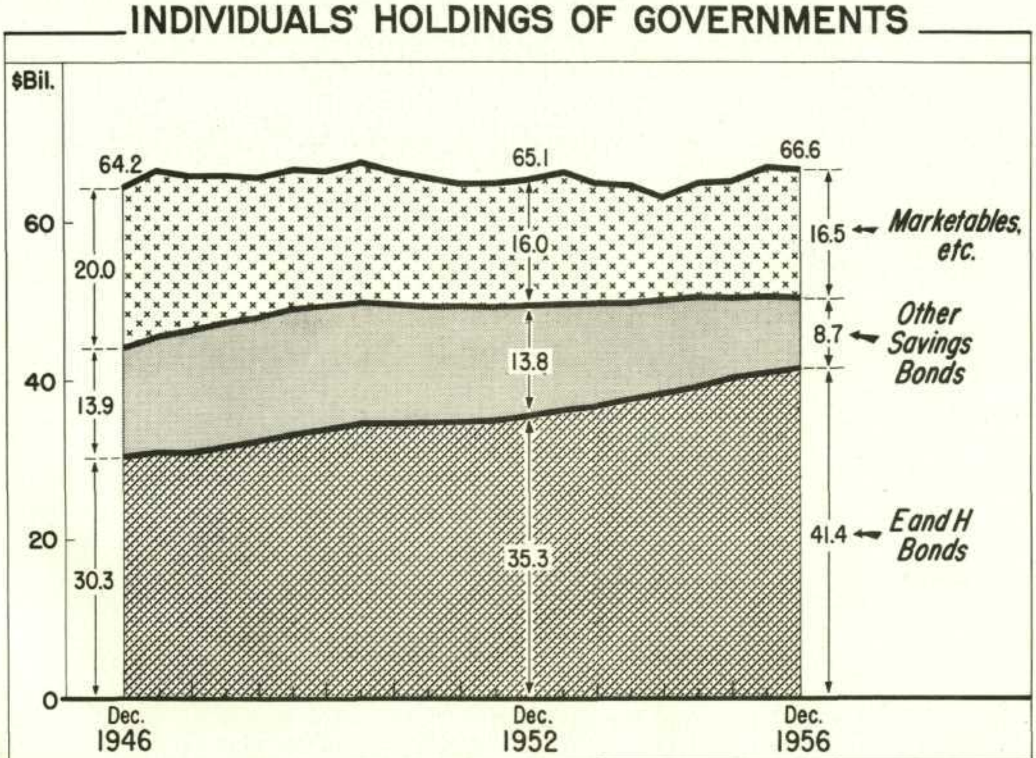

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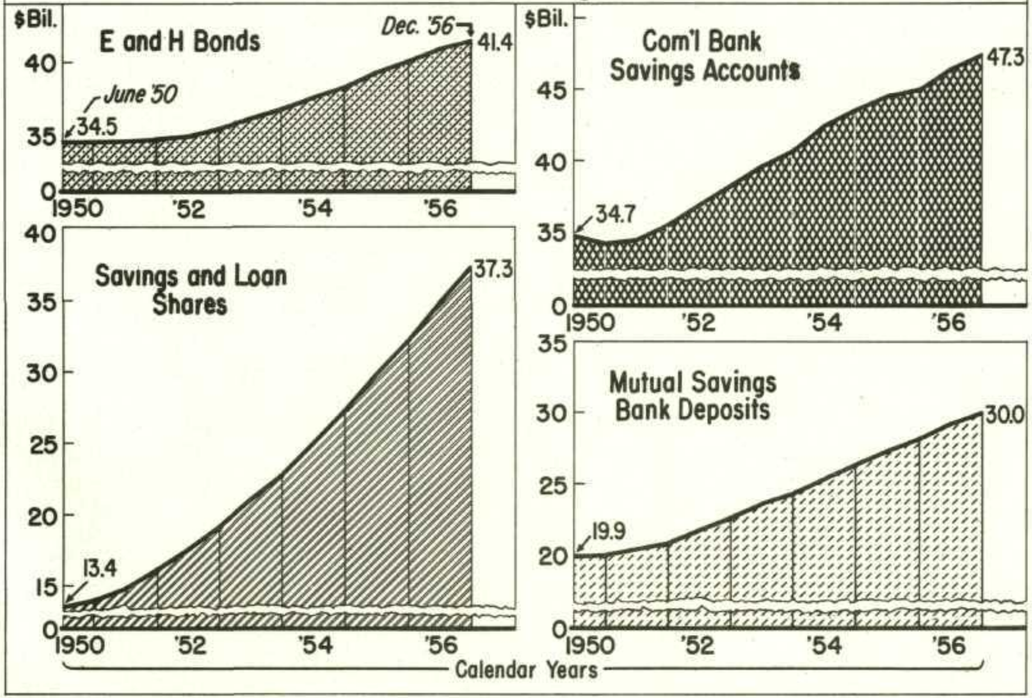
Chart 10

TRENDS IN INDIVIDUALS' SAVINGS

Amounts Outstanding, 1950-'56



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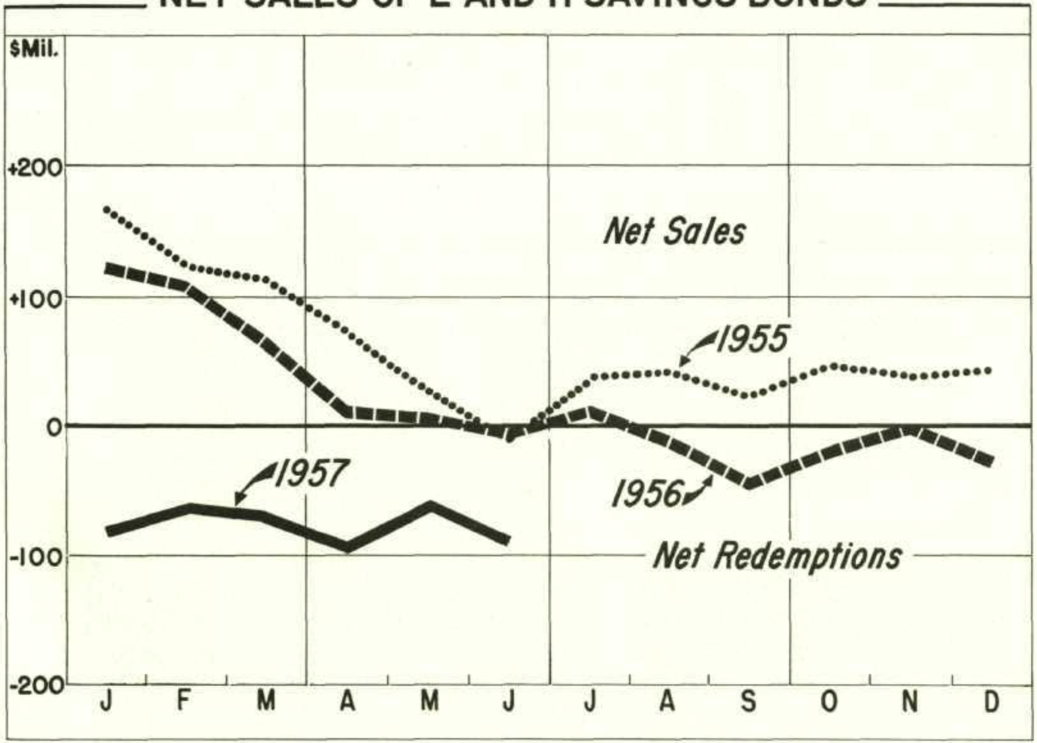
C-892-D-6

Chart II

NET SALES OF E AND H SAVINGS BONDS



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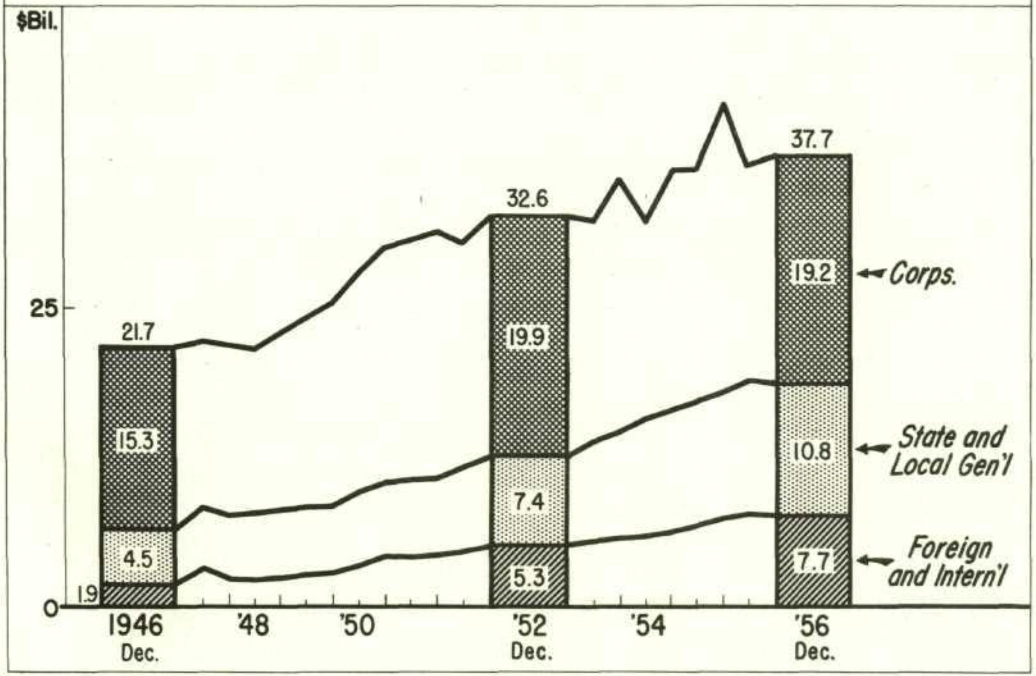
B-1317-2

Chart 12

FEDERAL SECURITIES HELD BY SHORT-TERM INVESTORS*



*Nonbank only.

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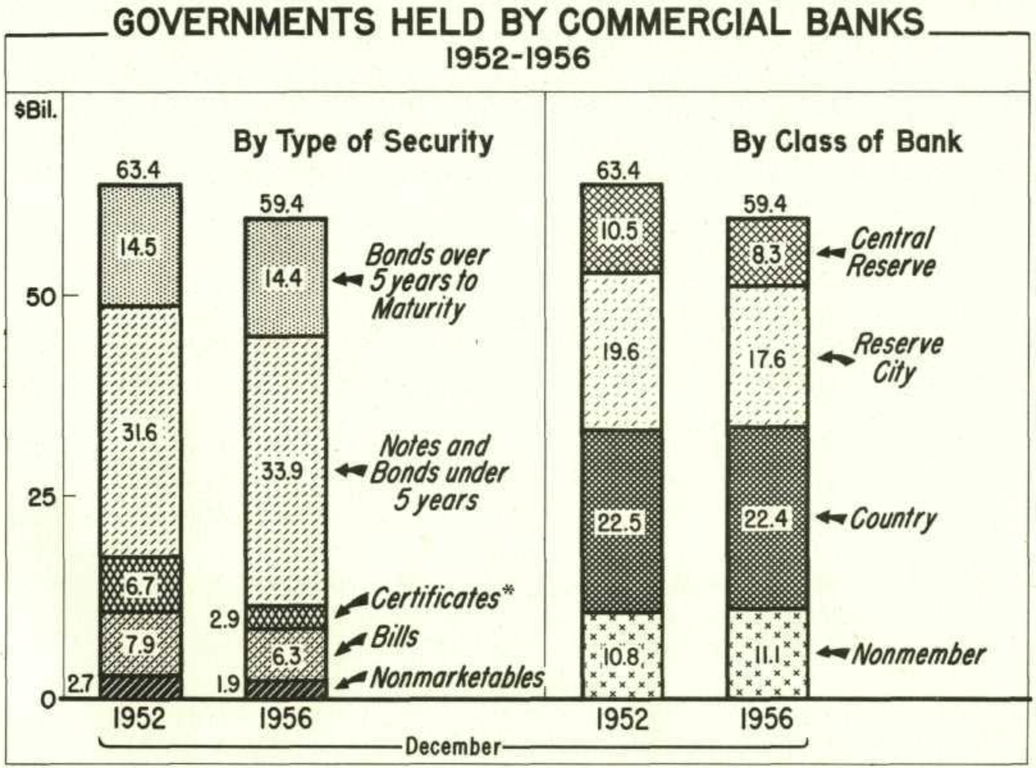
B-1281-4

Chart 13



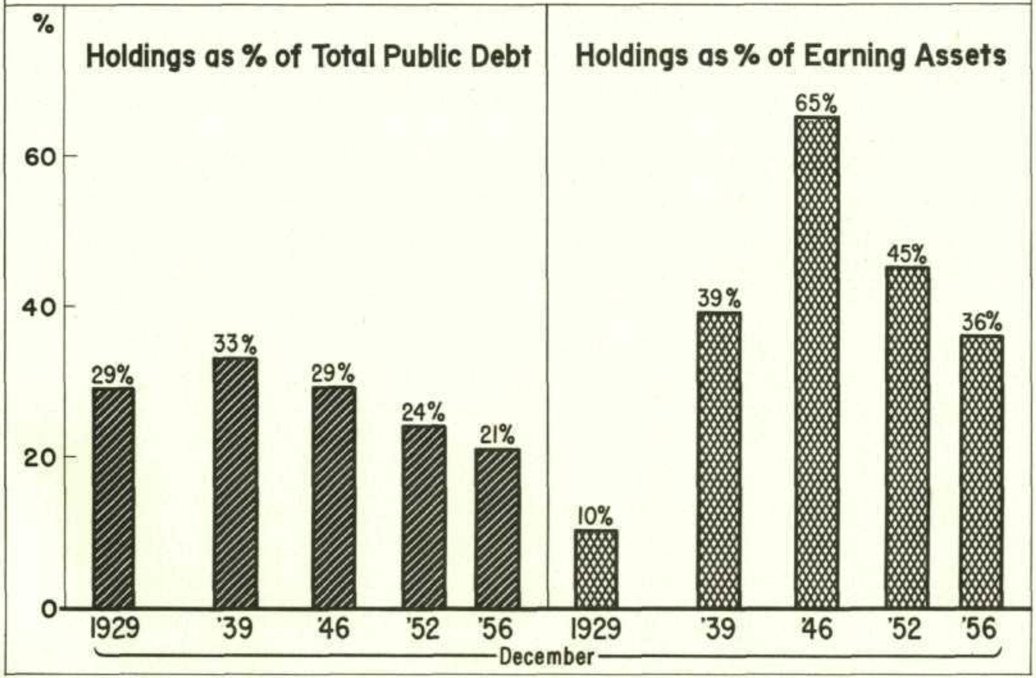
*Includes notes originally 14 months or less to maturity.

Office of the Secretary of the Treasury

B-1316

Chart 14

RELATIVE SIZE OF COMMERCIAL BANK HOLDINGS OF GOVERNMENTS

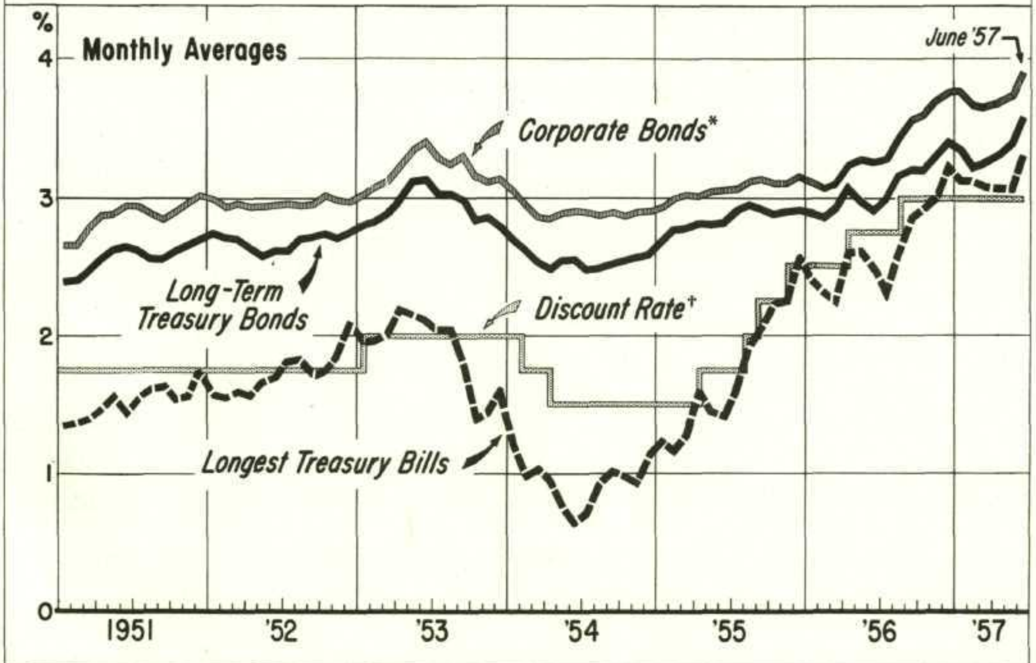


Office of the Secretary of the Treasury

B-1314

Chart 15

MARKET YIELD TRENDS OF SHORT AND LONG-TERM SECURITIES



*Moody's Aaa. †Federal Reserve Bank of New York.

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B-1261-A-6

Chart 16

INTEREST COST ON NEW TREASURY ONE-YEAR ISSUES

And Comparable Market Rates

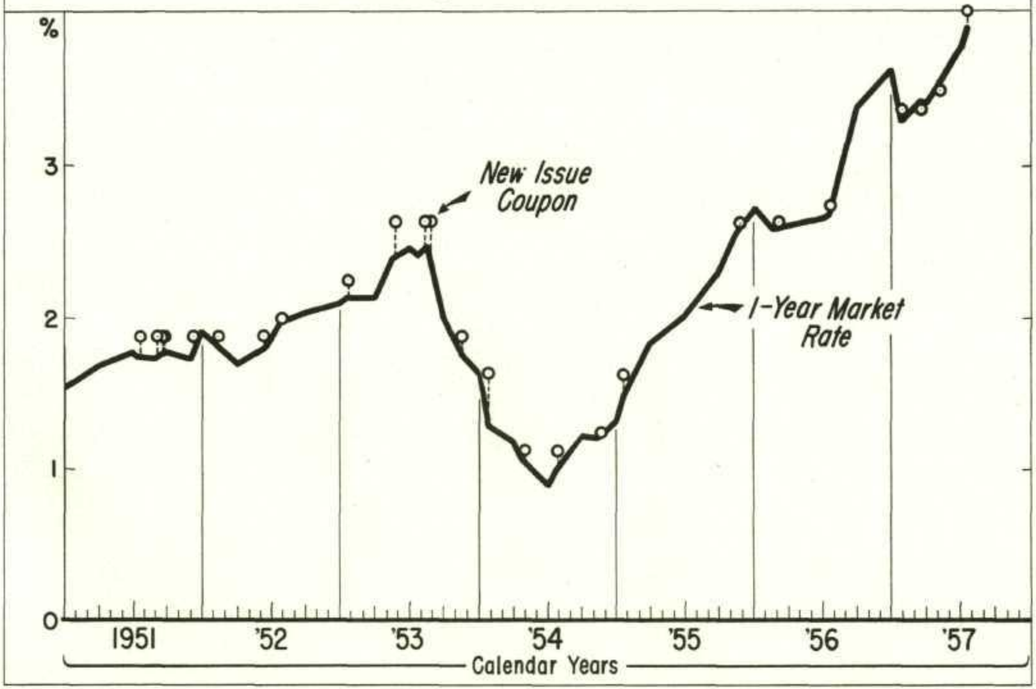

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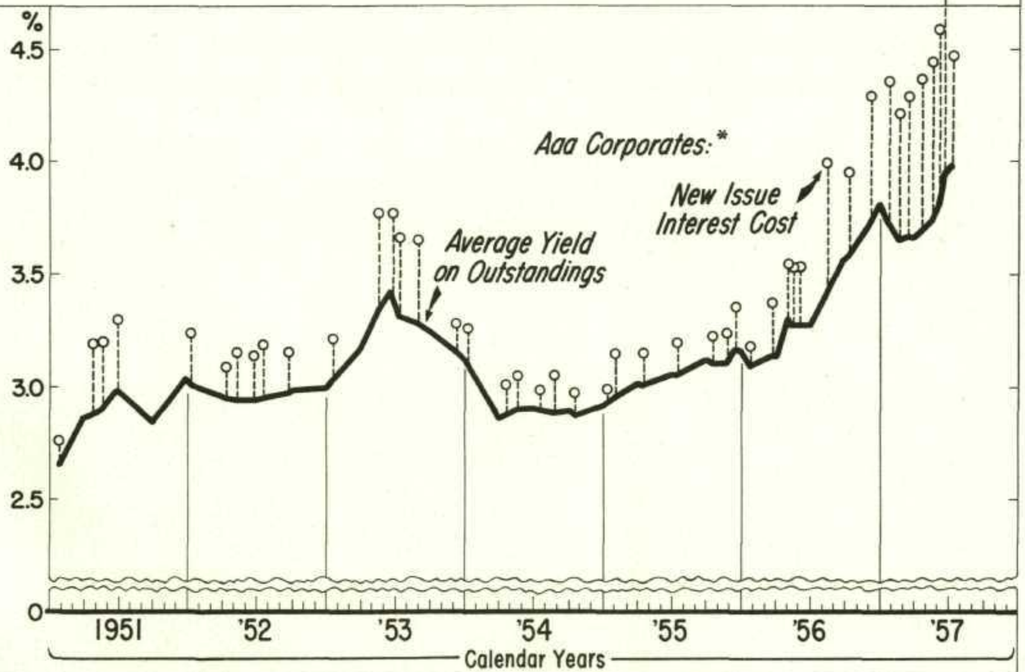
Chart 17

INTEREST COST ON NEW CORPORATE LONG-TERM BONDS
And Comparable Market Yields



*Moody's Investors Service.

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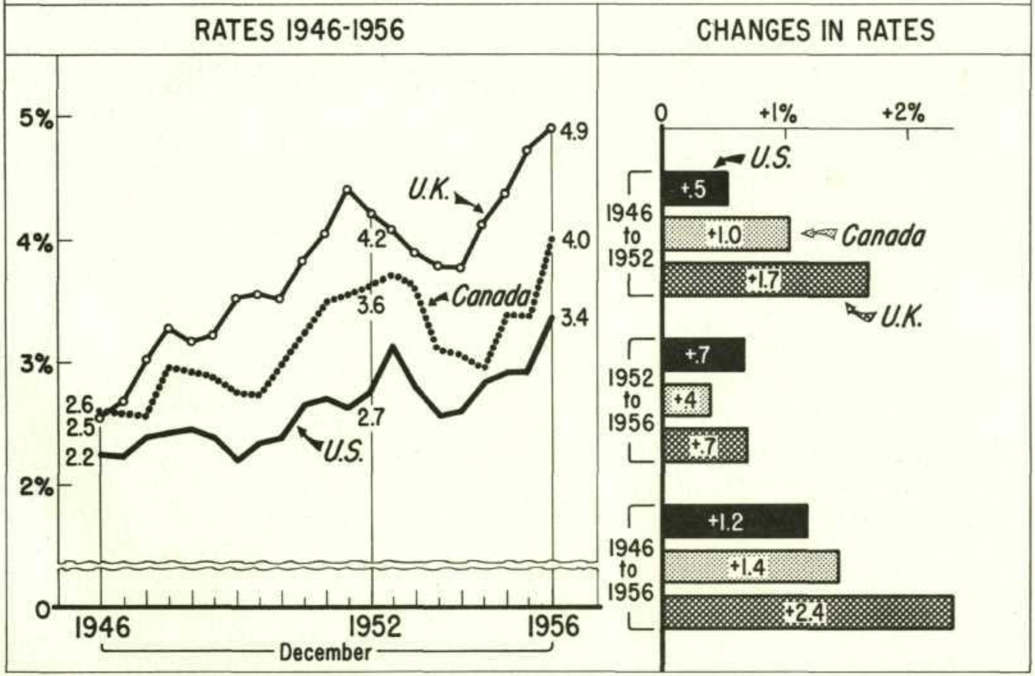
C-1032-2

Chart 18

INTEREST RATES ON LONG-TERM GOVERNMENTS

United States, Canada, and United Kingdom



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B-1315

INTEREST RATES ON TREASURY BILLS

United States, Canada, and United Kingdom

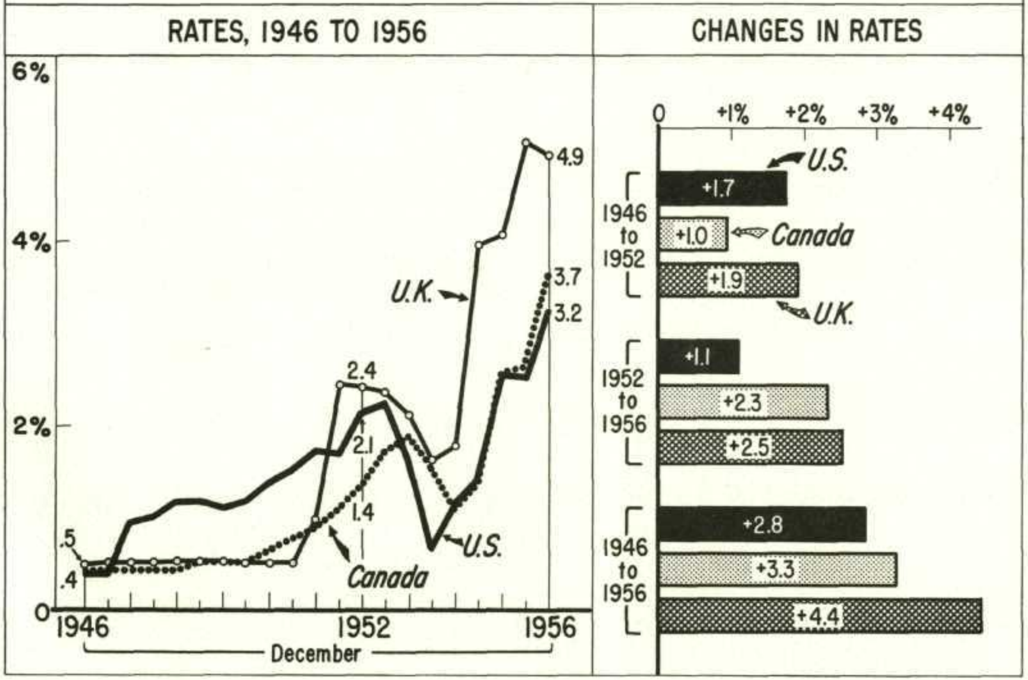
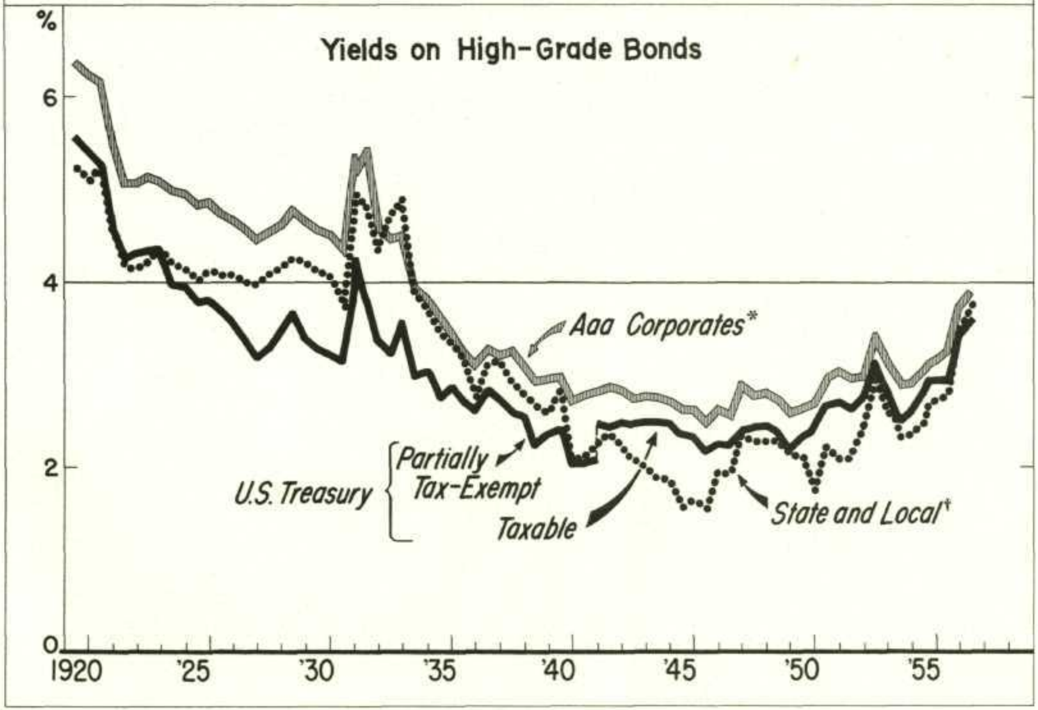


Chart 20

LONG-TERM INTEREST RATES SINCE 1920



*Moody's Investors Service. †Standard and Poor's Municipal Average.

Office of the Secretary of the Treasury

F-610

Statement by Under Secretary of the Treasury, W. Randolph Burgess before the Committee on Finance, United States Senate, 10:00 A.M. EDT Monday, July 29, 1957.

MANAGEMENT OF THE PUBLIC DEBT

I am glad to appear before your Committee today to discuss the problems of the management of our public debt in more detail than was included in Secretary Humphrey's presentation.

Let me review some of the more important changes in the debt in recent years, with particular emphasis on the period of four and a half years that Secretary Humphrey and I have been at the Treasury.

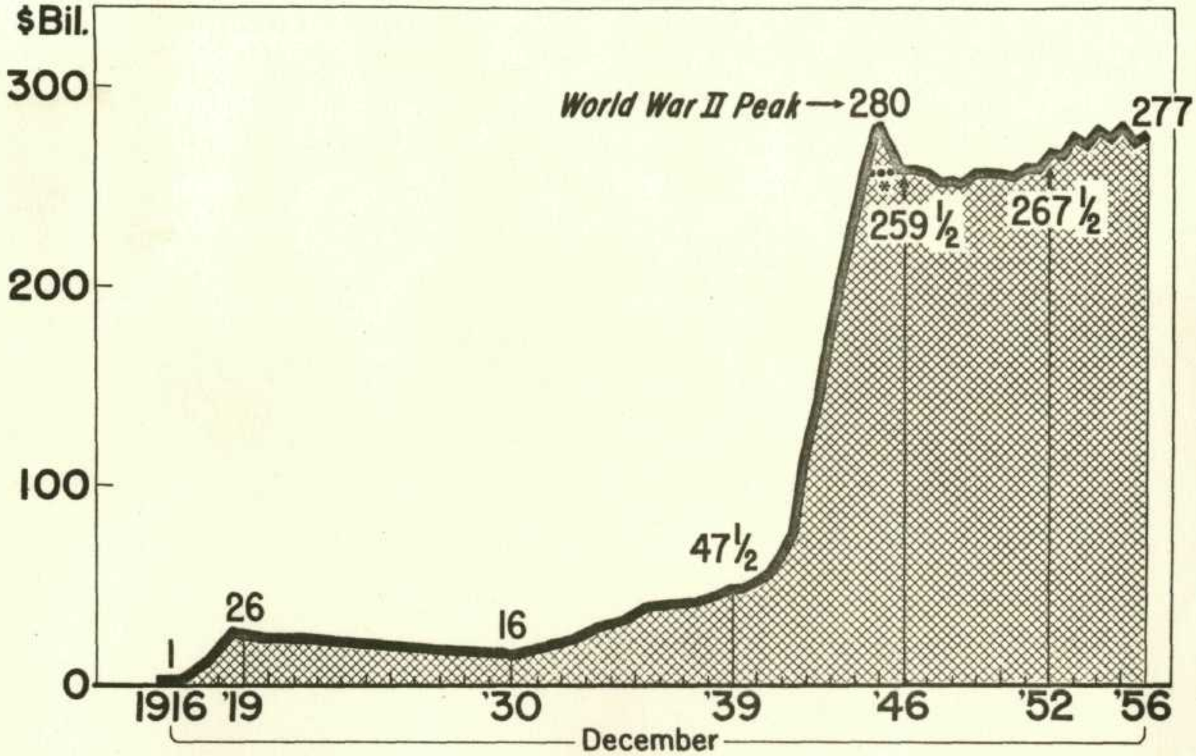
1. Trends in the size of the debt. The history of our national debt is, of course, a direct reflection of wars and depressions and changing financial policies over the years. In the first of several charts which illustrate some of our problems is a comparison of the debt over the past 40 years.

The public debt just before World War I was only $1 billion, but by the end of that war the Treasury was faced with the management of a then unprecedented debt of $26 billion. There was $10 billion of debt reduction out of budget surpluses during the prosperity of the 20's, but then came the depression and the debt trebled -- from $16 billion to $47-1/2 billion.

During World War II the debt rose to new heights and reached a peak of $280 billion in February 1946. Part of that debt, however, represented a large amount of borrowing during the Victory Loan which, as it turned out, was not needed because of a more rapid reduction in war spending than had been anticipated. Therefore, about $20 billion of that excess cash was used to pay down debt in the remainder of that year. The figure of $259-1/2 billion in December 1946 is a more representative figure of the public debt at the end of the war.

Chart I

THE PUBLIC DEBT



*Excluding Victory Loan proceeds used to repay debt in 1946.

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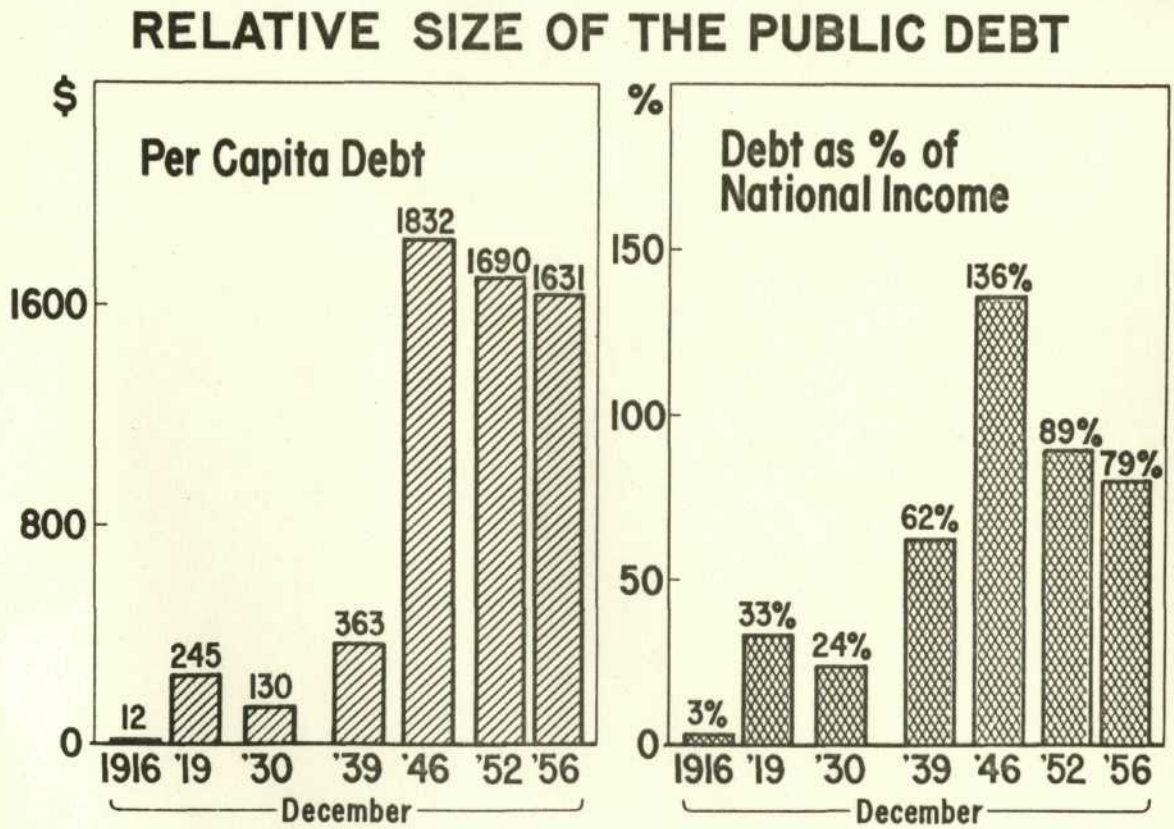
B-1204-12

Post World War II debt reduction out of budget surpluses in 1947 and 1948 was about $8 billion. Then with Korea, and an expanded defense program, there was further deficit financing and the debt grew to $267-1/2 billion in December 1952. Inherited deficits, which could only gradually be eliminated, brought the debt to an all-time seasonal peak of $281 billion by the end of 1955. This past December the debt was back down to $277 billion, reflecting budget surpluses and a better balanced seasonal pattern of corporation tax payments. Our debt of $270-1/2 billion on June 30, 1957, the seasonal low point, was $2 billion below a year ago. While this reduction is not large the important point is that despite huge defense expenditures the upward sweep of the debt has been checked and reversed.

2. <u>The burden of the Federal debt relative to our strength</u>. As our economy grows steadily and confidently, so does our ability to carry a given amount of public debt without too great a strain on the economy. Thus the sound economic growth of our Nation in recent years has made the Federal debt somewhat less burdensome.

Chart 2



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The left-hand side of Chart 2 shows the relative size of the Federal debt on a per capita basis. By December 1946 it had risen to a high point of $1,832 for every man, woman, and child in America. By December 1956 it had shrunk by about $200 per capita, by reason of the growth of the population. By June 30, 1957 the per capita debt was down further — to $1,581.

When the Federal debt is related to national income -- on the right side of Chart 2 — the reduction in burden is much greater. Ten years ago the $259-1/2 billion public debt was one-third larger than our national income of about $190 billion. National income has now grown to more than $350 billion, so that our $277 billion national debt in December 1956 was equal to only 79% of national income. As of June 30, 1957 the ratio had fallen further -- to 75%.

Unfortunately, a part of this reduced ratio of debt to income -- particularly prior to the Federal Reserve-Treasury accord in 1951 — was a reflection of the inflation of the earlier post war years which brought about a significant decline in the purchasing power of the dollar. In spite of inflation, however, a large share of the reduction represents the growing productivity of our Nation in real terms -- the increased ability to produce more houses, industrial plants, highways, schools, cars, TV sets, etc. With greater price stability during the past four years, increased productivity has accounted for almost all of the reductions since 1952.

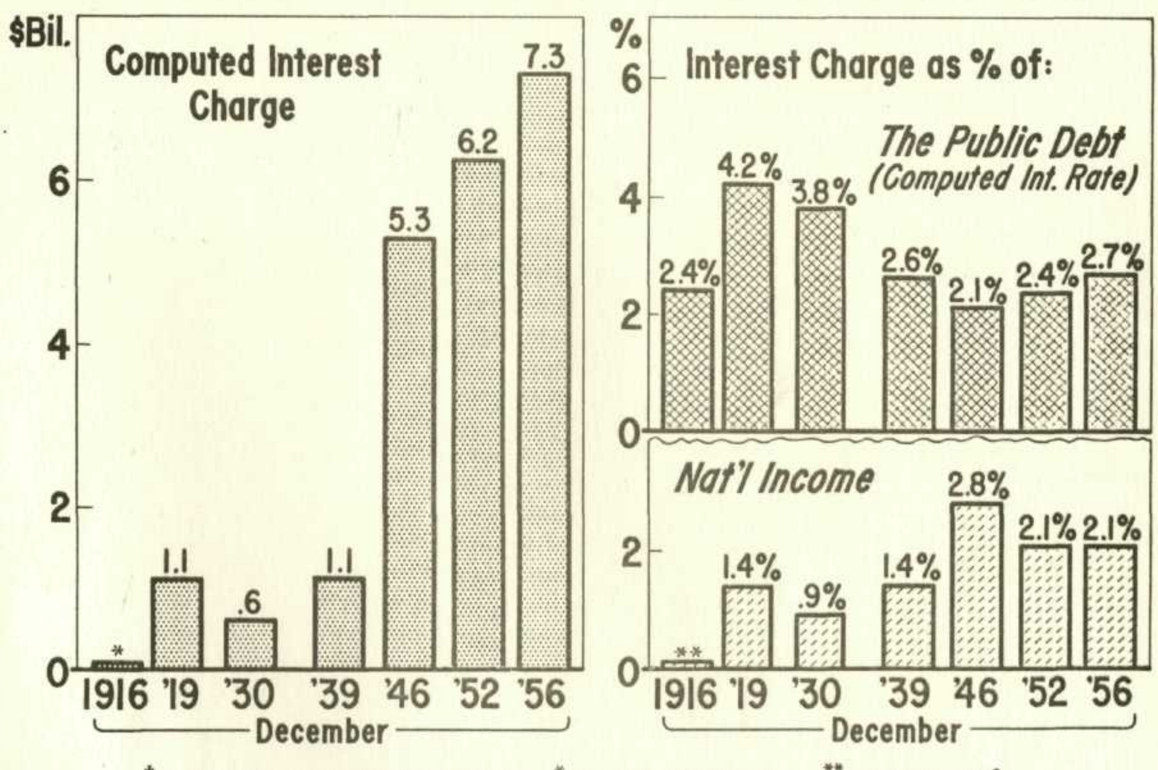
In this way we are gradually growing up to the debt, so that even though the dollar amount of debt is not declining as much as we might wish, the debt still becomes somewhat less burdensome.

Another way of looking at the public debt is in terms of its interest burden.

The left-hand side of Chart 3 shows the computed interest charge on the debt, which has been rising during the past decade, partly because of the increased size of the debt and partly because of the increased interest rates associated with the strong demand for money in our record prosperity. By December 1956 the interest charge on the debt had risen to $7.3 billion a year, an increase of $1.1 billion in four years as against an increase of $.9 billion in the preceding six years.

Chart 3

INTEREST BURDEN OF THE PUBLIC DEBT†



*†Excluding guaranteed securities. *Less than $50 million. **Less than .05%.*

B-1219-6

It should be remembered that these total interest costs are not a proper measure of the net cost of interest to the people of the country or the net drain on the Federal budget.

The money used to pay the interest is collected from many people in taxes, and the money is paid out again partly to the same people and partly to others. About as many people benefit directly or indirectly from these interest payments as are hurt by them.

As to the budget, the Federal Treasury gets back promptly in taxes a substantial slice of the interest it pays out. Also much of the interest goes to Government trust accounts — or to the Federal Reserve System which returns 90% of its net earnings to the Government.

The upper right-hand side of Chart 3 shows that the computed interest rate on the public debt has risen by about three-tenths of one percent in the four years ending December 1956, after increasing about three-tenths of one percent from 1946 through 1952. The rate as of June 1957 was 2.7% and even after the current refunding operation is completed the rate will be 2.8%.

Looking back, we note that the current average interest charge on the debt is not much higher than it was in 1916, just prior to our entry into World War I; it is well below the average rates in the 20's; and it is very close to what it was in 1939 at the outbreak of World War II, despite the fact that the earlier rates were partially tax-exempt.

Of course, during World War II interest rates were held at artificially low levels and that carried over into the post war era. The current rates are high only in comparison with the abnormally low rates during periods of depression, war, and rate pegging. In terms of history these are not very high interest rates.

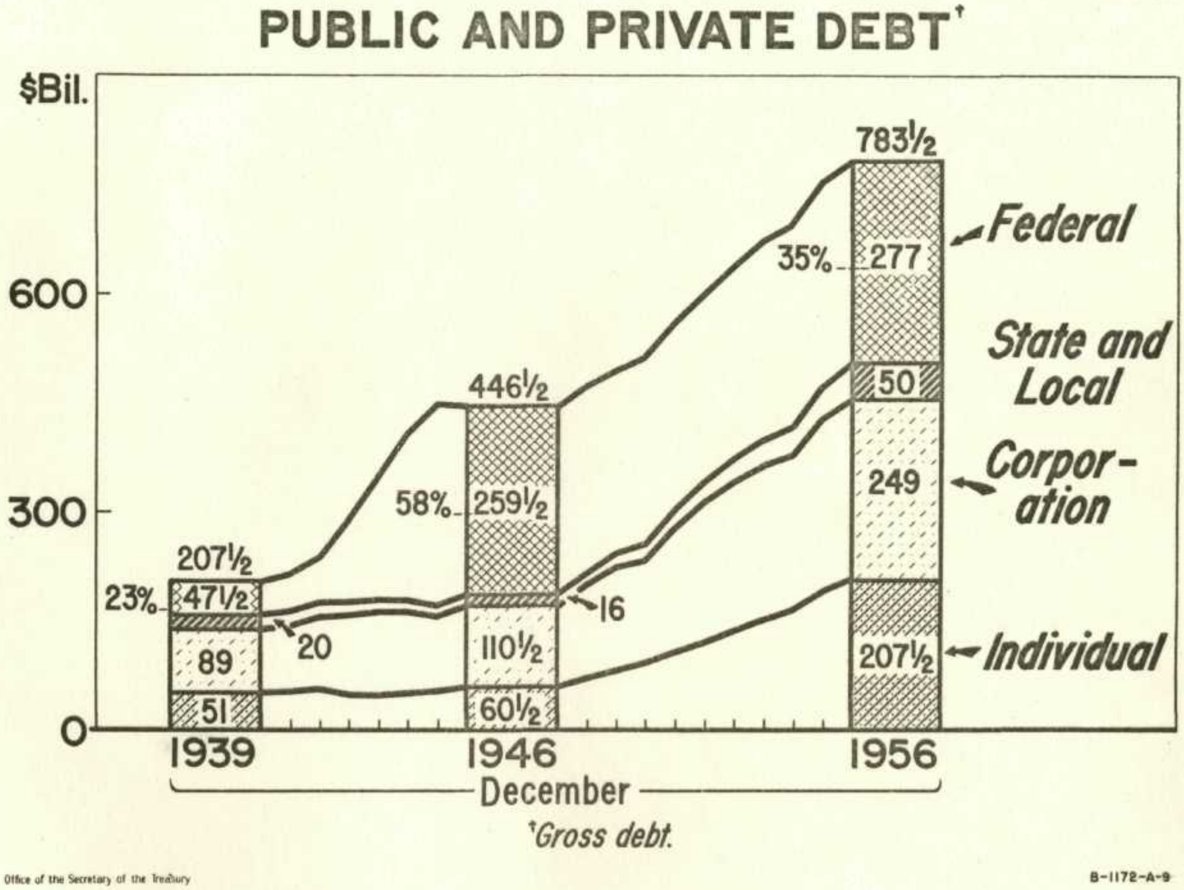
Relating these interest rates to national income we find that now, as in 1952, they represent only 2.1% of national income as against a high point of 2.8% of national income in 1946.

We should, of course, continue vigorously our policy of seeking to reduce the debt. That is the American way. We have done it before; we are doing it right now. Debt reduction helps to combat inflation; it releases funds for other uses; it strengthens our national readiness for any contingency.

3. The Federal debt and other debt. Another way to look at the Federal debt is in its relation to other kinds of debt in the United States. Chart 4 shows the total public and private debt on a gross basis over a span of years. The chart starts in 1939, just before the war, when the total public and private debt of the Nation was $207-1/2 billion. In financing the war over-all debt was increased tremendously, with almost all of the change in the Federal sector as the Federal debt rose from $47-1/2 billion to $259-1/2 billion. During the war, when civilian activities were kept under wraps, private debt increased very little. Financial as well as physical resources were diverted to the war effort. State and local government debt actually decreased because maturities were paid off and new projects were limited. The corporation and individual debt increased only slightly during those seven years.

The change during the past decade is shown by the bars in the middle and on the right side of Chart 4. The Federal debt has increased $17-1/2 billion since 1946. In terms of percentage of the total debt structure, however, it has declined from 58% of the total to 35%, but it still exceeds the pre-war percentage of 23% by a substantial margin.

Chart 4



The total debt at the end of 1956 was $783-1/2 billion, which is up about 75% over the past decade. During that same period our national income has nearly doubled, again partly by inflation and partly by real growth. Thus, our total debt today is a smaller percentage of our national income than it was ten years ago.

State and local government debt increased as the States and localities went ahead with new highways, schools, hospitals, public buildings, and utility services on an unprecedented scale -- programs which had been held back during the war. The total State and local debt is now about $50 billion.

The corporate debt also has increased by leaps and bounds as corporations have undertaken post war expansion and modernization programs. These figures include bank loans and accounts payable as well as new corporate bonds and notes. The pressure on the security markets of these huge demands for money is the major source of present problems in Treasury financing.

The individual debt more than tripled during the last ten years, from $60-1/2 billion to $207-1/2 billion, mostly in the form of increased home mortgages and consumer debt.

As Secretary Humphrey has already mentioned to you, the total of all debt has increased $146-1/2 billion during the past four years, with all but $10-1/2 billion of the increase accounted for by nonbank sources rather than by increases in the money supply. It thus rests very largely on a sound base of savings rather than on any excessive bank credit expansion, but it has been heavier than the present flow of savings could take care of without straining the capital markets. Many buyers of bonds and mortgages have been getting part of their funds by selling Government securities.

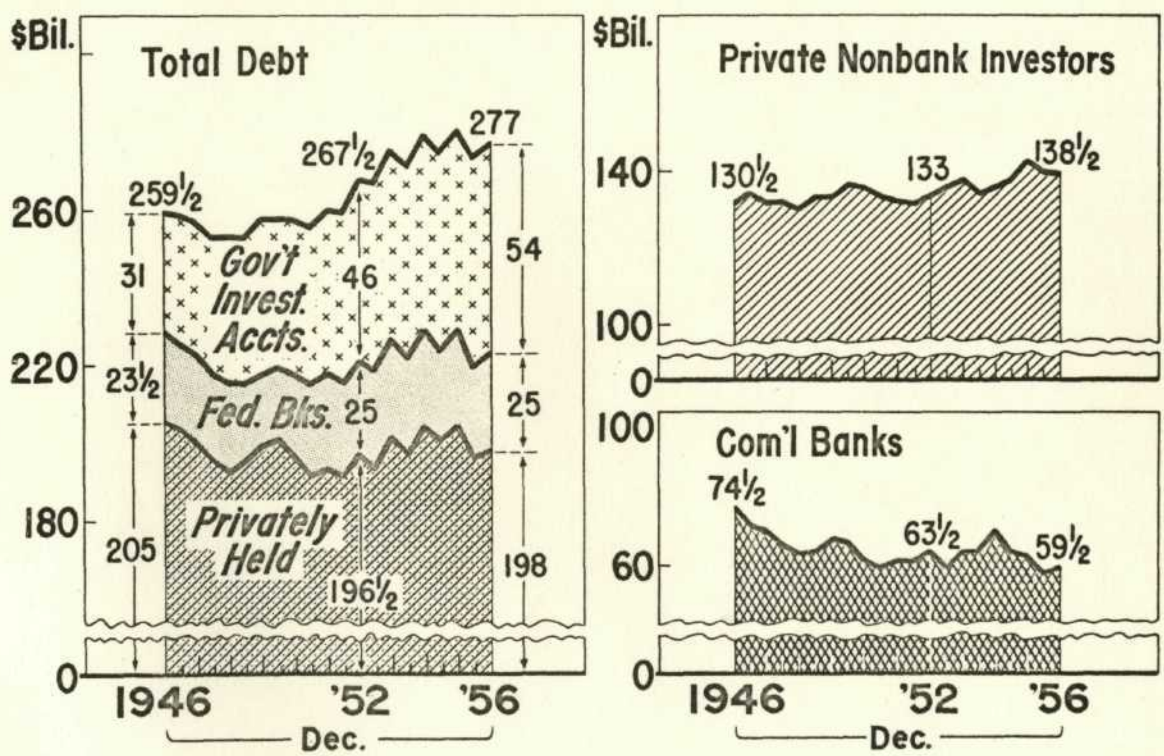
Of the record of the past two years it might well be said that almost everybody except the Federal Government has been increasing his debt. Nevertheless, the Federal debt is still the largest single sector of debt and has a great impact on the country.

The effect of the huge public debt on the country's economic growth and stability depends a great deal on how the debt is distributed among the citizens and financial institutions and the types and maturities of the securities which make it up. So I ask your indulgence in presenting the facts on these points.

4. Who holds the debt? Chart 5 presents the picture on the ownership of the public debt from 1946 to date. During the four years ending in December 1956 the debt has risen -- as shown earlier -- by $9-1/2 billion. About $8 billion of that is accounted for by an increase in the ownership of Government securities by Government investment

Chart 5

PUBLIC DEBT OWNERSHIP TRENDS



Office of the Secretary of the Treasury

B-1300-2

accounts -- largely representing savings by or for individuals in the form of social security, veterans' life insurance, retirement reserves, etc. With Federal Reserve bank holdings of Governments showing no net change during these four years this left only about $1-1/2 billion to be absorbed privately.

As shown on the right-hand side of the chart, at the end of December 1956, commercial banks held $59-1/2 billion of the debt. That was $4 billion less than in December 1952. It should also be noted that the banks had only 36% of their earning assets in Government securities at the end of 1956 as against 45% in 1952 and 65% ten years ago. Bank holdings were further reduced through June 1957. These reductions reflect bank sales of governments to get funds to meet the loan demands of their customers. Financing the Treasury during this period without adding to bank holdings of U. S. securities has kept down one inflationary potential.

The upper right-hand part of Chart 5 shows an increase of $5-1/2 billion in the holdings of Government securities by what we call "private nonbank investors". All of this increase may be credited to those individuals who have added more than $6 billion to their holdings of Series E and H savings bonds during the past four years. The Treasury has put great emphasis on the widespread sale of these small-saver bonds.

Pension funds (State and local as well as corporate) have also been net buyers of Government securities and so have short-term investors, such as foreign accounts and state and local general funds. These increases have been enough to more than offset net sales by insurance companies and savings banks as they responded to the tremendous demands on them for money for mortgages and capital expenditures.

5. Maturity structure of the debt. Parallel to the question of who holds the debt is that of the distribution of the debt among maturities.

The cheapest and easiest way to borrow is usually at short-term, relying first on temporarily idle funds of corporations, trust funds, foreign funds, and -- when necessary -- on the banks, which in turn might borrow from the Federal Reserve System.

There is indeed a large legitimate short-term market for the Treasury to tap, particularly today when lenders of money are trying to keep liquid. The present weekly roll-over of $1.6 billion to $1.8 billion of 91-day Treasury bills meets an important market need, is not inflationary, and does not strain the market.

But there are a number of reasons why short-term debt becomes undesirable beyond some reasonable amount.

First, a large body of short-term debt increases the frequency as well as the volume of Treasury financing. It may constitute an irritant at times to the smooth operation of the market for short-term funds and for corporate and municipal securities. Also, to the extent that the anticipation, the announcement, the offering and the digestion of new Treasury issues spreads over a large part of a year, the time available for the Federal Reserve to take appropriate credit and monetary policy actions may be restricted.

A large volume of short-term debt adds to the liquidity of banks and businesses and others who hold short-term Government securities as practically a cash reserve. This strengthens the position of the holders but by the same token makes them less responsive to changes in monetary policy. They can get cash readily by selling their short-term Government securities.

If at any time in the future the Treasury is faced with a financing emergency it will probably have to fall back on short-term borrowing. It is important, therefore, that this source of funds not be depleted unnecessarily ahead of time. In that way any minor emergency which arises may be handled by selling short-term securities to the private market rather than having to use the Treasury's authority to borrow directly from the Federal Reserve System.

Of course when short-term borrowing means increasing bank credit, i.e. the volume of money, that is directly inflationary. It is for these reasons that any country in time of war makes a vigorous effort to sell as much of its securities as possible outside the banks as well as for a longer term. To the extent war is financed out of taxes and savings the worst pressure for inflation is checked.

5a. War and post war program through 1952. In the Treasury War Loan drives of World War II the typical package of securities included savings bonds and notes, a long - term 2-1/2% bond, not eligible for purchase by commercial banks, a ten year 2% bond -- and also a short-term certificate and perhaps a medium-term note. During the war a large volume of bonds could be sold because investors had a limited number of other uses for accumulating savings. Few new mortgages were being written, and neither business nor local government units were heavy borrowers, as we saw in the chart on public and private debt.

The post war period brought different problems. All types of borrowers began clamoring for money. Government bonds were relatively unattractive at their low pegged interest rates, and it was clear to most lenders that rates could not be held at these levels, even though the Treasury tried.

In any event little progress was made from 1946 to 1952 in funding the debt, though there were several issues of notes and two short bonds prior to 1953. The refunding in 1951 and 1952 of a large block of 2-1/2% bonds into 2-3/4% nonmarketable Series B investment bonds with an optional exchange into 5-year notes had the effect of shortening the average length of the marketable debt. Excluding these issues the average maturity of the marketable debt declined by about 40% in the six years ending in 1952 largely through the passage of time.

5b. Program of the past 4-1/2 years. When the new Administration came in we set a goal of selling longer-term securities and giving the debt a wider distribution whenever the market made it possible.

We redoubled our efforts to sell Series E and H savings bonds widely to the people.

We began to shut down on the sale of other debt payable on demand at the option of the holders.

We began promptly the sale of long-term bonds to the market in the spring of 1953 at the interest rates necessary to sell them. In 1954 and 1955 we made substantial progress towards our objective by selling a large volume of intermediate-term securities, together with $2-3/4 billion of 3% 40-year bonds. In 1956 and 1957, in the midst of the current tremendous capital boom, we have sold no new bonds and only a limited amount of intermediate-term notes.

There are a number of ways of measuring the changes in the debt structure over the years. Some of them refer only to the marketable debt, such as figures on the average length of the debt. Others — more comprehensive — take into account not only the maturity distribution of the marketable debt but also the demand character of other portions of the debt.

All of these "yardsticks" show that we have moved forward in improving the structure of the debt during the past 4-1/2 years, especially in comparison with the record of the earlier post war period.

6. Average maturity of the marketable debt. One measure of the structure of the debt is the average length of time that the marketable debt has to run to maturity. The amount outstanding of each security making up the marketable debt is multiplied by the number of months it still has to run. These amounts are then added up and divided by the amount of marketable debt outstanding to give a figure on average length to maturity.

Although the average length of the marketable debt does not reflect changes in other types of debt like savings notes and savings bonds, it is still useful as a yardstick since it encompasses nearly 60% of the total debt outstanding, including the most volatile areas of the debt. The average length of the marketable debt to maturity (calculated to first call date on callable bonds) amounted to 7 years and 2 months in December 1939. By December 1946, that average had fallen to 6 years and 3 months, after excluding -- to make the comparison fair -- those 2-1/2% long-term bonds sold in 1944 and 1945 which were exchanged for nonmarketable investment bonds in 1951 and 1952. By December 1952 the average had fallen further to 3 years and 10 months. Although the average rose above 4 years for awhile during 1954 and 1955 when Treasury debt extension was most active, at the end of 1956 it was back down to 3 years and 9 months -- one month shorter than 4 years earlier. By June 1957, the average had fallen by two more months.

This record indicates a loss in average length of 3 months during a period of the past 4-1/2 years as against a loss of 29 months during the 6 preceding post war years. The loss since December 1952 is even less when only publicly held securities are considered, since Federal Reserve held securities, many of longer maturity originally, are being refunded into short-term issues under the present policy. (The average length, exclusive of Federal Reserve, was 4 years and 1 month in June 1957 as compared with 4 years and 2 months in December 1952.)

Furthermore, this measure of average maturity takes no account of nonmarketable demand debt, which has proved an awkward inheritance.

7. The "floating debt". A more accurate measure of changes in the structure of the public debt from the point of view of the job of the debt manager is a comparison between the "floating debt" on the one

hand and intermediate and longer-term issues on the other, basing the figures on publicly held debt. This means excluding securities held by the Federal Reserve banks and Government investment accounts, but including in the floating debt the most volatile part of the nonmarketable debt payable on demand.

The following table shows the composition of the debt from this point of view.

Structure of the Public Debt
(In billions of dollars)

	December 31			June 30
	1952	1953	1956	1957
Held by Federal Reserve banks and Government investment accounts	70.6	74.2	79.0	78.6
Held by the public:				
Floating debt:				
Under 1-year marketables	42.9	58.8	45.6	50.6
Savings notes	5.8	6.0	....	....
F, G, J and K savings bonds	22.6	21.0	14.9	13.1
Miscellaneous demand debt 1/	3.4	3.5	3.5	3.0
Total floating debt	74.6	89.3	63.9	66.7
Intermediate and longer-term issues:				
E and H savings bonds	35.3	36.7	41.4	41.5
Investment Series B bonds	9.1	8.6	7.5	7.2
Marketables maturing in:				
1-5 years	33.3	24.9	42.3	38.8
5-10 years	19.8	15.5	14.2	11.3
Over 10 years	24.8	26.1	28.4	26.5
Total, held by the public	122.3	111.7	133.8	125.3
Total debt	267.4	275.2	276.7	270.6
% floating debt to total	27.9%	32.4%	23.1%	24.7%

1/ Includes Investment Series A bonds, depositary bonds, matured debt on which interest has ceased, and debt bearing no interest.

We have made progress in our efforts to reduce the amount of "floating debt" which the Treasury may be called upon to handle each year. About 28% of the debt was in this category in December 1952. The percentage rose to over 32% in 1953, but fell to 23% by the end of 1956, and was about 25% on June 30, 1957.

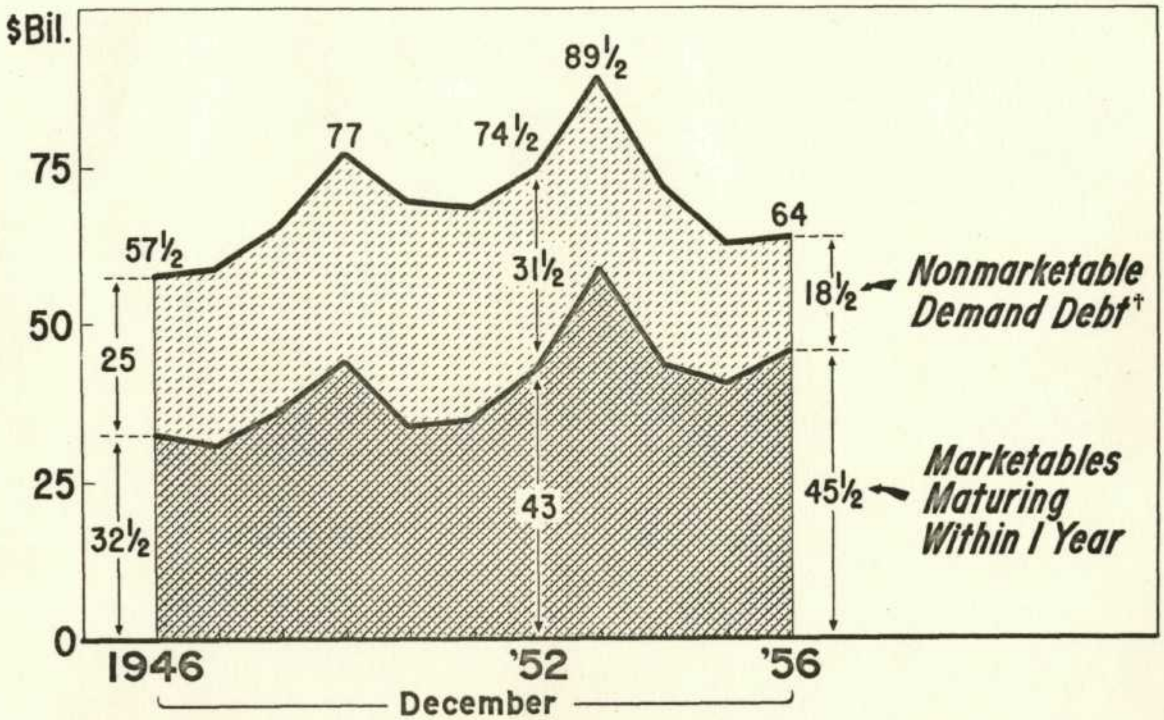
The floating debt as defined above has two basic ingredients: (1) Publicly held marketable securities maturing within 1 year (including callable bonds actually called), and (2) nonmarketable demand debt which is payable practically on demand and is in the hands of rather large holders who move freely from one investment to another in response to changing market conditions. We do not include Series E and H savings bonds -- the small saver's bonds -- as part of the floating debt since they are not as sensitive to fluctuations in market interest rates and the total outstanding is quite stable in contrast to the widely fluctuating volume of other savings bonds and savings notes.

Chart 6 presents data on the "floating debt" over the last decade. This type of debt was reduced by more than $10 billion between December 1952 and December 1956, and the figure at the end of last year was more than $25 billion below the all-time peak in 1953, which reflected largely the inheritance of scheduled maturities from earlier years and financing growing out of the 1953 deficit.

While the under-one-year marketable debt held outside Federal Reserve banks and Government investment accounts was $2-1/2 billion higher at the end of 1956 than in 1952, it was nevertheless $13 billion below its all-time peak in 1953. In contrast, this part of the floating debt rose by more than $10 billion between 1946 and 1952, when primary reliance was placed on the issuance of short-term securities and the passage of time kept shortening the debt.

Chart 6

THE FLOATING DEBT*



*Held outside of Federal Reserve Banks and Gov't Invest. Accts.
†Excluding A to E and H Savings Bonds.

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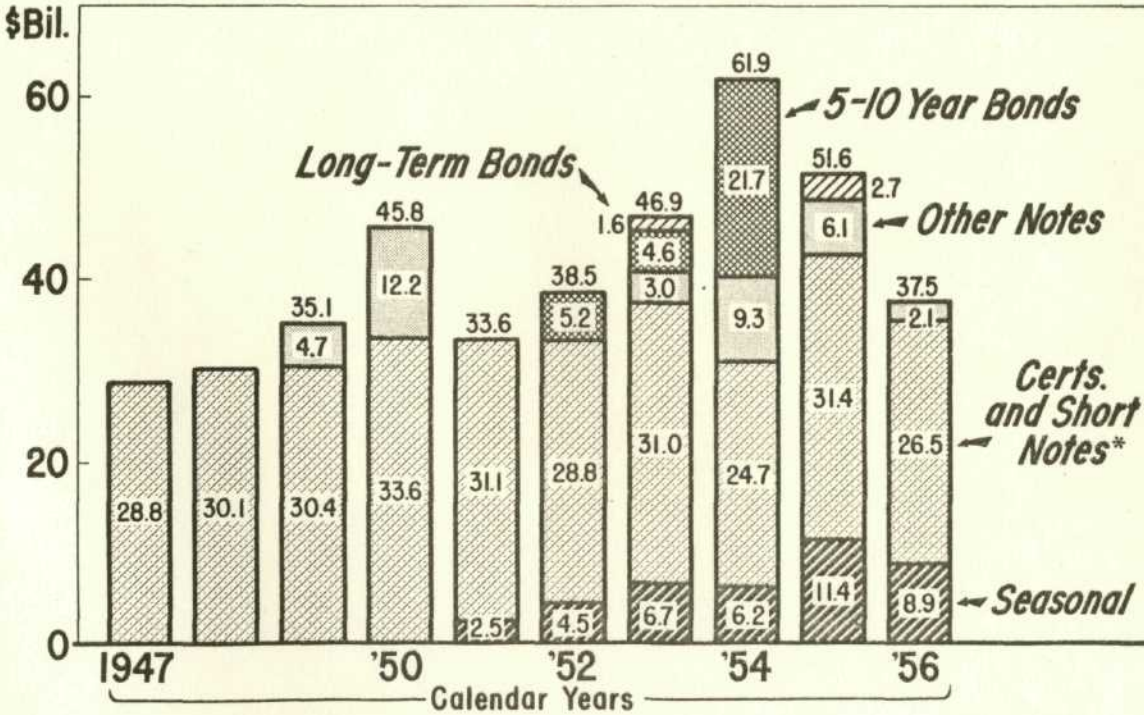
One of the most important ways in which the floating debt picture has changed, as you will note from the chart, is through the reduction of nonmarketable demand debt in the hands of large investors. It has been reduced by $13 billion since 1952. The elimination of the sale of short-term savings notes in the fall of 1953 and the recent dropping of sales of the investment-type J and K savings bonds as of April 30, 1957, represent major steps in the reduction of the more volatile Treasury demand debt.

8. Opening up the long-term market and adding to the supply of intermediate-term securities. In the absence of extensive debt payoffs the objective of reducing the floating debt can be accomplished only by selling more securities outside the one-year area.

Chart 7 shows the history of Treasury financing over the past decade, year by year, in terms of the relative amounts of short-term and longer-term financing. The chart also shows the seasonal borrowing which has grown during recent years -- borrowing repaid out of increasingly heavy tax payments each spring up until 1956, when the return to a more even quarterly distribution of corporate tax payments began.

Chart 7

VOLUME OF TREASURY MARKET FINANCING
(Excluding Weekly Roll-Over of Bills)



*Notes originally 20 months or less to maturity.

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As Chart 7 shows, there was a modest amount of intermediate-term securities issued in 1949 and 1950, which helped to reduce the Treasury's financing burden in 1951. Two short-term bonds were sold in 1952. The major efforts at debt extension, however, have been made during the past four and a half years.

Since 1952 the Treasury has sold $4-1/4 billion of long-term securities. The first of these, the 3-1/4's, totaling $1.6 billion in the spring of 1953, represented the Treasury's first long-term market issue since the end of World War II financing. Then in 1955, we sold $2.7 billion of the 3% bonds of 1995, the longest Treasury bond issued since the Panama Canal Bonds were issued in 1911.

This $4-1/4 billion of long bonds, together with the $26-1/2 billion of 5 to 10 year bonds issued in 1953 and 1954, and the $23-1/2 billion of 2 to 5 year notes issued since 1952, has thus made it possible for the Treasury to keep up with the ever-shortening public debt, and start reducing a little the annual volume of Treasury market financings. Also, the long-term offerings gave greater breadth and depth to the free long-term Government securities market.

A complete list of marketable securities issued since January 1, 1946, which mature in more than 2 years, is shown in Appendix A.

Before every Treasury financing we canvass the market for a long-term bond among dealers and potential buyers. In these 4-1/2 years I do not think we have failed to take advantage of any favorable opportunities to sell bonds successfully.

Our job in calendar 1957 is larger than in 1956 and perhaps a little above 1955. During the first half of the year we completed $22 billion of financing. Three billion dollars of that was extended beyond 3 years through the issuance of Treasury notes, so our record of debt extension in the first half of 1957 was already somewhat ahead of 1956. On July 3 we sold $3 billion of March 1958 tax bills for cash, and as will be covered later, we are now completing the refunding of nearly $24 billion of August and October maturities, more than $14-1/2 billion of which are held by Federal Reserve banks or Government investment accounts. We will have a December maturity to refund and we will also have more seasonal tax anticipation financing before then. This will bring our total job for 1957 to more than $55 billion (exclusive of weekly Treasury bill offerings). If Federal Reserve bank holdings are omitted the total is only about $35 billion.

These financings continue to be in competition with very heavy demands for funds in the capital markets. They require attractive rates and careful planning.

9. <u>Encouraging thrift by selling more securities to individuals</u>. I have already mentioned that individuals' holdings of Government securities have been growing and now stand near their all-time high. The major factor in this growth has been the Series E and H savings bonds program. The vigorous promotion of this program, aided by an improvement in terms in May 1952, brought an increase of more than $6 billion in E and H bond holdings during the 4 years ending December 1956.

The core of this thrift program has been the payroll savings plans, under which about 8 million workers are now buying savings bonds regularly. We estimate that approximately 40 million Americans now own $41-1/2 billion of these E and H bonds.

Some figures on E and H savings bonds may be interesting.

Growth of E and H Savings Bonds
Averages for Calendar Years
(In billions of dollars)

Annual averages	Cash sales and redemptions: Sales	Cash sales and redemptions: Redemptions	Cash sales and redemptions: Net	Interest accruals	Net change in outstanding	Amount outstanding end of period
Wartime:						
1941-45........	8.5	2.0	6.5	.1	6.6	30.7
Post war:						
1946-49........	4.2	4.1	.1	.6	.8	33.8
1950-52........	3.5	4.0	-.5	1.1	.5	35.3
1953-56........	4.9	4.5	.4	1.1	1.5	41.4

The record of savings bonds sales during the four years 1953-56 has been better on the average than during other periods since the end of the war. Redemptions have risen somewhat in recent years -- partly because of the cashing of bonds which have reached their 10-year maturity in increasing amounts. Nevertheless, the net excess of cash sales over redemptions of these bonds was higher in 1953-56 than in either earlier post war period.

About a year ago, however, savings bond sales started to slow down under the impact of higher interest returns available in alternative forms of savings. Then, as your Committee is aware, the Treasury received from the Congress authority to raise from 3 to 3-1/4% the over-all yield on E and H bonds if held to maturity. The interim yields have also been increased.

Savings bonds are not sold primarily for their yield but for their security, their redeemability, and their convenience. However, the buyer must feel he is getting a fair rate. The action you took was helpful.

The savings bond program is one of the best means we have of achieving a wider distribution of the debt and of encouraging the over-all volume of savings which the country so much needs to keep pace with the tremendous demands of the people for all forms of goods and services.

In summary, then, these are the ways in which the Treasury has sought to manage the debt so as to make it less of a disrupting influence on our economy. We have not always been able to move as fast as we might like toward our long-range objective of achieving a better debt distribution, but we have reduced the floating debt and the bank-held debt and so reduced the inflationary threat which the debt carries. In addition we have widened the sale of savings bonds and reopened the market for long-term bonds.

10. The techniques of debt management. Before I conclude, I want to discuss with you briefly the way in which the Treasury approaches each of its debt management decisions which involve the issuance of new marketable certificates, notes, and bonds.

Each Treasury financing represents an important event in the money markets of the country. It is, therefore, essential that the Treasury take every precaution to get information from every useful source in making decisions about these operations.

In the course of exploring the facts relating to a new Government issue the Treasury consults a great many people. We get valuable help from the Federal Reserve Board and the 12 Federal Reserve banks, with their offices throughout the country which are in contact with a large number of people and with the money and capital markets. We maintain contact with the people who handle investments of commercial banks, savings banks and insurance companies, pension funds (state, municipal, corporate and other private funds), security dealers, and trust companies which have money to invest.

We rely upon the banks and security dealers to keep their customers informed about our offerings of securities, in addition to our public announcements. After a new issue is announced the banks and dealers do an enormous amount of writing and telephoning to their customers to tell them about the new issue. In this way hundreds of thousands of investors are reached promptly.

The rates of interest which our securities carry are determined basically by the quotations in the Government securities market. Many millions of dollars of Government securities are bought and sold every day in the free market and the price determined in this way indicates the rates we have to pay on new issues.

Perhaps the best indication of the pricing of new Treasury issues is the record of the prices at which our issues have sold in the market on the day they were actually issued, usually a week or 10 days after the subscription books were closed.

In 1953 the Treasury put on the market almost $44 billion of certificates, notes, and bonds -- those securities on which we had to decide on a rate of interest. These issues were quoted in the market on the issue date at an average price of $100 and 5-1/2 thirty-seconds of a dollar per $100 bond. (Prices in the Government securities market are quoted in dollars and thirty-seconds; a thirty-second is equal to 3-1/8 cents.)

In 1954 we sold $59-1/2 billion of this type of security and the price on those in the market on the issue date was $100 and 11 thirty-seconds. Since then, our pricing has worked out even closer: Exactly $100 on the average on $49 billion of such issues in 1955, $100 and 1 thirty-second on $33 billion in 1956, and exactly $100 again on $16 billion of new coupon issues in the first half of 1957. (Appendix B shows these figures in detail.)

These figures encompass the entire $201-1/2 billion of certificates, notes and bonds we issued from January 1953 through June 1957. The problem is to make each new issue attractive enough to sell without being too generous. The attractiveness of a new issue is affected by such influences as the expectation of the market on interest rates and the volume of funds purchasers have available for investment. Also large issues and longer-term issues have to have a little more margin to assure their successful sale.

In addition to these coupon securities -- certificates, notes, and bonds -- the Treasury sells from $1.6 billion to $1.8 billion of 91-day Treasury bills at public auction each week and from time to time tax anticipation bills are also offered on the same bid basis. The rates at which these securities sell are determined by the market -- not by the Treasury. We have sold more than $375 billion of securities in this way since January 1953 -- actually much more than we have sold with interest rates fixed by the Treasury. The interest rates on these bills, together with the yields on purchases and sales of all types of securities in the open market, build up a pattern of interest rates which makes it reasonably clear what rate a new issue of securities has to carry to be sold successfully.

Thus, our discussions prior to a financing are not so much concerned with the rates of interest as with the question of what kind of security we should sell -- a bond issue (over 5 years to maturity), an issue of notes (1 to 5 years), or a short-term certificate (1 year or less), or a bill -- and just what maturity. The advice we receive is frequently conflicting and the Secretary makes his decision (subject to Presidential approval on maturities over one-year) only in the last hour before the public announcement.

11. The offering of the 3-1/4's in 1953. This general plan of preparation for financing was followed when the Treasury offered the 3-1/4% bonds of June 1978-83 in the spring of 1953. This was not only the first long-term marketable bond that the Treasury had offered since 1945, but it was also the first to be put out without Federal Reserve market support for a much longer period. As you will remember, inflationary pressures were heavy in the last part of 1952 and early 1953, under the impact of a then-record demand for money. Despite this heavy demand for private funds we were assured that there were some funds available seeking investment in a long-term Government bond.

Our offering of the 3-1/4's presented as difficult a pricing problem as the Treasury has ever had to face. We had to set the interest rate on the new issue in a market in which prices were moving gradually lower — a market which was still in the process of adjusting to freer market conditions.

Our longest outstanding bond — the Victory 2-1/2's of December 1967-72 — had fallen from almost three quarters of a point above par (2.45% yield) to 95-1/2 (2.80% yield) between the Federal Reserve-Treasury accord in March 1951 and the end of 1952. By April 8, 1953 — when the 3-1/4's were announced — it had fallen to 94 (2.90% yield). There were no long-term Treasury issues outstanding which would serve as a real guide to the interest rate such an issue should carry. The Victory 2-1/2's were 10-1/2 years shorter than the new issue, and the market curve of rates rose as maturities lengthened. One year money was worth about 2-1/8% as far as Government securities were concerned, and five year money a little more than 2-1/2%.

Therefore, we took the market curve on outstanding Treasury issues and extended it parallel to the curve on high-grade corporate issues — retaining, of course, a proper spread between the two types of obligations. That curve produced a rate of 3.08% as of June 15, 1978 and 3.12% as of June 15, 1983, the first call date and maturity date, respectively, of the new bond. The 3-1/4 coupon would appear to offer a rate, therefore, approximately 15 basis points (15/100 of 1 percent) above the market curve, but the spread would be much less than that if you take into consideration the fact that we were issuing the bond in competition with outstanding issues available in the market at a discount, which had a capital gains advantage for tax purposes. The Victory 2-1/2's at 94 were as attractive to a corporate taxpayer in after-tax yield as a new hypothetical 3.10% issue at par would be if both were held to a 1972 maturity.

This 3-1/4% rate was sufficient to enable the Treasury to sell $1.2 billion of the new bonds for cash and to induce the holders of $.4 billion of maturing F and G savings bonds to exchange them for the new issue. The estimated yield spread of about 15 basis points above the market was quite modest, however, compared to the 23 basis point average spread between the eleven new high-grade corporate issues put out during 1953 and the outstanding corporate market, and an average spread of 30 basis points on the 58 new high-grade corporate bonds that had been issued since January 1, 1951 in relation to the outstanding market (Moody's Aaa corporate bonds).

Nevertheless, the 3-1/4% rate was not sufficient to give incentive to speculators who thought they could turn over the new issue at a profit. The first price quotation in the market on the new 3-1/4's was 100 and 9/32 (April 15, 1953). Trading on the new bond between that date and the issue date of the bond fluctuated between a high of 100-11/32 and a low of 99-25/32. On the issue date of May 1 the 3-1/4's were selling in the market at 99-29/32, with a yield to the buyer of 3.26%. It was mid-July before the new 3-1/4's again rose above par. These figures demonstrate, I believe, that the 3-1/4% rate was the lowest rate at which we could possibly have sold a 25-30 year bond in a free market in the spring of 1953.

12. Our current refunding. This same general pattern of financing was also followed in our most recent refunding program which was announced Thursday, July 18. As you know, this offering did not involve the raising of any new cash. It was concerned solely with the refunding of four maturing issues:

$12,056	million 2-3/4% notes maturing August 1,
3,792	million 2% notes maturing August 15,
7,271	million 3-1/4% certificates maturing October 1, and
824	million 1-1/2% notes maturing October 1.
$23,943	million total maturing issues, of which more than $14-1/2 billion was held by Federal Reserve banks and Government investment accounts.

With an unprecedented heavy demand for funds in the private area we were convinced quite early in our studies that there was no substantial demand for long-term Government securities. The package offering that we decided upon included two certificates and a note, to be issued on August 1:

A 3-5/8% certificate maturing in 4 months (December 1, 1957),

A 4% certificate maturing in 12 months (August 1, 1958), and

A 4% note maturing in 4 years (August 1, 1961), but redeemable at the option of the holder in 2 years (August 1, 1959).

The choice of all three issues was given to the holders of the August maturities but the October holders were allowed to choose only between the two longer issues.

This package was designed to provide a very short security for corporations and other short-term investors who want their money before the end of the year, an attractive 4% one year security for other short-term investors, and a longer 4% issue which would appeal to two somewhat different groups of buyers: (1) those who were not sure that they wanted to invest their funds for as long as four years in case interest rates continue to rise and, therefore, liked the idea of being able to redeem at the end of two years, and (2) those who felt that the present heavy demand for money is perhaps close to its peak and were anxious to get part of their portfolios invested for a longer period than two years at a 4% rate on the theory that a 4% rate might not be available again for a long time.

The pricing on these three issues was done in line with the outstanding market. The market pattern of yields at noon on July 18, just before the announcement was made, showed rates of approximately 3-1/2% at the 4-month point on the curve, 3.90% at the 1-year point, 3.95% at the 2-year point, and 3.98% at the 4-year point. This pricing was as close or closer to the market curve than the average pricing that the Treasury has done during the entire period of more than 6 years since the Federal Reserve-Treasury accord in 1951. The new pricing was not, however, quite as thin as on the issues that we put out in February and May of this year, when new short-term issues fell slightly below par on their first market quotation. The large volume was also a factor in pricing the new issues. All three new issues showed closing bid price quotations of 100 and 1/32 on the first day of trading — Monday, July 22.

The operation was successful. The cash turn-in of $1.1 billion on this refunding (preliminary figures) was the smallest percentage of publicly-held maturities turned in for cash of any refinancing since March a year ago. Furthermore, we succeeded in selling $2-1/2 billion of the new 4-year notes, again helping to keep the debt from shortening.

When we term this a successful operation we do so with full recognition that this refunding alone has added 1/10th of 1 percent to the computed interest rate on the entire public debt, with an increase of about $250 million in our computed annual interest charge. More than one-half of this added interest comes back directly to the Treasury since $14-1/2 billion of the $24 billion maturity was held by the Federal Reserve banks and 90% of their net earnings are returned to us. The remainder of approximately $100 million does not represent a net addition to the Federal budget since a substantial share of it will be paid back to the Treasury in taxes.

We would prefer to do our borrowing at lower rates. Naturally, any debtor would. We fully recognize, however, that this is one of the costs to the American taxpayers of a monetary and credit policy which is the primary bulwark against the loss of untold billions of dollars through inflation.

I have presented the background of the 3-1/4% bond issue and the recent financing to illustrate the point that the Treasury does not force rates up, as sometimes stated. It has always been our policy to sell our securities at the lowest interest rates at which the maturities offered can be sold.

In conclusion, I would like to present a further series of background charts to outline the particular problems we consider. This is a sort of market analysis of our product and the potential buyers. I believe these charts are one of the best means of giving this Committee an understanding of the basis for our financing decisions.

Appendix A

Treasury Offerings of Intermediate and Long-Term Marketable Securities
January 1946-August 1957

(In millions of dollars)

Date subscription books were opened	Date of issue	Description of security	Period to maturity	Amount issued: Cash	Amount issued: Exchange	Amount issued: Total	Yearly totals
2 to 5 years							
1946:		None					
1947:		None					
1948:		None					
1949: Dec. 5	Dec. 15	1-3/8% Note 3/15/54	4 yr 3 m	...	4,675	4,675	4,675
1950: Feb. 17	Mar. 15	1-1/2% Note 3/15/55	5 yr	...	5,365	5,365	12,219
Dec. 4	Dec. 15	1-3/4% Note 12/15/55	5 yr	...	6,854	6,854	
1951:		None					
1952:		None					
1953: Sep. 2	Sep. 15	2-7/8% Note 3/15/57	3 yr 6 m	...	2,997	2,997	2,997
1954: May 4	May 17	1-7/8% Note 2/15/59	4 yr 9 m	2,205	2,897	5,102	9,257
Sep. 23	Oct. 4	1-5/8% Note 5/15/57	2 yr 7-1/2 m	4,155	...	4,155	
1955: Feb. 1	Feb. 15	2% Note 8/15/57	2 yr 6 m	...	3,792	3,792	6,075
Nov. 28	Dec. 1	2-7/8% Note 6/15/58	2 yr 6 m	...	2,283	2,283	
1956: Mar. 15	Dec. 1	2-7/8% Note 6/15/58	2 yr 6 m	...	2,109	2,109	2,109
1957: Feb. 4	Feb. 15	3-1/2% Note 5/15/60	3 yr 3 m	...	1,464	1,464	5,634
Mar. 18	Feb. 15	3-1/2% Note 5/15/60	3 yr 3 m	942	...	942	
May 6	May 1	3-5/8% Note 2/15/62	4 yr 9-1/2 m	...	647	647	
July 22	Aug. 1	4% Note 8/ 1/61 1/	4 yr. 1/	100 2/	2,481p	2,581p	
Total				7,402	35,564	42,966	
5 to 10 years							
1946:		None					
1947:		None					
1948:		None					
1949:		None					
1950:		None					
1951:		None					
1952: Feb. 18	Mar. 1	2-3/8% Bond 3/15/57-59	7 yr 1/2 m	...	927	927	5,172
June 16	July 1	2-3/8% Bond 6/15/58	5 yr 11-1/2 m	4,245	...	4,245	
1953: Feb. 2	Feb. 15	2-1/2% Bond 12/15/58	5 yr 10 m	...	620	620	4,607
Oct. 28	Nov. 9	2-3/4% Bond 9/15/61	7 yr 10 m	2,239	...	2,239	
Nov. 18	Feb. 15	2-1/2% Bond 12/15/58	5 yr 10 m	...	1,748	1,748	
1954: Feb. 1	Feb. 15	2-1/2% Bond 11/15/61	7 yr 9 m	...	11,177	11,177	21,738
Aug. 3	Aug. 15	2-1/8% Bond 11/15/60	6 yr 3 m	...	3,806	3,806	
Nov. 22	Dec. 15	2-1/2% Bond 8/15/63	8 yr 8 m	...	6,755	6,755	
1955:		None					
1956:		None					
1957:		None					
Total				6,484	25,033	31,517	
Over 10 years							
1946:		None					
1947:		None					
1948:		None					
1949:		None					
1950:		None					
1951:		None					
1952:		None					
1953: Apr. 13	May 1	3-1/4% Bond 6/15/78-83	30 yr 1-1/2 m	1,188	418	1,606	1,606
1954:		None					
1955: Feb. 1	Feb. 15	3% Bond 2/15/95	40 yr	...	1,924	1,924	2,745
July 11	Feb. 15	3% Bond 2/15/95	40 yr	821	...	821	
1956:		None					
1957:		None					
Total				2,009	2,342	4,351	

1/ Redeemable in 2 years (August 1, 1959) at option of holder.
2/ Issued in special allotment to Government investment accounts.
p Preliminary.

July 27, 1957

Appendix B

Market Prices of Each New Marketable Treasury Issue on First Date Quoted and on Date of Issue 1/, January 1953-August 1957

Issue	Maturity	Amount issued (millions)			First quote		Issue date quote	
		Cash	Exchange	Total	Date	Price 2/	Date	Price 2/
1953:								
2 1/4% Certificate.....	2/15/54	......	$ 8,114	$ 8,114	2/ 2/53	100.03	2/16/53	100.05
2 1/2% Bond............	12/15/58	......	620	620	2/ 2/53	100.03 1/2	2/16/53	100.06
3 1/4% Bond............	6/15/78-83	$ 1,188	418	1,606	4/15/53	100.09	5/ 1/53	99.29
2 5/8% Certificate.....	6/ 1/54	......	4,858	4,858	5/20/53	100.00	6/ 1/53	99.30
2 1/2% Tax Certificate.	3/22/54	5,902	......	5,902	7/ 7/53	99.31	7/15/53	100.01
2 5/8% Certificate.....	8/15/54	......	2,788	2,788	8/ 5/53	100.03 1/2	8/17/53	100.04
2 5/8% Certificate.....	9/15/54	......	4,724	4,724	9/ 2/53	100.04 1/2	9/15/53	100.08
2 7/8% Note............	3/15/57	......	2,997	2,997	9/ 2/53	100.04 1/2	9/15/53	100.09
2 3/4% Bond............	9/15/61	2,239	......	2,239	10/29/53	100.28	11/ 9/53	100.24
1 7/8% Note............	12/15/54	......	8,175	8,175	11/18/53	100.09	12/ 1/53	100.08
2 1/2% Bond............	12/15/58 3/	......	1,748	1,748	11/18/53	100.11	12/ 1/53	100.11
Total..........................		9,329	34,442	43,771	....	100.05 1/2	....	100.05 1/2
1954:								
1 5/8% Certificate.....	2/15/55	......	7,007	7,007	2/ 1/54	100.12	2/15/54	100.14
2 1/2% Bond............	11/15/61	......	11,177	11,177	2/ 1/54	100.12	2/15/54	100.24
1 1/8% Certificate.....	5/17/55	......	3,886	3,886	5/ 5/54	100.11 1/2	5/17/54	100.09
1 7/8% Note............	2/15/59	2,205	2,897	5,102	5/ 5/54	100.15 1/2	5/17/54	100.08
1% Tax Certificate.....	3/22/55	3,734	......	3,734	7/22/54	100.02	8/ 2/54	100.02
1 1/8% Certificate.....	8/15/55	......	3,558	3,558	8/ 3/54	100.11	8/15/54	100.11 1/2
2 1/8% Bond............	11/15/60	......	3,806	3,806	8/ 3/54	100.12	8/15/54	100.19
1 5/8% Note............	5/15/57	4,155	......	4,155	9/24/54	100.01	10/ 4/54	100.00
1 1/8% Certificate.....	12/15/55 3/	......	4,919	4,919	11/22/54	100.06	12/15/54	100.02
1 1/4% Certificate.....	12/15/55	......	5,359	5,359	11/22/54	100.06	12/15/54	100.02
2 1/2% Bond............	8/15/63	......	6,755	6,755	11/22/54	100.06	12/15/54	100.11
Total..........................		10,094	49,364	59,458	....	100.09	....	100.11
1955:								
1 5/8% Note............	3/15/56	......	8,472	8,472	1/28/55	100.04	2/15/55	100.02
2% Note................	8/15/57	......	3,792	3,792	1/28/55	100.04	2/15/55	100.00
3% Bond................	2/15/95	......	1,924	1,924	1/28/55	100.11	2/15/55	100.06
1 3/8% Tax Certificate.	6/22/55	3,210	......	3,210	3/23/55	100.00	4/ 1/55	99.31
2% Note................	8/15/56	2,532	3,174	5,706	5/ 4/55	99.31 1/2	5/17/55	100.00
1 7/8% Tax Certificate.	3/22/56	2,202	......	2,202	7/11/55	99.31 1/2	7/18/55	100.02
3% Bond................	2/15/95 3/	821	......	821	7/11/55	100.03	7/20/55	100.00
2% Tax Certificate.....	6/22/56	......	1,486	1,486	7/20/55	100.01 1/2	8/ 1/55	99.31 1/2
2% Note................	8/15/56 3/	......	6,841	6,841	7/20/55	100.02	8/ 1/55	99.29
2 1/4% Tax Certificate.	6/22/56	2,970	......	2,970	10/ 4/55	99.31	10/11/55	99.30 1/2
2 5/8% Certificate.....	12/ 1/56	......	9,083	9,083	11/28/55	99.31	12/ 1/55	99.31
2 7/8% Note............	6/15/58	......	2,283	2,283	11/28/55	99.31	12/ 1/55	99.31
Total..........................		11,735	37,055	48,790	....	100.01 1/2	....	100.00
1956:								
2 5/8% Certificate.....	2/15/57	......	7,219	7,219	3/ 5/56	100.03 1/2	3/ 5/56	100.03 1/2
2 7/8% Note............	6/15/58 3/	......	2,109	2,109	3/ 5/56	100.03 1/2	3/ 5/56	100.03 1/2
2 3/4% Note............	8/ 1/57	......	12,056	12,056	7/16/56	99.31 1/2	7/16/56	99.31 1/2
2 3/4% Tax Certificate.	3/22/57	3,221	......	3,221	8/ 7/56	99.29	8/15/56	99.28
3 1/4% Tax Certificate.	6/24/57	......	1,312	1,312	11/19/56	100.00	12/ 3/56	100.02
3 1/4% Certificate.....	10/ 1/57	......	7,271	7,271	11/19/56	100.00	12/ 3/56	100.03
Total..........................		3,221	29,967	33,188	....	100.00 1/2	....	100.01
1957:								
3 3/8% Certificate.....	2/14/58	......	8,414	8,414	2/ 4/57	100.01	2/15/57	100.01
3 1/2% Note............	5/15/60	......	1,464	1,464	2/ 4/57	100.01	2/15/57	100.04
3 3/8% Certificate.....	2/14/58 3/	2,437	......	2,437	3/19/57	99.29 1/2	3/28/57	99.30
3 1/2% Note............	5/15/60 3/	942	......	942	3/19/57	99.31 1/2	3/28/57	100.02 1/2
3 1/2% Certificate.....	4/15/58	......	2,351	2,351	5/ 6/57	99.29	5/ 6/57	99.29
3 5/8% Note............	2/15/62	......	647	647	5/ 6/57	99.29	5/ 6/57	99.29
3 5/8% Certificate.....	12/ 1/57	100 4/	9,869p	9,969p	7/23/57	100.01	8/ 1/57	n.a.
4% Certificate.........	8/ 1/58	100 4/	10,462p	10,562p	7/23/57	100.01	8/ 1/57	n.a.
4% Note................	8/ 1/61	100 4/	2,481p	2,581p	7/23/57	100.01	8/ 1/57	n.a.
Total through August.............		3,679	35,688	39,367	....	100.00 1/2	....	100.00
Total, January 1953-August 1957.......		38,058	186,516	224,574	....	100.04	....	100.04 1/2

July 27, 1957

1/ Marketable certificates, notes, and bonds; excludes Treasury bills, and notes issued solely in exchange for non-marketable 2 3/4% Investment Bonds, Series B.
2/ Closing bid quotations as reported by the Federal Reserve Bank of New York.
3/ Reopening of existing issue.
4/ Issued in special allotment to Government investment accounts.
n.a. Not available.
p Preliminary

Statement by

Secretary of the Treasury George M. Humphrey

Before

Committee on Finance,

United States Senate

Tuesday, June 18, 1957

INTRODUCTION

Mr. Chairman, Gentlemen:

I appreciate the opportunity of meeting with you today as you commence your study of the financial condition of the United States.

Such a study will undoubtedly involve an appraisal of our current financial condition, the management of the Federal debt, fiscal and monetary policies employed during the past four years, and an analysis of supplemental or alternative courses of financial policy which may be suggested. In order to assist you in this inquiry, it seems appropriate that I provide a statement as to the problems we have faced, the goals we set, and the record of our accomplishments in the past four years.

It is a record of a prospering America with new high levels of employment, rising income, and increasing purchasing power. It is a record of more and better jobs, more homes, more cars, more leisure, and more recreation. It is a record of unequaled prosperity with both the blessings and the problems of such a period.

Last year an average of 65 million of our people were gainfully employed, an increase of 3,700,000 in only four years. During the same four years, unemployment has averaged only 3.8% of the civilian labor force compared to 4.1% during 1949 through 1952, and 15% from 1937 until the beginning of World War II. The present low level of unemployment has been achieved although the civilian labor force has increased from 63 million in 1952, to 68 million today. For the first five months of this year, unemployment has averaged about 3.7%.

The record of the past four years is also a record of rising levels of living, widely shared. During this period, average annual family income, after

Federal income taxes, has increased from less than $4,600 to an estimated $5,200, an increase of about 12%, even after eliminating the effect of price changes. In 1956, the average family purchased 12% more goods and services, in real terms, than in 1952.

Almost 5 million families have moved into new homes since 1952. Almost 30 million families own their own homes today, an increase of 13% in only four years. The number of homes with electric refrigerators has increased from 38 million to 45-1/2 million, accounting for 96% of all wired homes. In only four years, the number of homes with food freezers has increased from 5 million to 8-1/2 million; the number with clothes dryers (either electric or gas) from 1-1/2 million to 5-1/2 million, and the number with television sets from 21 million to 38-1/2 million. The number of families owning automobiles has increased from 31 million to 37 million.

This growing prosperity has extended to nearly all segments of our society except the farmer. The postwar adjustment in farm income has only recently been reversed, with a small increase last year for the first time in several years. Farm income per worker last year was $1,862, up $151 from 1955. Farm prices have been rising moderately in the last few months, and on May 15, were up 3 points above the level of a year earlier. The objective of this Administration is to enable our farm families soon to share more fully in the record prosperity which characterizes the rest of our economy.

The record of the past four years is one of great enhancement in personal financial security. The number of life insurance policies increased from 219 million in 1952, to an estimated 265 million in 1956, an increase of 21%, and the number of persons covered by hospital insurance increased from 91 million to 112 million, or 23%. Time deposits in banks and share accounts in savings and loan associations increased from $79 billion to about $112 billion, or 41%, and the estimated number of shareholders in American industry increased from 6-1/2 million to more than 8-1/2 million.

The record of the past four years is also one of increased leisure. There has been a 19% increase in the amount of time Americans took for their vacations — 85% with pay. About 55 million of our people visited national park areas last year, an increase of 30% in the last four years, and approximately 60 million are anticipated this year.

This great increase in the income, the living standard, the recreation, and security of our people has been achieved at a time when there has been a substantial contraction in our defense expenditures. Our free economy has again demonstrated its ability to absorb reductions in government expenditures not by contracting, but by expanding employment and the living standards of our people.

The record of the past four years has been one of unequaled investment. The Nation has devoted a vast amount of its resources to improving and enlarging its productive capacity. Businesses have spent an all-time high of $152 billion on new plant and equipment, compared with $123 billion in the preceding four years. This record volume of capital outlays has provided a dramatic answer to those who would contend that our economy would run down without the artificial stimulus of chronic deficit spending and the backlog of private demands deferred by the war. Outlays to make better provision for needed public facilities have also been at very high levels in recent years. Total public construction in 1956 was $13.4 billion, 23% above 1952 levels, and educational construction outlays during this same period increased 56%, from $1.6 billion in 1952, to $2.5 billion in 1956.

The increased confidence of our people and of our business concerns, that they will be free to determine their own course — free from unnecessary regulation or harassment -- greater confidence in the stability of our Government and the wider distribution of purchasing power, have encouraged our consumers, our home owners, our business concerns, and our communities, to plan for the future, and to buy the automobile, or the home, to build the factory or the schoolhouse, that a brighter future justifies.

Thus the record of the past four prosperous years has been characterized by the many blessings of widely shared prosperity -- but it has also been beset by one of the problems of prosperity.

The tremendous outlays to expand our public and private facilities have required financing, and this has inevitably given rise to a heavy demand for borrowings. With growing confidence on the part of lenders as well as borrowers, there has been a rapid increase in the volume of both long- and short-term credit. Almost all of this increase has come from savings and not from an increase of money supply in the banks. Nevertheless, there has been, and is, the ever-present threat of rising prices.

The monetary policies of the Federal Reserve and the fiscal policies of this Administration have been designed to encourage the growth of the supply of goods (as the foregoing figures indicate), but not to encourage excessive credit expansion. The cost of living has risen an average of only 6/10 of 1% per year for the past four years, as compared with an average increase at the rate of about 7% per year for the preceding 13 years. In short, the rise in prices during this Administration has been at only one-tenth the average annual rate of the preceding 13 years. Even this rise is more than I like to see, but it is a record of far better price stability than in many years. Nevertheless, prices have been rising a little faster for the past 12 months, and the threat of renewed inflation, which had been so severe from 1946 to 1952, is perhaps our most serious domestic economic problem.

The greater increase in demand for credit than in the supply thereof has inevitably brought about higher interest rates.

The record of the past four years is one of sensitive and flexible adjustments to the release of controls, and to the return to free markets, an accommodation of the post-Korea curtailment in military spending, and of a free market's emphasis first on housing, then automobiles, and now new plant construction with continuous improvement in the total economy. It is a record of encouraging savings and investment in increased productive capacity, of encouraging an adequate volume of credit, but of not encouraging that excess of credit which, in a period of high employment, could only penalize our people by bidding up prices without increasing production. It is essentially a record of flexible and quickly adjusting fiscal and monetary policy designed to continue the sound improvement in levels of living, widely shared, which is the wonder and ambition of all the rest of the world.

It is a most significant record, important to us all, because the monetary activities of the Federal Reserve System and the fiscal activities of the Treasury affect the wages, the standard of living, and the savings — indeed the entire financial well-being — of each one of our citizens.

It is above all a record of the renewal of widespread confidence of the people in the preservation of their individual freedom of choice, in their jobs, in their right to the enjoyment of the fruits of their own initiative and endeavor, and in the security of their savings. It is a record of renewed confidence in the security of our country.

Feeling as I do that there should be the widest possible public interest in this subject, and feeling such a deep pride in what this Administration has done and is doing, I welcome this opportunity to speak to your Committee, and through you, to the more than 171 million Americans whom the Congress represents.

Let me review the major policies of, and the fiscal actions taken by, this Administration since we took office in January 1953.

In discussing fiscal, monetary and credit policies, as I am doing today, I do not want to give the impression that they alone can prevent inflation and assure economic growth. They are, however, a subject of the present inquiry and I shall concentrate my attention on them. Certainly if they are not sound, there is little chance for sound money and sound long-term economic growth.

As a preface to our present policies, let us review the situation as it existed when we came into office.

I. WHERE WE WERE IN 1953

A. THE DIRECTION IN WHICH WE HAD BEEN GOING

You will recall the tremendous changes that had occurred in the period before 1953. In 10 of the 13 fiscal years from 1939 through 1952, the Government operated at a deficit, as it had in the preceding 9 years. Largely as a result of World War II, the Federal debt increased in only 13 years from $47-1/2 billion at the end of 1939, to $267-1/2 billion at the end of 1952. The interest charge on this indebtedness had grown from an annual rate of $1-1/4 billion per year in December 1939, to $6-1/4 billion in December 1952, an average increase in interest cost of almost $400 million per year.

In 13 years, annual Federal taxes had increased from a little less than $5 billion in 1939, to almost $65 billion in 1952. This amounted to an increase in the average tax burden of each American citizen from $36 in 1939, to $413 in 1952.

B. THE CONDITIONS WHICH WE FACED UPON TAKING OFFICE IN 1953

When this Administration came to office in January of 1953, we faced --

1. A Federal debt equal to 89% of our annual national income.

2. Budget expenditures of $74.3 billion for fiscal 1953, and proposed budget expenditures of $77.9 billion for 1954.

3. A budget deficit of $9.4 billion for 1953, and a planned deficit of $9.9 billion for 1954.

4. A continuing spiral of inflation which had reduced the purchasing power of the dollar from 100 cents in 1939, to 77 cents by 1945, and had further reduced it to 52 cents by 1952.

In appraising these conditions and the course to pursue, we were influenced by a recognition of the overpowering importance of preventing another devastating postwar inflation, which, prior to 1953, the Government was attempting to control by inadequate means.

II. THE GOALS WHICH OUR ADMINISTRATION SET FOR ITSELF

Within less than a month of his taking office in 1953, President Eisenhower, in his State of the Union Message, called attention to the "inescapable need for economic health and strength", and stated:

> "Our immediate task is to chart a fiscal and economic policy that can:
>
> "FIRST, REDUCE THE PLANNED DEFICITS AND THEN BALANCE THE BUDGET, WHICH MEANS, AMONG OTHER THINGS, REDUCING FEDERAL EXPENDITURES TO THE SAFE MINIMUM;
>
> "SECOND, MEET THE HUGE COSTS OF OUR DEFENSE;
>
> "THIRD, PROPERLY HANDLE THE BURDEN OF OUR INHERITANCE OF DEBT AND OBLIGATIONS;
>
> "FOURTH, CHECK THE MENACE OF INFLATION;
>
> "FIFTH, WORK TOWARD THE EARLIEST POSSIBLE REDUCTION OF THE TAX BURDEN;
>
> "SIXTH, MAKE CONSTRUCTIVE PLANS TO ENCOURAGE THE INITIATIVE OF OUR CITIZENS."

Let us review these goals and our efforts, our difficulties, and our accomplishments to date, in achieving them.

III. WHAT THIS ADMINISTRATION HAS ACCOMPLISHED

A. "FIRST, REDUCE THE PLANNED DEFICITS AND THEN BALANCE THE BUDGET, WHICH MEANS, AMONG OTHER THINGS, REDUCING FEDERAL EXPENDITURES TO THE SAFE MINIMUM."

To what extent have we accomplished this goal?

1. We First Reduced and Then Entirely Eliminated Planned Deficits.

The budget in effect when we took office in 1953 produced a $9.4 billion deficit, and the budget proposed for the fiscal year 1954 called for a $9.9 billion deficit. Our Administration immediately went to work with the help of the Congress to reduce the planned deficit for fiscal 1954, and indeed the final deficit ($3.1 billion) was only one-third of that anticipated by the prior Administration.

Without the largest tax cut in our Nation's history, the budget would have been balanced in 1955. However, in view of the transition resulting from the reduction in military spending, and anticipated further reductions in spending which in fact materialized concurrently with our action, we were able to pass some of the savings from our reduced expenditures back to the people, even though this meant another year's delay in achieving a balanced budget. Fiscal 1955 was, however, the last year of deficits.

2. We Have Balanced the Budget.

By fiscal 1956, we had entirely eliminated deficits, balanced the budget, and completed the year with a surplus of $1.6 billion.

The 1957 budget will result in another surplus, and the budget proposed by the President for 1958 provides for a third successive surplus for the first time in 25 years.

3. We Have Reduced Federal Expenditures.

Federal expenditures were reduced from $74.3 billion in the inherited budget of 1953, to $67.8 billion in 1954, and $64.6 billion in 1955. As a result of additional programs authorized by the Congress, substantial pay increases, and the need for increasingly expensive military equipment, expenditures increased slightly in the past year to $66.5 billion, with further increases anticipated to $68.9 billion for 1957 and $71.8 billion for 1958.

The 1957 budget is $5.4 billion below the budget we inherited in 1953, and is but 16% of our current gross national product now as compared to 21% in 1953.

B. "SECOND, MEET THE HUGE COSTS OF OUR DEFENSE."

Major national security expenditures have been reduced from $50.4 billion in 1953, to $46.9 billion in 1954, to an estimated $41.0 billion in 1957, with a proposed $43.3 billion in 1958. This reduction has been achieved despite the fact that, though not at war, we are still engaged in a titanic contest which requires not only the expense of preparedness, but extremely expensive research and development. Such research is necessary to assure preparedness for tomorrow, and the days beyond, in the terrible race for primacy in the most complete transition from old to new weapons in the history of the world.

While our fantastically costly weapons of tomorrow are still in the expensive research and development stage, we must continue to maintain our maximum strength in the weapons of today. This means that during this transition period we must support increased costs of two systems of defense.

We have met these huge costs with a balanced budget and with a reduced tax burden. We have provided the necessary large amounts of expensive and revolutionarily new equipment needed for our national safety, greatly expanded our productive facilities, and at the same time enabled far more capital and labor to be directed toward building more cars, more houses, more of all of the good things our people need and want.

C. "THIRD, PROPERLY HANDLE THE BURDEN OF OUR INHERITANCE OF DEBT AND OBLIGATIONS."

As you have invited the Under Secretary, Mr. Burgess, to meet with you, I have asked him to report to you in detail on our handling of the debt.

In preface to his remarks, I might say that the management of $275 billion of debt is not a simple assignment under any circumstances. The Federal Reserve's proper withdrawal from the pegging of the Government bond market, which withdrawal was the most effective single action taken in the battle against inflation, has made it more difficult to manage debt operations than it was when a fixed rate was assured. Had such a policy continued, however, the resulting inflation would eventually have produced even greater complications for debt management than we have experienced under a system whereby interest rates are determined by the forces of the market.

In January 1953, when this Administration took office, the average rate on all Government interest-bearing issues outstanding was 2.35%. The total net computed interest cost at an annual rate at that time was $6.2 billion. Four years later the average rate on all Government issues outstanding was 2.67% or an increase of about three-tenths of one percentage point. The total net annual computed interest cost, as of December 31, 1956, was $7.3 billion, of which $0.9 billion is due to increased interest rates, and $0.2 billion is due to an increase in the debt incurred to pay obligations inherited from previous commitments.

This increase in interest rates results from the free market influences of supply and demand in a period of unparalleled prosperity. It is a continuation of a rise that has been going on for the past ten years under the growing pressure of borrowing demands.

Computed Interest Rate on the Public Debt

	Computed interest rate
December:	
1946..........	2.06%
1952..........	2.35
1956..........	2.67
May 1957..........	2.75

For the entire period from December 1946 through May 1957 there was an increase of 69/100 of 1% in the computed interest rate on the public debt. Of that increase, 29/100 occurred prior to this Administration, and 40/100 occurred during this Administration.

During the past four years there has been no increase in public debt interest cost in relation to national income. The interest cost was 2.1% of national income in December 1952, and was the same percentage in December 1956, for the increase in interest cost has only kept pace with the increase in national income.

Furthermore, the $1 billion increase in interest paid reflects increased earnings received by the investors who own the securities.

Of the $7 billion of interest paid on the public debt during calendar year 1956, $1.4 billion represented the payment of interest to social security funds and other Government investment accounts.

About $0.6 billion of public debt interest was received by the Federal Reserve banks, 90% of which is returned to the Treasury as surplus earnings.

Commercial banks received approximately $1.4 billion of such interest last year. About $0.6 billion went to other financial institutions (mostly insurance companies and savings banks), $0.5 billion to corporations, $0.4 billion to state and local governments, and $0.4 billion to nonprofit institutions, foreign accounts, etc.

The remainder of about $1.8 billion -- the largest single segment of the interest on the public debt -- went to individuals, either in the form of cash payments or accumulated interest to the 40 million holders of savings bonds. Millions of Americans are benefiting from these higher interest rates.

I am asking Mr. Burgess to review other phases of our debt management program.

D. "FOURTH, CHECK THE MENACE OF INFLATION."

1. The Problem.

At the risk of over-simplification, let me condense the story of inflation to about a dozen lines.

Almost all of our employable labor force is employed — and at higher wages than they have ever received before. Our people are buying virtually all that they are producing, but they want to buy more, both more consumer goods and more productive facilities. Being confident of the future, they desire to borrow to buy more. The lenders are lending more than ever before, but still not as much as the public would like. However, with most resources fully utilized, additional bank credit would not put any more people to work -- it would merely provide additional demand in excess of the supply of both labor and goods. Such a demand in excess of supply would cause a rise in prices if it were fed by excessive bank credit expansion.

A rise in prices hurts every housewife, everyone on a pension, every person with a fixed or lagging income, every saver. It robs labor of much of its gain in wages. This rise in prices has been a principal cause of the farmers' difficulties, because while income per farm remained fairly static during the last ten years, the farmer has had to pay higher prices. As a consequence, he has been particularly hurt by the inflation which, to a lesser extent, injures every one of us.

There are two ways to check this rise in prices: (a) increase the supply of goods, and (b) slow the expansion in the number of dollars bidding for the goods.

We have utilized both methods. The Administration in many ways has encouraged an increase in productive facilities which is the only way to increase the supply of goods. The Federal Reserve and the Administration have taken action to restrain a too rapid growth in the number of borrowed dollars available to bid up the price of the limited supply of goods and services.

2. The Respective Roles of the Federal Reserve and the Treasury.

I would like to take a moment to identify the respective roles played, on the one hand by the Treasury, which influences fiscal policy (through its recommendations on tax and budget policy as well as its management of the public debt), and on the other hand by the Federal Reserve, which is responsible for monetary policy (through its influence on the cost and availability of money and credit).

A mere statement of the respective functions demonstrates the major role of the Federal Reserve in the effort to stop inflation. The Federal Reserve has the authority and the tools to take monetary and credit action. We do not. The Treasury cannot determine the level of interest rates but must pay the rates determined by market forces. The Federal Reserve can influence the levels of market rates although there are definite limits to its power to maintain any fixed level of rates, as is shown by history. I do not point this out to shift any responsibility from the Treasury. On the contrary, we approve wholeheartedly the course which the Federal Reserve has followed, and have admiration for the courage and decisiveness with which the Board has acted.

(a) Through 1952.

As you will recall, throughout the decade prior to 1951, the Federal Reserve followed a policy of supporting the market for United States Government securities at or above par. This was done to enable the Government to sell, at a low interest cost, the great volume of securities which was necessary to finance World War II. It accomplished that purpose, but, it created cruel inflationary conditions which required the sale of more bonds and increased debt to pay the resulting higher costs of the war.

In artificially holding interest rates at low levels, the Federal Reserve made credit cheap, not only for the Government, but for all borrowers. By maintaining a market which enabled the banks to liquidate their Government bonds at any time at par or better, it encouraged a continuance of the war-born expansion of excessive bank credit. This cheap and plentiful credit was an important cause of the wartime inflation which, despite wartime restrictions of direct controls and rationing, robbed the dollar of 23 cents of its purchasing power between 1939 and 1945.

Calendar year average	Consumers price index (1947-49 = 100)	Purchasing power of dollar (1939 = 100)
1939..................	59.4	100.0
1940..................	59.9	99.2
1941..................	62.9	94.4
1942..................	69.7	85.2
1943..................	74.0	80.3
1944..................	75.2	79.0
1945..................	76.9	77.2

At the end of World War II there was an acute shortage of goods. There was, however, a pent-up demand, a demand made effective by both a large amount of liquid assets accumulated during the war and a rapid increase in private credit. The war-born policy of the Federal Reserve, mistakenly continued into peacetime under Treasury insistence, enabled the supply of credit to rise too rapidly with the result that this credit-backed demand for goods exceeded the supply of goods. While interest rates were held at artificially low levels, prices continued their serious rise, at an average annual rate of over 7% from 1945 to 1951, and in those six years the dollar lost another 23-1/2 cents of its purchasing power.

Calendar year average	Consumers price index (1947-49 = 100)	Purchasing power of dollar (1939 = 100)
1945.................	76.9	77.2
1946.................	83.4	71.2
1947.................	95.5	62.2
1948.................	102.8	57.8
1949.................	101.8	58.3
1950.................	102.8	57.8
1951.................	111.0	53.5

It was becoming clear to increasing numbers of observers that the unwise credit stimulus provided by the Federal Reserve should be withdrawn. Such a withdrawal could be achieved only by paying the lesser penalty of an increase in the interest rates to be paid. It was clear that if the Federal Reserve ceased purchasing Government securities at par, natural market forces, reflecting increasing demand for credit, would result in the higher interest rates which the Federal Reserve purchase policy had so far postponed. During this postwar period the Federal Reserve made several modest moves toward freer short-term markets but was held back by the Treasury. After a most thorough review of the relative advantages and disadvantages of such a change, the Subcommittee on Monetary, Credit and Fiscal Policies (the "Douglas Subcommittee") concluded in 1950 that:

> "As a long-run matter, we favor interest rates as low as they can be without inducing inflation, for low interest rates stimulate capital investment. But we believe that the advantages of avoiding inflation are so great and that a restrictive monetary policy can contribute so much to this end that the freedom of the Federal Reserve to restrict credit and raise interest rates for general stabilization purposes should be restored even if the cost should prove to be a significant increase in service charges on the Federal debt and a greater inconvenience to the Treasury in its sale of securities for new financing and refunding purposes."

Partly as a result of that review and report, the Administration then in office and the Federal Reserve, by an agreement referred to as the "accord", changed the prior policy, and the Federal Reserve began to withdraw its support of the market for Government bonds in March of 1951. While this was a step in the right direction, it was not a complete step. On a number of occasions during 1951 and 1952, the Treasury still relied on Federal Reserve purchases to keep new issues from sinking in the market.

Let me pause in this chronology to remind you of the facts about that change in policy.

It was put into effect by an independent agency, the Federal Reserve.

It was urged by many of the best informed members of Congress.

It occurred during the preceding Administration -- 21 months before this Administration took office.

This new policy of the Federal Reserve was not so much anti-inflationary as it was a tempering of what formerly had been positively inflationary action. The Federal Reserve began to reduce the amount of credit it had been artificially creating. It freed natural market forces.

As an incidental result of the reduction in the volume of artificial credit generated by the Federal Reserve, the supply of credit grew somewhat more slowly than the demand for credit. As a consequence, interest rates began to rise, and the market prices of bonds went down.

Though the full force of this change in the Federal Reserve policy was not immediately effective, almost a quarter of the increase in the computed interest rate on the public debt (from 2.22% at the time of the Federal Reserve-Treasury accord in 1951, to 2.75% in May 1957) occurred in the 21 months prior to the time this Administration took office.

As a result, banks and insurance companies, which had such large blocks of Government securities, were more hesitant to sell them at a 3 or 4 point loss in order to make a loan. This caused them to make fewer loans than they would have made had the earlier policy been continued.

Although by the "accord" of March 1951, the Administration then in office had reluctantly agreed to the right of the Federal Reserve to take such monetary action, that Administration itself continued to rely on direct controls on wages, prices, and rents. In addition, after the short-lived budget surplus of 1951, increasing Government spending, and renewed deficits in 1952, largely as a result of the Korean conflict, encouraged a further depreciation in the dollar to 52.3 cents.

Calendar year average	Consumers price index (1947-49 = 100)	Purchasing power of dollar (1939 = 100)
1951..................	111.0	53.5
1952..................	113.5	52.3

Inflation had been appreciably slowed, but if inflation was to be effectively checked, the Federal Reserve's new policy had to be supported more vigorously and supplemented with parallel fiscal policies.

(b) Since 1952.

In 1952, General Eisenhower campaigned for the Presidency in part on the ground that further inflation must be prevented, and advocated:

> "A Federal Reserve System exercising its functions in the money and credit system without pressure for political purposes from the Treasury or the White House."

i. Federal Reserve's monetary policies.

We have lived up to that promise to the letter. To do so, however, has subjected the Treasury to certain burdens, just as it has other borrowers. Not to do so would have created much more serious burdens for all of us.

Although new financing was less expensive and easier in 1954, it has again become more costly. With a very high percentage of bank and insurance company assets now in loans, these institutions are not clamoring for long-term -- or even intermediate-term -- Government securities.

We must, therefore, at present, sell mostly shorter-term securities, which are attractive because of their high liquidity. I do not say this to complain, but to acknowledge an obvious fact. We will meet these difficulties and solve them as we have in the past, continuing our flexible policy, postponing debt extension when we must, achieving it whenever we can.

There is a strong demand for short maturities. Our bill auctions each week are always well over-subscribed. The Treasury faces no crisis. Our securities are the most highly regarded in the world. But in a free market, we must compete for funds. That means the factors of supply and demand determine the rates we must pay. Rates may decline or they may go higher. I would be disappointed to see them go higher, but if that is the price we must pay to prevent the growth of excessive credit and consequent inflation, it will well justify the price.

This Administration, in addition to supporting the Federal Reserve's independence, has utilized its debt management and fiscal functions to help check inflation.

ii. Planned deficits have been eliminated.

Federal deficits necessitate increased Federal borrowing. More Federal borrowing, to the extent it comes from the banks, means the creation of additional bank credit. This tends to create more spendable dollars than there are goods to buy. As your Chairman, Senator Byrd, so clearly pointed out in his remarks to the Senate on August 13, 1954:

> "Deficit spending is perhaps the greatest single factor in the cheapening of the value of the money."

In ending deficits, we have eliminated this very inflationary pressure.

iii. The debt is being reduced.

We reduced the public debt in fiscal 1956 as a result of our budget surplus of $1.6 billion. Another budget surplus is being applied to the debt this year and we expect to do it again in 1958. Reduction of the public debt is one of the best ways to fight inflation.

iv. Government expenditures have been reduced.

Government expenditures are inflationary, particularly when the economy is at a high level of output and employment. Taxes divert to Government spending some funds which, in the hands of the taxpayer, would have gone into savings. Furthermore, some Government expenditures go into payrolls to produce goods and services (especially military equipment and services), which neither contribute to the Nation's capital account nor become available for private consumption. Yet this additional purchasing power competes for the existing supply of both goods and services.

By reducing Government expenditures, we have released more workers and materials directly to private industry where they could add further to the supply of goods and services needed to meet our heavy demands for plant and equipment, and greatly increase the supply of homes, cars, television sets, and other consumer products necessary for our rising standard of living. Reduced Government expenditures have been an anti-inflationary influence.

v. We have reduced the floating debt.

The amount of marketable public debt maturing within a year, plus demand obligations (other than E and H savings bonds) in the hands of the public -- securities which in many ways are close to cash -- has been reduced by $25 billion from the high point in 1953.

vi. We have shifted some of the debt away from the banks.

Since increases in bank loans represent additional spendable money, they tend to be more inflationary than loans that grow out of a transfer of existing savings. As a consequence, one of the Treasury's long-range debt management objectives has been to reduce bank holdings of Government securities to a reasonable minimum. To this end we have, in the past four years, reduced the amount of Government securities held by the banks by ﾠ.4 billion. This has been achie[illegible] in part by paying off some securities and in part by designing the terms of new issues (such as tax anticipation bills and certificates) to be particularly attractive to nonbank investors.

vii. <u>We have stimulated increased savings.</u>

Greater confidence in the future, higher rates of interest, and increasing confidence in the stability of the dollar, have all encouraged our people to save more both in dollars and in relation to disposable income. As one means of encouraging savings and combatting inflation, we have emphasized the continued sale of Series E and H savings bonds. The amount of these small-saver bonds outstanding has increased from $35.3 billion to $41.4 billion during the past four years.

Moving thus on all of these fronts, by ending deficits, by reducing the debt, by reducing expenditures, by keeping down the bank-held debt, by reducing the floating debt, and by selling more E and H savings bonds, as well as by working closely with the Federal Reserve, we have accomplished a tempering of inflationary pressures during these years, with a decline in the purchasing power of the dollar of only eight-tenths of a cent in four years.

Calendar year average	Consumers price index (1947-49 = 100)	Purchasing power of dollar (1939 = 100)
1953..................	114.4	51.9
1954..................	114.8	51.7
1955..................	114.5	51.9
1956..................	116.2	51.1

The past four years have been characterized by greater price stability than any other four-year period since 1939. But inflation is not stopped. It is only slowed down. Indeed there has been a disturbing renewal of pressures in the last twelve months, during which the dollar has lost almost two cents in purchasing power.

Month	Consumers price index (1947-49 =100)	Purchasing power of dollar (1939 = 100)
1956: April........	114.9	51.7
July	117.0	50.8
October......	117.7	50.5
1957: January......	118.2	50.3
February.....	118.7	50.0
March........	118.9	50.0
April........	119.3	49.8

This most recent decline in purchasing power is disturbing. It reinforces our conviction that we must continue the vigorous pursuit of our present policies. We should certainly not abandon them.

3. <u>The Necessity for Flexibility</u>.

While over the past four years it has been necessary to follow generally anti-inflationary fiscal and monetary policies, we have had changes in the economy which have required us to moderate them on occasion, and we may encounter other circumstances which may require some relaxation at some times in the future. We approve the philosophy expressed in the "Douglas Subcommittee Report" that:

> "Timely flexibility toward easy credit at some times and credit restriction at other times is an essential characteristic of a monetary policy that will promote economic stability rather than instability."

Our Administration had been in office only a few months when the coincidence of the full effect of the Federal Reserve's new policy, and the curtailment of defense spending, temporarily changed the problem. We were, at that time, more concerned with preventing a decline in employment and production than with a rise in prices. Taxes were reduced, and the Administration relaxed downpayment and maturity terms on FHA and VA guaranteed housing loans. At the same time, Federal Reserve policy also eased, making funds more readily available. The decline was stopped and a sound economic expansion got under way with renewed public confidence in the courage of the Administration and the flexibility of its policies. By 1955, economic activity was again vigorous and the problem was one of inflationary pressures (which have continued), and easy bank credit expansion was no longer encouraged.

4. The Available Alternatives.

In view of the breadth of the subject of your inquiry, it is appropriate that we consider what might have been some available alternatives to general monetary and credit policy.

These alternatives are:

(a) Direct controls prohibiting or limiting certain types of credit.

(b) Compulsory saving.

(c) Physical controls on prices and wages -- plus, perhaps, rationing and allocation of materials and labor.

(d) Higher taxes and large governmental surpluses to be applied on the bank-held debt.

(e) Greater individual savings and voluntary effort at restraint.

(f) A reversion to the pre-1951 policy of Federal Reserve purchase of Government securities at or above par -- and consequent encouragement of severe inflation.

The use of any of the first three alternatives in peacetime would have been inequitable, impractical, and inconsistent with our traditions of freedom. The fourth alternative would have required the imposition of additional taxes on top of our present heavy load, and would not have been acceptable. The fifth, which the President emphasized in his State of the Union Message just a few months ago, can help immeasurably but can be achieved only if other policies are effective.

Thus, as a practical matter, the real choice is between the anti-inflationary course which we have pursued, and a new round of inflation.

Those who, in a period such as this, urge an abandonment of our anti-inflationary policies, those who urge either deficit financing or a policy of artificially creating more spendable dollars are, whether unwittingly or by intention, inflationists. No matter what their motives, their proposals for further credit expansion are proposals to further reduce the purchasing power of the dollar, to rob every housewife, every farmer, every pensioner, every wage earner, and every family with savings. Their arguments must be understood to urge just that.

There can be no doubt as to the wisdom of our choice in utilizing the tools of monetary and credit policy. As to the extent to which we used these tools, I can only say that I gain confidence from the fact that we are criticized with equal vigor by those who feel that credit has been restricted too severely, and those who feel it has not been restricted severely enough.

Despite some recent tendency for prices to rise again, the Administration can take considerable pride in what has been achieved to date in respect to this, the President's fourth goal.

E. "FIFTH, WORK TOWARD THE EARLIEST POSSIBLE REDUCTION OF THE TAX BURDEN."

The Eisenhower Administration and the Congress, working together, have already made possible the greatest single tax cut in history.

In 1954, in order that the people might benefit from the substantial reduction in Government expenditures, we brought about a tax cut that has provided them with annual savings of about $7-1/2 billion.

As the President pointed out in his letter of April 18, 1957, to the Speaker of the House, this tax cut "has already saved our people almost $25 billion in taxes."

More than 60% of that reduction went to individuals. Every taxpayer benefited.

That was a creditable accomplishment by the Congress and the Administration. Tax receipts are now at an all-time high as a result of our current prosperity, but even so, Federal taxes account for a slightly smaller proportion of our national income than they did in 1953.

We intend to go further at the earliest justifiable opportunity, for the tax burden is still far too heavy. However, the possibility of a reduction in taxes depends upon the degree of success of the Administration and the Congress in keeping the budget position sound.

F. "SIXTH, MAKE CONSTRUCTIVE PLANS TO ENCOURAGE THE INITIATIVE OF OUR CITIZENS."

A primary goal of this Administration is a free and prosperous America. To encourage the initiative, energy, and savings of our people, which are the only means to prosperity, our most important steps were our anti-inflationary actions which have increased public confidence in the security and stability of our economy. In addition, we have taken other helpful action.

1. We Relieved the Public of the Burden of Controls.

When this Administration took office in 1953, the country was still handicapped with controls over prices and wages, and the use of certain materials. We promptly terminated these controls.

2. We Have Reduced Government Activities Which Compete with Private Business.

During the past four years, some 500 Federal enterprises competing with business have been abolished. We have disposed of the Government-owned synthetic rubber producing facilities and the Government-owned tin smelter to private enterprise, and the Reconstruction Finance Corporation is now in the process of liquidation. Surplus real estate, worth $366 million, has been sold and turned back to local tax rolls.

3. We Have Created a More Favorable Climate for Enterprise.

(a) We have moved vigorously to prevent monopolies.

The number of anti-trust prosecutions has been materially increased and the number of convictions, guilty pleas, and consent decrees obtained in the past four years has been more than 40% higher than in the preceding four years.

The number of prosecutions under Section 7 of the Clayton Act, as amended in 1950, has increased from only one in the two years, 1951 and 1952, to 29 during this Administration.

(b) We have encouraged small business.

Upon the success of small business firms to prosper and grow depends much of our production and our survival as a free competitive society. This Administration has sought in many ways to aid smaller firms and to relieve them of burdensome taxes and requirements.

In the past four years small business has benefited materially from tax law changes -- the expiration of the excess profits tax law, the reduction in personal income tax rates in 1954, and the extensive revision of the Internal Revenue Code. Even more important to the smaller firms is the general prosperity of the past four years.

To aid small firms which are unable to obtain adequate credit from normal sources, President Eisenhower signed the Small Business Administration Act on July 30, 1953. That Act created the Small Business Administration, and authorized a revolving fund of $275 million to provide needed loans to small business concerns. Subsequently, the Administration supported increases in the SBA funds to $375 million in 1956, and to $455 million in 1957. The Administration now has a bill pending to increase this to $600 million, and to make the SBA a permanent organization. Each year the SBA has made a larger number of loans, with over $125 million made in the last 10 months, and currently is making loans to about 60% of the applicants whose files have been reviewed.

(c) We have encouraged trade with other countries.

This Administration has effected measures which have aided the increase in our total foreign trade in 1956 by 22% (exports 25%) over 1952. In addition, the Treasury, with the cooperation of your Committee, has put into effect a number of Customs Simplification Acts which have reduced the complexities attendant on the movement of goods into the United States. We have also provided greater certainty in our administration of the tariff laws.

(d) We have encouraged initiative and activity.

Throughout the past four years this Administration has continuously attempted to encourage rather than discourage enterprise. As a result, our productivity and living standards have been rising steadily.

During the past four years, 500,000 new business corporations were formed in the United States. Of course, not all succeeded. A free economy is not a riskless economy. During that period, 44,000 enterprises -- noncorporate as well as corporate -- failed but that is lower in relation to the number of new corporations formed than during the preceding four years (34,000 failures and 355,000 new incorporations).

(e) We have encouraged savings.

The importance of savings as the anti-inflationary source of financing is so great that I would like to make these points.

i. <u>There are many people who benefit from higher interest just as there are many who find it an additional cost.</u>

You and I hear complaints today about the increased cost of money. We know it is nowhere as important as the increased cost of labor, but we also know that higher labor cost is a two-sided coin. Someone pays more -- but someone receives more. The same is true of interest.

Although many of us owe money in one form or another, it is equally true that many of us have savings in one form or another. As a result, we have a stake in protecting our principal against deterioration in the value of the dollar. We have a further stake in a higher interest return on our money. We are owners of millions of share accounts in savings and loan associations, time deposits in banks, and mutual life insurance policies. Many of us belong to a pension system and our benefit payments tend to increase as interest earnings rise.

Some critics allege that higher interest rates benefit only the bankers. That is nonsense. Earnings of insured commercial banks as a return on average capital accounts in 1956 were 7.82%. This is lower than the average for the prior three years, or for the years 1948-1952. Such bank earnings have averaged 8.29% for the past four years. This is less than the average of 8.62% for the entire eight years of the prior Administration. Bank earnings for 1956 of 7.82% are substantially less than the average earnings of all manufacturing companies which averaged 12.3%. In 1952, bank earnings of 8.1% compared with manufacturing earnings of 10.3%.

Bankers are brokers of money. When they receive more, they pay more. Our people have approximately 90 million savings accounts in banks and savings and loan associations. As you know, during the past few years most banks and savings and loan associations have increased the rates they pay to the saver. The amount of return paid or accrued for savers in the savings and loan associations (members of the Federal Home Loan Bank System) increased from less than $500 million in 1952, to an estimated billion dollars in 1956. The amount of interest so accrued for savers in mutual savings banks rose from $500 million to almost $800 million in 1956. Interest paid or accrued to depositors in commercial banks increased from about $450 million in 1952, to about $800 million in 1956. In the past four years, interest rates on all these types of savings have been moving upward, and, in a modest way, we have followed with our recent increase in the interest rates on newly purchased savings bonds.

ii. Increased interest stimulates savings.

The higher interest rates paid in the past few years have encouraged greater savings. During the four years of the Eisenhower Administration, our people saved more both in terms of dollars ($75 billion of personal savings compared to $56-1/2 billion in the preceding four years), and in relation to disposable income, 7.1% as compared to 6.4%.

iii. Increased savings are a major means of assuring continued high employment and prosperity.

Increased capital investment (more tools, more factories, more equipment), is necessary to provide the jobs with the high wage levels which are paid in this country. It is the principal means by which we can raise our living standards. To the extent such increases in capital investment are provided by excessive bank credit expansion, they are inflationary. To the extent they are financed out of savings, they are not.

With the great increase in capital investment in tools, it is essential to encourage savings in order that as little of this investment as possible be financed in such a way as to stimulate another round of inflation.

In the past four years, we have moved to an unparalleled prosperity. More people are living better than ever before. It is this prosperity, in turn, which creates heavy demands for money and requires some anti-inflationary restraint.

We have made great progress toward the sixth goal established by the President -- to make constructive plans to encourage the initiative of our citizens.

IV. CURRENT MONETARY AND FISCAL POLICIES HAVE BEEN BENEFICIAL TO THE ECONOMY

This Administration has successfully encouraged saving, enterprise, and production. This is a demonstrable and desirable accomplishment. With such means as it has had at its disposal, the Administration has attempted to arrest inflation and has been largely successful.

I note, however, that there have been some complaints that the monetary and fiscal policies have been too severe and have affected certain segments of the economy unfairly.

A. HAS THE ADMINISTRATION'S ANTI-INFLATIONARY PROGRAM BEEN INJURIOUS?

Let me review again what the Administration has done to fight inflation.

We have reduced the Government debt.

We have reduced Government expenditures.

We have balanced the budget.

We have reduced the floating debt.

We have moved some of the debt out of the hands of the banks and put more of it into the hands of individuals.

The reduction in Government expenditures has perhaps injured those corporations which might have received orders had the Government spent more money. The entire course of action, having been anti-inflationary, may have injured those few who might have benefited, at the expense of the rest of our citizens, from runaway inflation. But, except for these few, the good of the overwhelming majority of our people was best served by the course we have followed.

We have also endorsed the independence of the Federal Reserve and conducted our affairs in such a way as to avoid interference with its anti-inflationary monetary policy.

B. HAS THE [illegible]ERAL RESERVE'S ANTI-INFLATIONA[illegible] PROGRAM BEEN INJURIOUS?

1. By Restricting the Growth of Credit?

The Federal Reserve's program is one of allowing the natural market forces to operate, while adjusting credit availability to meet the needs of normal seasonal activities and sustainable economic growth. The Federal Reserve has ceased its earlier policy of creating additional bank credit, except to the extent needed to meet the basic requirements of a healthy economy.

(a) The Federal Reserve has not reduced the volume of available credit.

Some current discussions of Federal Reserve policy proceed on the mistaken assumption that the Federal Reserve has reduced the amount of credit below an amount previously available. Nothing could be further from the truth. Credit (the aggregate of new savings and new bank credit) has expanded substantially in the past four years, and at a rate fully equal to the need.

There is more credit outstanding today than ever before -- $146-1/2 billion more than in 1952.

Uses and sources of credit	Amount outstanding Dec. 31, 1952	Dec. 31, 1956	Change
	(In billions of dollars)		
Uses of credit:			
Individual:			
Mortgage..................	82.4	131.5	+49.1
Consumer..................	27.4	41.9	+14.5
Other.....................	25.7	34.1	+8.4
Total.....................	135.5	207.5	+72.0
Corporate..................	202.9	249.3	+46.4
State and local government.	31.2	50.0	+18.8
Total (other than Federal).	369.6	506.8	+137.2
Federal Government.........	267.4	276.7	+9.3
Total.......................	637.0	783.5	+146.5

As important as the fact of the increase in credit, is the source of this increase.

Sources of credit:			
Nonbank credit (savings)...	508.0	643.8	+135.8
Bank credit (money supply).	129.0	139.7	+10.7
Total......................	637.0	783.5	+146.5

In 1956 alone, tal debt (other than Federal Government) increased $37-1/2 billion. Of this increase, $17.5 billion was individual debt, $15.5 billion corporate, and $4.5 billion state and local government debt. (The Federal debt was reduced by $4.1 billion in the calendar year 1956.)

The increase in total credit in the past four years has been greater than in either of the two preceding four-year periods. But a most important fact to note is that 93% of this increase has come from savings and only 7% from an expansion in the money supply.

Uses and sources of credit	Increases in four year period: Dec. 1944-48	Dec. 1948-52	Dec. 1952-56
	(In billions of dollars)		
Uses of credit:			
Individual:			
Mortgage.................	19.4	32.0	49.1
Consumer.................	9.3	13.0	14.5
Other....................	3.7	7.4	8.4
Total....................	32.4	52.4	72.0
Corporate................	29.6	63.2	46.4
State and local government.	2.7	11.5	18.8
Total (other than Federal).	64.7	127.1	137.2
Federal Government.........	20.8	14.5	9.3
Total......................	85.5	141.6	146.5
Sources of credit:			
Nonbank credit (savings)...	64.3	124.2	135.8
Bank credit (money supply).	21.2	17.4	10.7
Total......................	85.5	141.6	146.5
Percent of increase accounted for by:			
New savings................	75%	88%	93%
Expansion in money supply..	25%	12%	7%
Total......................	100%	100%	100%

Of the $146.5 billion increase, $135.8 billion has come from existing funds of nonbank investors (which amount may be called "savings"), and only $10.7 billion from bank credit expansion, or increased money supply (new and additional spendable dollars). The total increase has been adequate for our most healthy economic expansion in many years. The growth in the money supply, at the rate of only 2% per year, has prevented any objectionable bank credit inflation. The secret of success in providing adequate funds for proper expansion without inflation is to encourage savings as the principal source. That we have done.

The foregoing table points out three most important facts:

1. Total loans have increased substantially in the past four years -- indeed more than in either of the two preceding four-year periods.

ii. This inc[illegible]ase has been primarily in priva[illegible] credit -- credit to buy homes, cars, consumer goods -- rather than tanks or guns.

iii. This increase has come much more from savings and less from bank credit expansion than in prior years -- hence it has been much less inflationary.

The Federal Reserve policy of not encouraging more rapid bank credit expansion has been based on the premise that further expansion of bank credit would merely have enabled more would-be buyers to bid up the price of the limited supply of goods and services. This policy has been necessary and in the best interests of the great majority of our people. But despite the substantial credit expansion that has taken place, since there has been less new credit created than the demand therefor, there has been some disappointment, and in some cases, real hardship.

It is said that the unavailability of unlimited credit has been particularly burdensome on the housing industry, on small business, and on state and municipal projects. As these areas are very important to all of us, perhaps we should briefly review them.

(a) Housing.

It is charged that we have impeded the flow of credit to housing. During the past 25 years, far from restricting credit to housing, the Government has greatly increased the volume of credit available to this industry -- over what it would be in a normal free market -- by stepping in and guaranteeing the payment of millions of home owners' mortgages. This has helped to provide many Americans with homes which they otherwise could not afford. On the whole, this has been a good program, but we must recognize that it has introduced certain artificialities into the free market for the purpose of diverting credit from other uses into home mortgages -- credit that wouldn't be available to housing without these Government guarantees. That was true under the prior Administration; it is true under this Administration.

Has this Administration restricted the terms on new housing loans? We have not -- we have relaxed them. We have lowered the minimum down payment on FHA loans, and we have permitted 30-year loans in place of the former 25-year maximum. We have materially liberalized FHA mortgage terms on existing homes. In addition, FNMA special assistance programs have been innovated since 1952 to provide mortgage support for relocation, redevelopment and rehabilitation housing under Sections 220 and 221 of the National Housing Act, for housing for the elderly, and for Capehart military housing. Also, the Voluntary Home Mortgage Credit Program, started in 1954, has helped obtain home financing for veterans and others in small and remote communities, and for minority group members.

Has the Administration restricted the availability of mortgage funds by curtailing the FNMA secondary market operations? Again, let's look at the record.

Purchases of mortgages by FNMA in the secondary mortgage market, during the last twelve months, have totaled nearly a billion dollars, an amount surpassed only in the calendar year 1950. Furthermore, in 1950 all of those funds were provided by the Treasury; under the sounder participating program as Congress has now revised it, the funds largely come from private sources.

According to preliminary figures, in May of this year there were 96,000 private non-farm housing starts. This is a second consecutive monthly increase on a seasonally adjusted basis, and brings the annual rate of new housing starts in May up to 990,000. While this is somewhat below the annual rate of 1,146,000 starts in May a year ago, and even further below the 1,398,000 rate in May 1955, it is still a substantial volume of housing.

There are undoubtedly many contributing causes to this decline. For the past few years home construction has been running ahead of new family formation, with a consequent reduction in the backlog of young families needing a home. Building costs have risen substantially in the past ten years. The price of land has also risen, as have state and local taxes, which are an element of cost. As the aggregate of these costs result in substantial increases in the price of a home, the number of potential purchasers is reduced. This cost increase has been accentuated by the host of new labor-saving appliances and luxury equipment which our people feel are now necessary in a home. There has been actual overbuilding in some localities and a diminishing supply of desirable building sites in others.

All of these factors have had an adverse effect on new home construction, but the unavailability of unlimited mortgage credit is also a major factor, and it falls most heavily on those who heretofore have been able to obtain mortgage credit only through Government assistance.

The number of new homes financed through conventional mortgages (based entirely on the credit of the borrower and the amount of his equity) has not declined. Indeed the number of such housing starts so financed in the first five months of this year (269,400) was slightly higher than the number so financed in the first five months of last year. It is the Government-guaranteed mortgages which are finding the less receptive market. The number so financed in the first five months of this year (114,200) was 42% less than the number financed in the first five months last year. This decline is due to the lower interest rate which such guaranteed loans bear. The increase in the maximum rate on FHA loans from 4-1/2% to 5% has given such financing renewed strength, but the lack of Congressional authorization of an increase in the rate on VA guaranteed mortgages has made it increasingly difficult for a veteran to obtain such a loan.

The significance of rate limitations is indicated by the most recent figures. Housing starts financed by conventional mortgages increased from 63,900 in April to 69,000 in May (which compares with 64,500 in May 1956). Housing starts under the FHA program increased from 12,100 in April, to 15,000 in May (as compared with 19,700 in May 1956). Housing starts under VA inspection <u>declined</u> from 13,500 in April, to 12,000 in May (compared with 26,600 in May 1956).

Thus it appears that there is only a relatively limited supply of mortgage credit available for the small downpayment, extended terms, and 4-1/2% interest rate on VA guaranteed loans. There is a substantial volume of mortgage money available for FHA insured mortgages at the 5% rate, although there is some insistence on higher downpayments than the minimum permitted under FHA terms. There appears to be sufficient mortgage credit available to finance those borrowers who can make an adequate downpayment and pay the going rate of interest.

This is the result of a free money market. It undoubtedly has caused many young families to postpone the purchase of a new home. Their disappointment, and that of the builder, is understandable. Yet how much better off would they have been if a more than adequate supply of credit had brought about increased prices not only of their home but of all of the other articles which they desire?

(b) Small business.

I am sure that there have been some small business firms which have been unable to obtain all of the credit that they would have liked at the rates they would like to pay. I believe this has been true in every year through history, and it has been true for each of the past four years, but this does not mean that there has been any reduction in the dollars of credit extended small business in the past four years. Quite the contrary. Both the number and amount of loans made to small business have been increasing substantially.

In this connection we must remember that the great majority of our banks are themselves quite small and the size of the loans they can make is limited by law. Of the 13,101 insured commercial banks in the United States, 10,853 have deposits of less than $10 million each, and, in general, cannot make loans above $100,000. Total loans of banks in this category increased by almost $2.1 billion during the past four years, an increase of 19%. Virtually all of their loans are to farmers, home owners, consumers, and small business firms.

Another 1,802 banks generally can make loans up to $500,000, but most of their loans would actually be in amounts of less than $100,000. Total loans of banks in this category increased by $4.4 billion during the past four years, an increase of 44%.

The remaining 446 banks do indeed represent almost 65% of the Nation's deposits, and are of great importance to the economy. They are the primary source of bank credit to larger business firms, but even they make many loans to small business. A survey made of a representative group of 78 such large banks indicated that in the year from September 1, 1955 to August 31, 1956, their small business loans (for amounts of under $100,000) had increased by $228 million, or 14%, and that the number of such loans had increased by 5%. Within this group there was more of an increase, both in numbers and dollar amount, in the loans under $50,000 than in those between $50,000 and $100,000.

While it is true that total business loans of banks increased somewhat more rapidly than those loans for amounts under $100,000, this is a pattern which would be expected in such a period of rapid economic expansion for the cyclical heavy goods industries naturally tend to require a larger volume of credit in such a period. At all times the established, successful firm is more able to obtain necessary credit than is the new, unproven or unsuccessful company, and this is particularly true of a period of credit stringency. Not all firms have obtained all of the credit they have wanted. Yet, in the aggregate, they have obtained more than ever before.

In addition to the increased amount of bank credit received by small business during the past four years, there has also been a sizable volume of book credit extended by larger firms to smaller firms (distributors, merchants, and suppliers).

I do not mean to minimize the disappointment, inconvenience, and in many cases real hardship that some businesses have experienced because of their inability to obtain as much credit as they would have liked.

Indeed this is a matter of deep interest to the Administration, which, as you know, has supported the creation of the Small Business Administration, the enactment of improved tax laws and the granting of exemptions from certain Securities and Exchange Commission regulations. In addition, we have made vigorous efforts to see that more defense work is sub-contracted to smaller firms.

I understand that you intend to invite Mr. Mueller, Assistant Secretary of Commerce, to testify before you, and I believe he will discuss the matter of small business financing at somewhat greater length. I do, however, want to make the point that there has been a large volume of credit available to, and used by, small business in the past four years.

(c) States and municipalities.

In the past four years, a quarter of a million new school rooms have been built for our youngsters. Total public construction in 1956 was 23% above 1952 levels, and educational construction up 56%.

During 1956 alone, new borrowing by states and municipalities totaled $5.4 billion, and during the last 9 months for which figures are available, more elementary and secondary school bonds were sold than in any 9-month period in our history.

State and municipal financing has increased by $18.8 billion in the past four years. This is more than it has ever increased in any other four-year period, and compares with $11.5 billion during the period 1948-1952.

These figures do not demonstrate any extraordinary burden on state and municipal financing from lack of available credit. Undoubtedly, local governments have been unable to obtain all of the funds they would have wished, but they have built more and financed more than in any other four-year period.

The Federal Reserve's monetary policy for the past four years has been, and is, one of discouraging the growth of credit at quite as rapid a rate as would-be borrowers desire. As a consequence, some individuals, some home purchasers, some small businesses, and some municipalities, and other categories of our citizens, have felt some pinch as a result of limited credit.

But --

In the past four years, small loans to business have increased substantially.

In the past four years, $57-1/2 billion has been spent for housing -- as much as had been spent in the preceding six years.

In the past four years, $16.7 billion has been spent for new highway construction -- more than had been spent in the preceding 11 years.

In the past four years, $8.8 billion has been spent for school construction -- more than had been spent in the preceding 20 years.

This is not the record of extreme credit stringency. Any freer credit would have inflated prices.

2. By Permitting Interest Rates to Rise.

The Federal Reserve's abandonment of its pegging of prices in the bond market has prevented an unlimited growth in credit. It was intended to, and did, slow the rate of growth of bank credit. It also has resulted in some increase in interest rates. It is alleged by some that this increase in interest rates has brought about a severe increase in the burden of taxes and in the prices we pay for manufactured goods, or utility services; that it has materially increased farmers' costs, or the price of a home. Is this true?

Higher interest (although the result of a lesser supply of credit than the demand therefor, a condition which prevents far greater inflationary increases in other costs) is itself an element of general costs and in some cases may be reflected in higher prices. However, interest payments are such a small fraction of the total cost of business operations, that a rise in the rate does not represent much of an increase in total cost.

(a) The interest burden on the taxpayer.

Total budget expenditures for fiscal 1957 are estimated at $68.9 billion. Of this, $7.2 billion, or 10.4% represents interest expenditures. The per capita cost of all expenditures of the Federal Government for this fiscal year is $406; for interest alone, the per capita cost is $42.40. In 1952, interest on the public debt was $37.57 per capita. Thus the increase in interest on the public debt during the past four years amounts to less than $5 per person.

(b) The price of manufactured goods.

In 1946, gross sales of all manufacturers amounted to $132 billion. Manufacturers had net interest expense in that year of about $154 million, equal to 1/8 of 1% of total sales. In 1952, interest expense had increased to about 1/4 of 1%, and on the basis of limited information now available, it appears that the 1956 ratio will be about 1/3 of 1%. Thus, interest costs are only 1/3 of 1% of the average sales price of manufactured goods. Of the cost of an article selling for $100, about 33 cents represents interest, with no more than 10 cents of that representing an increase since 1952. Furthermore, the increase in this minor item of interest costs reflects an increase in the amount of debt as well as an increase in interest rates.

The relative unimportance of interest as a part of total costs is reflected in the fact that during the same 10-year period, prices of goods that consumers buy rose 27-1/2%, or $27.50 on a $100 item (due to labor and other costs), compared to the 20 cent increase due to higher interest. The far greater significance of the increase in labor and other costs is reflected quite clearly in the price of consumers' services which have risen 43-1/2% during the same 10 years.

It is apparent from these figures that even with increased interest rates and increased indebtedness, the burden of interest costs on manufacturers in reference to their total costs is very slight. The effect of higher interest on the sales price of goods is hardly significant.

This is even more apparent when we compare the increased costs of the last year. Prices of goods bought by consumers (which reflect material, labor, interest, and profit) have risen 1.3%. The price of consumers' services (which reflect primarily labor costs) has gone up 2.3%.

(c) Public utility rates.

It has been suggested that higher interest rates lead to substantial increases in public utility rates. This sounds plausible because public utilities rely heavily on bonded indebtedness. However, the latest figures available indicate that the net interest expense of public utilities is still less than 4% of gross revenue -- the same proportion as in 1952. Even for electric utilities, where average interest cost on long-term debt now exceeds 5% of gross revenue, the relative cost of interest has risen very slowly. The estimated average of 5.2% for both 1955 and 1956, compares with 4.8% in 1952 and 5.0% for 1946.

(d) Farmers' costs.

Difficult as the farmer's position has been, it is not the result of interest rates. The Department of Agriculture estimates that only about 5% of farmers' costs are for interest. Interest rates on farm loans outstanding in insured commercial banks on June 30, 1956, averaged 6.1%. This was 4/10 of a percentage point higher than the average rate reported in a similar survey made in 1947. Thus this 4/10 of 1% increase in rate would be less than 1/2 of 1% of his total costs, or 5 cents on a sale of $10 worth of farm products.

(e) The cost of a home.

The effect of higher interest rates in relation to the decline in private non-farm housing starts from 465,000 units in the first five months of last year to 384,000 for the same period this year, has been grossly exaggerated. Housing is perhaps the most dramatic example of the effect of rising costs. Hourly wage rates in building construction have risen 21% in the past four years. In the manufacture of some products, the increased cost due to hourly labor rates has been offset by greater efficiency. Through use of additional capital goods (tools), the productivity per man hour has been increased enough so that the total cost has been kept fairly stable. This is true of most of our home appliances. However, in those fields in which mechanization is not practicable or in which restrictive practices or legal requirements have prohibited maximum efficiency, the cost of the finished product has risen in close relation to the increase in hourly labor rates. There is no better example of this than housing.

Many home purchasers consider only the size of the required monthly payment -- not the number thereof or the elements that make it up. To them, interest is of no significance. To the more sophisticated purchaser who inquires as to the component elements in his mortgage payments, increased interest rates are small in relation to increased labor and material costs. This is apparent if we compare the cost and financing charges of the same house in the spring of 1946, 1953, and 1957. Let us take as an example a house that cost $10,000 to build in the spring of 1946, and compute the required monthly payments on the basis of 15% down and the balance over a period of 20 years.

	Spring of 1946	Spring of 1953	Spring of 1957
Estimated cost of house............	$10,000	$17,300	$19,000
Interest rate (FHA)................	4%	4-1/4%	5%
Monthly payment (for 20 years).....	$51.51	$91.06	$106.58
Increase in cost of house since 1946......................		$7,300	$9,000
Increase in monthly payment since 1946:			
Due to interest rate...........			$8.71
Due to other costs.............			$46.36

The monthly payment has more than doubled in 11 years. Of this increase of $55.07, $46.36 reflects higher labor and material cost, and $8.71 is due to higher interest rates. During the past four years in which our policies have resisted inflation, the sales price of that house has gone up much less (about $400 per year as compared to about $1,000 per year from 1946 to 1953). Which has been the major factor in discouraging construction? The $9,000 increase in building cost ($46.36 per month), or the 1% increase in the cost of interest ($8.71 per month)?

While interest is an element in the cost of mortgaged homes, the increase in interest rates has not been the major factor in delaying home construction. Mortgage interest rates were higher in 1955 than in any prior recent year, yet new non-farm housing starts were the second highest in history, at more than 1,300,000.

Almost 5 million new dwelling units have been built in the past four years. Less than 3-1/2 million new households have been formed in that period, so that 1-1/2 million units have gone to satisfy prior shortages and to cover houses abandoned or razed to make way for new construction. The proportion of married couples without their own household has declined 21% since 1952.

A strong desire continues to exist for better housing -- but it is hindered from becoming an effective demand by today's inflated prices. To attempt to force an acceleration in home construction today by making more credit available for housing, would add further to the already increased building costs. This would not only be inflationary, it would encourage uneconomic practices and curtail the new construction that we might otherwise expect in years to come.

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The foregoing review of the effects of this Administration's fiscal policies indicates that the supply of credit has not been reduced. The supply of credit has merely been prevented from expanding as rapidly as the demand therefor. This slowing of the rate of growth of credit has inconvenienced those who have found credit unavailable, and imposed a higher charge on those who have borrowed. These results are hardly welcomed for their own sake -- but they are the price we have had to pay for the price stability that we have achieved in the past four years. This has been a far greater stability in prices and in the purchasing power of the dollar than we have enjoyed for two decades. Faced with this choice between the inconvenience of limited credit and the robbery of renewed inflation, our people would certainly choose the course which we have pursued for the past four years.

CONCLUSION

I have attempted to review for you the conditions existing when the Eisenhower Administration took office, the goals that the President set for us, and our progress toward those goals.

We have not achieved perfection. We have been unable to fully accomplish some of our debt management objectives. We have perhaps checked, but not entirely stopped inflationary pressures. In the process, some of our citizens, some of our municipalities, and some of our businesses, have been unable to obtain all of the credit they would have liked. We have had a large measure of success in encouraging the initiative of our citizens, but not every business has prospered as much as it might, nor every citizen had all of the comforts he would enjoy.

I acknowledge imperfections in our accomplishments, but I entertain no doubt as to the propriety of our goals or the wisdom of our policies. To aid you in your consideration of the alternative courses, and to help you measure their promises against the actual results of the past four years, let me remind you of some of our achievements.

When we took office in 1953, the Federal debt was equal to 89% of our national income -- in December 1956, it was 79%.

For the fiscal year 1953, budget expenditures were $74.3 billion, and for the year 1957, they are estimated at $68.9 billion, and $71.8 billion for 1958.

For the fiscal year 1953, the budget resulted in a deficit of $9.4 billion -- for 1957, it will result in a surplus.

From 1939 through 1952, the cost of living increased an average of 7% a year -- for the past four years, the average increase has been only 6/10 of 1%.

In the past four years, civilian employment has risen 6%, average weekly earnings of production workers in manufacturing have risen 18%, and after allowance for the 2.4% increase in consumer prices which occurred between 1952 and

1956, the gain in workers' earnings, after taxes, amounted to about $10 per week, or more than 15%.

Personal income of individuals has risen every year, from $272 billion in 1952, to $325 billion in 1956, a gain of 20%, and an estimated 340 billion for 1957.

Labor income has not only risen in dollars, it has increased from 67.2% of national income in 1952, to 69.8% in 1956 (while corporate profits declined from 12.7% of national income, to 11.9%).

Striking achievements have been made in housing. The 5 million dwelling units that were constructed exceeded the number built in any previous four-year period and substantially enlarged the housing stock available to the American people. There were improvements in the size, design, and equipment of new homes, and sizable outlays for repairs and alterations added to the comfort and convenience of existing homes. A growing proportion of our homes were owner-occupied -- 60% in 1956, compared with 55% in 1950.

This is a gratifying record of the improvement in the level of living that can be achieved only through a vigorous competitive, free market economic system which offers both individual freedom of choice and the stimulation of initiative through personal incentive. In particular, it shows the capacity of such a system to bring about confidence and daring in enterprise, and widespread participation in the benefits of economic expansion. This is in sharp contrast to the artificial restrictions, interferences, and controls of a paternalistic bureaucracy.

The past four years have demonstrated the ability of the Nation's private economy to expand, to provide an increasing number of better jobs, at better pay, and to raise levels of living. These four years have tested the capacity of our economy to adjust to large changes in the pattern of demand and the effectiveness of public policies designed to promote growth of individual freedom and stability in the economy. Because the problems are continually changing in a dynamic economy, policies aimed at promoting stable growth must be flexible. This fact was well illustrated in the past four years of the Eisenhower Administration. Our problems have shifted from those of a controlled wartime economy to those of a rapidly widening prosperity. We have been able to encourage this prosperity.

Through the flexibility of monetary and fiscal policies, the Government has been able to adjust to the rapid changes in our economy. We have moved forward toward our goals and demonstrated the great capacity of a free economy to correct imbalance and to maintain growth with a high degree of stability.

We have accommodated the reduction in wartime Government spending, accompanied by record-breaking tax reduction, and offset a threatened decline in employment and business activity in 1953-54. We have encouraged an expansion of enterprise to new high levels, and through expenditure and debt reductions, as well as debt management, we have slowed the growth of inflationary credit. We have encouraged a rapidly rising economy which has brought more wealth, more purchasing power, more comfort, more jobs, more homes, more luxuries, more leisure, more education, and more security to our people than they have ever enjoyed before.

Gentlemen, I take great pride in making this report.

Senators Byrd, Gore,
Bennett - Statements

Statement of Senator Albert Gore
at Public Hearings of the Committee on Finance
United States Senate
July 11, 1957

For Release to P M Press

Mr. Chairman, in an effort to avoid repetition of the many questions which have been submitted to the distinguished Secretary of the Treasury, I have chosen to make a brief summary statement, covering certain aspects of the problem, upon which, after I have made it, I will invite Secretary Humphrey to comment as he may wish.

My first fundamental point of difference with the position of Secretary Humphrey, as taken before this Committee, concerns the nature of the inflationary threat with which our country is confronted. There is no disagreement between us as to the consequences of inflation. Perhaps some of my colleagues may recall the role I played in combatting inflation both before Pearl Harbor and after. The term "inflationist", by which in his opening statement Secretary Humphrey described all those who disagree with his policy, may fit some, but does not fit me. Even so, there are some who unfortunately and unwisely consider it an utter impossibility to be in opposition both to inflation and to current governmental policies which allegedly are for the purpose of combatting inflation but which have notably failed in this regard.

We have "true inflation", according to the weight of accepted authority, when an increase in the quantity of demand produces no further increase in output and therefore spends itself entirely in price increases.

I do not believe we are in such a period or such an economic state. On the other hand, it seems fair to conclude that Secretary Humphrey does think we have just such a classical inflationary condition. Indeed, he said to this Committee that further "expansion of bank credit would merely have enabled more would-be buyers to bid up the price of the limited supply of goods and services." As a further explanation of his understanding of the current situation, Secretary Humphrey stated that, "The reason that these inflationary pressures are on us now is because of the great prosperity which the country is enjoying at the present time. It is the demand for building, it is the demand for goods, it is the demand for all sorts of things that are exceeding the supply." The Secretary also agreed with the thumbnail summary of his views that this inflation "was caused by a bigger demand than productive capacity could supply."

Now, as the facts have been developed, no significant scarcity in goods and commodities has been revealed except in a very limited number of specialty items such as large structural steel shapes. To the contrary, surpluses of goods or of productive capacity to turn out more goods are in evidence almost everywhere we look.

The "limited supplies", as we have seen, are not in goods but rather in money and credit. The "excessive" supplies, on the other hand, as we have seen, are not in money and credit but rather in goods and commodities. Thus, Mr. Chairman, we have found our economic situation to be in sharp variance with the classical type of inflation which Secretary Humphrey has assessed and assumed the situation to be.

Then, I completely reject the position which Secretary Humphrey has repeatedly stated to this Committee that the United States Government is, and should be, as helpless in marketing its securities and in managing the public debt as a local merchant "trying to sell a fur-lined overcoat in August." Many of the hurtful consequences of such a concept and of such abandonment of responsibility have been developed during this hearing and are plain for all to see.

Now, starting with these basic disagreements as to the nature of our problem and as to the capacity of the government to serve its fiscal necessities or to protect its fiscal integrity, disagreement on policy to cope adequately with the situation as it is, in contrast with what it has been assumed to be, is an entirely logical, if not unavoidable, consequence.

Even if we were, contrary to fact, in a period characterized by short supplies of goods, commodities and services and by excess supplies of money and credit, the economic policies now being pursued by this Administration, admittedly of some value in such a situation, should only be used with restraint and discretion. This would be true because of disturbing trends, both long-term and short-term, in our economy and our society which pose a basic threat to true free enterprise and reasonable equality of economic opportunity, to which I will later refer; and, also, because such policies, if badly organized or indiscriminately applied, tend to disarrange and often worsen desirable distribution of goods and fair distribution of income.

But when such policies are applied to the conditions as they are today, in sharp contrast to what they have been assumed to be, these policies are disclosed to be fallacious and hurtful because they create imbalance, not balance; instability, not stability; poorer, not better distribution; inadequate, not adequate economic growth and progress. All this is true because these policies encourage rather than discourage the peculiar kind of selective price and income inflation combined with selective price and income deflation which continue to threaten our economy.

What we have, as I see it, is a highly selective, non-uniform price and income inflation. I know of no better example -- though there are others -- than the current inflation in the price of steel. This, as the Secretary has acknowledged, will stimulate inflation of prices over a "wide area" of our economy. A hardware merchant has told me that, immediately after the recent price increase of steel was announced, his wholesale supplier notified him that fencing wire would be increased $1.00 per bale. This means higher prices for nails, hammers, saws, refrigerators, air conditioners, television sets, automobiles, plumbing fixtures, and down to such little things as metal compacts, lipstick containers, locks and keys, and to such big things as structural steel for buildings and highway construction. Indeed, Mr. Chairman, our whole industrial economy has a strong metallic base. Our highly industrialized economy of today cannot exist without a constant supply of basic metals like iron, steel, copper and aluminum. The whole nation is dependent for steel upon a very few tightly controlled large corporations.

This steel price increase has not been dictated by a depleted profit position in the steel industry. On the contrary, profits have been, and are, enormous. This inflationary increase in the price of steel has not been dictated by the classical inflationary condition of demand exceeding current productive capacity. The steel mills are currently operating at only about 80% to 90% of capacity, as we have seen. This price increase can hardly be blamed on competition.

What, then, is the reason for inflating the price of steel? Well, there is no mystery surrounding the reason for the increase in the price of steel. The Chairman of the Board of U S Steel advised the stockholders at the annual meeting on May 7, 1956 that a projection of the financial needs of the company showed that they would need an additional $140 million. He then proposed to the stockholders that the method to use to get expansion capital "is by raising prices from time to time --- as circumstances require and permit."

Similarly, the minutes of the Standard Oil Company of New Jersey for the meeting of the Board of Directors on December 13, 1956 showed that "for the first time in many years" the company was faced with the probability that they would have to use something more than internal financing to "cover replacements, modernization, and expansion". However, this company was able to increase its prices to the extent that it was unnecessary for the company to resort to external financing.

This type of price inflation, primarily to finance expansion, is actually encouraged, nor discouraged, by current government policies. High interest rates and diminished possibility of competition, both created by current policies, encourage and invite big business concerns to finance their capital expansion and improvement in large part from inflated prices and consequent swollen profits. In this way, Mr. Chairman, the public is unfairly forced to pay for the further concentration of the nation's economic strength and wealth in big corporations, thus intensifying the growing threat to competition and equality of enterprise. Thus you see, like most other elements of inflation, it feeds upon itself.

The social injustice of this practice can be seen in the fact that the mass of our people are forced unfairly to pay higher prices for the products of big business, thus forced themselves to contribute to the further disparity of wealth and income between themselves and a comparative few who have large holdings in such corporate enterprise. Because consumers are being made to pay unfairly for added plants and profits, through unfairly inflated prices and because of various tax concessions, these stockholders collect larger and larger dividends, and in addition can daily watch the rapid appreciation of their fortunes.

Steel is by no means the only example of such unfair gouging of the public by the big, the powerful and the rich. Indeed, this is characteristic of our current economy and is encouraged and abetted by governmental policy. According to the statistics from the Securities and Exchange Commission, corporations spent 35.1 billion dollars in 1956 for expansion. Of this amount, only approximately 10 billion dollars came from long-term borrowings or new stock issues. The overwhelming proportion came from internal financing -- inflated prices and swollen profits. Though expansion financed in part by profits may be sound practice, this extreme profiteering appears unconscionable.

This disturbing development is not only abetted by monetary policy, but possibly even more by tax policy, by appointments to and policies of regulatory agencies favorable not to the public interest but to the very interests which such agencies are supposed to regulate, and by other actions and policies of the Administration which create what Secretary Humphrey described to us as "an improved climate for enterprise."

I find myself in agreement with both Secretary Humphrey and the new Secretary-Designate, Mr. Anderson, that higher interest rates are both inflationary and deflationary. It so happens, though, that the deflationary effect of higher interest rates is most effective in that portion of our economy in which we have the least amount of price and income inflation (or even deflation), and is most ineffective in that portion of our economy in which we have administered price inflation.

Though higher interest rates, as Secretary Humphrey has said, help one group of our people a great deal, they hurt most people severely.

Secretary Humphrey has repeatedly referred to action by the government to hold interest rates down as "artificial" but has referred to action to increase interest rates as "natural". The fact is that one is as "artificial" as the other, both being the result of positive action by the government.

Though we have heard much about the sale of Government securities "on the nose" at what the market will take, actually Government bonds have been deliberately sold at interest rates higher than necessary, thus placing an unnecessarily heavy burden on taxpayers for many years to come.

On yesterday, in fact, Secretary Humphrey, with characteristic candor, expressed the opinion that we might be better off if he had led the market "a little more than we did."

On yesterday, too, Secretary Humphrey jocularly remarked that we often try to go in two directions at once. In all seriousness, that is exactly how Governmental policies have been applied in some instances. For instance, in 1953 the Government raised rediscount rates in the Federal Reserve System, thus increasing interest rates throughout the nation's banking system and, in the same year, not only lowered reserve requirements, thus expanding credit, but also lowered by 33-1/3% margin requirements, thus stimulating speculation in corporate securities. In fact, both reserve requirements and margin requirements are lower even today than in January 1953, even though from March 1955 to now, the rediscount rate has been increased successively eleven times, thus giving a boost in interest rates to the nation's banking system, on installment credit and in the market place.

Thus, Mr. Chairman, it will be seen that interest rates have been increased primarily for the purpose of increasing income from interest.

The greatest artificiality of our age is the corporation. It is a fictitious person, but nevertheless a legal entity. I accept the necessity of a corporate entity. It has been very valuable in our economic development. I do question, however, the unreasonable and unjustifiable favoritism toward income from corporate investment and other policies which, in general, encourage the creation of corporations and unduly encourage investment and speculation in corporate stock.

The monetary and economic policies of the Eisenhower Administration, labled "anti-inflationary," seem to me to miss the mark. They severely hurt, as already demonstrated, large segments of our population and economy, particularly those segments of our economy that are characterized by competition and multiplicity of small business concerns and those people who must borrow money or buy goods, homes and automobiles on time. Major sources of inflationary pressures in our economy, on the other hand, are augmented by, instead of repressed by, these policies.

The result is to make the big bigger, the rich richer, and to threaten the existence of a climate truly favorable to individual enterprise and equality of opportunity. These trends have produced conditions in our country and attitudes on the part of government officials, as well as on the part of many private citizens, which are unhealthy. We have found it possible, for instance, to repeal the excess profits tax, but we have not found it possible to increase tax exemptions for a child or an aged dependent. We have not found it possible to return to the pre-war policy of giving some preference in income taxation to income actually earned by human efforts, but instead we have gone so far in the opposite direction as to give a tax preference to unearned income from dividends. We have given vast benefits through rapid tax write-offs to bring about construction of more factories, even though existing productive capacity was by no means fully utilized, but we have not found it possible to pass a school construction bill. We have given vast interest-free loans to big business to build plants, but programs to help people become home owners falter and fail because of deliberate government policy of forcing higher and higher interest rates on home mortgages.

In these ways, and in many others, Mr. Chairman, our Government is favoring material values over human values. This I challenge. I challenge it in whole and in part.

The resolution adopted by this Committee is a broad one. It encompasses the whole economy, and is not limited, as some may have concluded, to monetary and fiscal policy.

I hope this investigation will be a searching inquiry into not only current monetary and fiscal policies, which are an important part, but only a part, of policies or lack of policies, action or lack of action, creating the conditions which I have briefly described and which I view with alarm, but also tax structure, economic concentration, maladjustments of distribution, threats and impediments to free enterprise, and the whole economic fabric of our society.

Statement by Sen. Wallace F. Bennett in Finance Committee, August 9, 1957

Mr. Chairman: I want to begin by complimenting Mr. Burgess on the fine presentation which he has made and the manner in which he has clearly and directly answered the many questions which have been asked of him. Also, I wish to express my regret over the fact that the Treasury is losing the services of such a distinguished individual and a superb technician in this field. I extend to him my sincere best wishes as he undertakes his new assignment.

These hearings began June 18th, and in the 51 days that have passed there have been hundreds of points of contention--but most of them are minor. By a thorough review of the transcript, I have noted 16 that I consider worth recording, 10 in the field of monetary policy, three touching debt management policies, and three of general economic significance. But before I discuss them separately, I should like to make some general observations.

Behind these conflicts lie some more fundamental disagreements in basic economic philosopy. On the one side--the Treasury's--is a general acceptance of the validity of what might be called "classic" economics. On the other is a variety of unorthodox economic theories. Some of these are hangovers from the economic experimentation of the '30's. Some are calculated to give special benefits to certain groups. Some indicate a preoccupation with depression--and the past--by a general program of making all economic comparisons within the past 25 years. Some indicate an unwillingness to trust free markets to produce prosperity. In one way or another and from many angles, the time proven principles of economics are under attack .

Thus far our chief concern has been with inflation--its cause and cure. We know it exists in the form of a world-wide epidemic. We have not yet completed our study of its cause or causes. Whether it is a flare-up of a form of the disease that has been dormant at times--or whether it is a new and different form of the disease, we have yet to learn fully. It is being treated as though it is of the usual type. The orthodox monetary doctors say we are trying to use more energy than we possess--and taking the narcotic of inflation to keep us going. They are trying to slow us down to a rate that can be sustained by our natural increase in strength--even though it means postponing some things we would like to enjoy now.

Resentment of this program has developed in a number of forms. Some apparently believe that inflation isn't a disease after all--but a desirable way to increase our rate of growth. Some say the cure is worse than the disease. Others say that the cost in higher interest rates is too high. A few have suggested that this is all a plot between the doctors and the druggists (the banks) to make extra profits out of our illness--and that we can be cured at less cost. There are those who want the doctor fired--or at least they want to dictate the treatment. They say that the treatment has been going on for some months now--and hasn't cured the disease. They also point to the times when the doctors permitted a little stimulation and the disease didn't immediately show up and therefore assume that there is no relationship between the disease and the cure. On the basis of this argument they call for more stimulant, saying that by this means we may be able to take more exercise and thus develop more muscle. They are not concerned about the effect on our economic heart--the essential and healthy stability of the dollar.

Mr. Secretary, as I have listened to the questions during our many sessions, both with you and with Secretary Humphrey, I have been impressed by the fact that both of you have had to deal with what amounts to a series of charges, carefully organized and buttressed with data, tabular material, relevant quotations and all the rest of it. The time and effort which must surely have gone into the preparation of the charges is impressive--but I have been even more impressed with the answers that you and Secretary Humphrey have provided. It is clear to me that some are seeking nothing less than a complete over-turn of the sound principles which have been developed over the course of long and hard experience.

My colleagues have been so thorough in their questioning that I feel it would be repetitious for me to cover again, by means of still more questions, the ground which has already been traveled. However, it does seem to me to be particularly important that the issues developed out of the charges and the answers be clearly defined. Accordingly, rather than to question you, I should like to list briefly the issues as I have understood them and I will give you an opportunity to comment at any point at which you feel my understanding is inadequate or faulty. In this way I know that you can be the most help to me, personally, in understanding the basic issues which have been developed, and perhaps also it will be of assistance to other members of the Committee and to the public.

Monetary Policy

1) With respect to the issues in the field of monetary policy or monetary theory, the first is the nature of the current inflation. It is charged that these price increases have behind them none of the elements of a classic inflation but, instead, are caused by "tight money" and manipulated prices in semi-monopolistic industries. The answer the Treasury has given to this is that current price increases are basically caused by the same factors which must operate during every inflation: increased demand pressing against a limited supply of goods and services, with demand, in this case, particularly strong in the capital goods field.

1a) There are two correlative issues here. It is claimed that restrictive monetary policy has not been successful in preventing price rises during the last year and a half. This has been answered by the fact that we now have relatively full utilization of some basic resources, particularly labor; and if these policies had not been adopted, there would have been considerably more inflation.

1b) The other correlative issue--one which is particularly difficult for me to take seriously--arises out of the claim that correct policy in combatting inflation is to provide for more rapid increases in the money supply than are currently permitted in order to secure substantial increases in output (for example, in housing), and that these output increases would depress prices. The response is that there is little possibility of output increasing at a faster rate than is already the case, regardless of excess capacity, because there is virtually no unemployment above the frictional level. Furthermore, although it is possible to conceive of substantial increases in output in some individual sector of the economy, like housing, it is an increase in the entire economy which must be considered in a situation of this sort. I said earlier that I find it difficult to take the issue seriously because I cannot comprehend how anyone can honestly advocate increasing the money supply to combat inflation. Are we then to believe—as we must, following this logic—that the way to halt a severe decline in prices is to contract the money supply?

2) The second major issue in the field of monetary policy arises out of the claim that the Federal Reserve System can support prices of government bonds, thereby reducing the interest burden on the national debt and interest rates generally, without the necessity of making large purchases of government bonds and, therefore, without being inflationary. On the other hand, the Treasury has made it clear to me that the Federal Reserve cannot start a policy of pegging bond prices without, at the same time, relinquishing its control over monetary policies. The data which purport to show that the Federal Reserve can support bond prices without adding considerably to bank reserves through necessary purchases of government securities are taken from carefully selected years with conditions not comparable to the present.

3) The next two issues relate to the effectiveness of higher interest rates in combatting inflation. It is claimed that higher interest cannot be a deterrent to capital investment since the volume of such investment is now at a peak. But it can certainly be said that with lower interest rates the volume would undoubtedly be much larger and inflationary pressures that much more severe.

4) It is also suggested that higher interest is inflationary because it enters into costs and stimulates demand for higher wages. The other side of the issue is that the deflationary effect of higher interest is far more important than its inflationary effect, particularly when it is remembered that higher rates reflect tightness in the availability of money. Interest is, after all, a very small part of most costs, and the difference in rates that has developed is even less significant.

5) The next issue arises out of the charge that current monetary policy is hurting only small business; that it does not hurt large business. Although it can safely be said that such a policy will adversely affect all marginal businesses, there is no reason to assume that all marginal businesses are small business. It is possible, as Secretary Humphrey admitted, that many small businesses may feel the pinch but the data which were submitted, particularly after analysis, did not prove that small business was hurt any more seriously than large business.

6) The sixth issue has developed out of the charge that current monetary policy, which is allegedly providing insufficient growth in the money supply and is characterized by higher interest rates, will cause a depression, just as similar policies during the 1920's resulted in the depression of 1929-33. On the other side of this issue we find the wise judgment--which I believe was expressed in your testimony--that the primary value of current monetary policy is in preventing excesses of the type which eventually can lead to depression; and that the greater the excess--the deeper the depression. Also, you have noted that the money supply is not growing at too slow a rate when increases in velocity are taken into consideration, and finally, that monetary policy during the 1920's was not so much incorrect as poorly timed.

7) The next two issues in my informal tabulation relate to the causes of higher interest. It has been stated that rates are higher because the Federal Reserve has increased its rediscount rate on a number of occasions since 1953. On the other hand, if I interpret the data correctly, changes in the rediscount rate have followed--not led-- changes in the interest rate. Further, Federal Reserve influence over interest rates is exercised primarily through its control over the volume of money.

8) A charge which, in my opinion, is entirely unsupported has created my eighth issue. This begins with the claim that the Treasury has the power to set the general level of interest rates through the rates it selects for its own securities; and follows with the charge that it has deliberately used that power to increase interest rates. I believe that both Secretary Humphrey

and you have emphasized that the Treasury has never attempted to increase interest rates through its operations, but has accepted the market rate. Treasury operations, if I understand you correctly, are a factor in the market but there are, in addition, many other factors and influences.

9) The ninth and tenth issues as I have tabulated them relate directly to the Federal Reserve. If I understood your testimony of several days ago (page 1604 of the transcript) the primary function of the Federal Reserve is to maintain a volume of money which will assure price stability and sound economical growth. But this has been challenged with the claim that the primary function is to provide all of the funds demanded by a growing economy, presumably without regard to the effect on the price level.

10) The tenth issue is developed out of the claim that the Federal Reserve has almost unlimited power in its field and is controlled by only a few men who are, in effect, independent of any supervision. The other side of the issue--with which I am in agreement--is that although the Federal Reserve has great power, that power is not unlimited; its policies are directed by a large number of men from all areas and representing diverse economic backgrounds. In the final analysis, the Federal Reserve is an agent of the Congress, which can and should exercise its authority whenever appropriate. I might observe that the whole question of the independence of the Federal Reserve System seems to be developing rapidly.

There have been indications that some members of the Committee are considering legislation which would have the effect of destroying the independence of the Federal Reserve by requiring that it center its activities on supporting the prices of U. S. government obligations. This would place the Federal Reserve in a subordinate position to the Treasury, therefore subject to the political pressures which must necessarily be present.

Debt Management

1) Turning now to the field of debt management, it seems to me that here three basic issues have been developed. The first

relates to the maturity distribution of the public debt, and is based on the claim that because sales of longer term securities are deflationary, such sales should be attempted now, even though Federal Reserve policy has made this more difficult than it need be. The answer given is that the time is not appropriate for the flotation of longer term securities since the Treasury would now have to pay excessive rates. There is simply no market for long-term bonds in large amounts at rates which the Treasury is permitted by law to pay.

2) The second issue arises out of the charge that the Treasury has deliberately put itself at the mercy of the market in floating its securities. But the alternative, as I understand it, to acceptance of the competitive rate by the Treasury is to maintain artificially low rates through rigid price supports by the Federal Reserve. As indicated earlier, this policy would mean the acceptance of considerable inflation in return for lower interest rates.

3) The third issue relates to the Treasury policy of consulting with market representatives. It has been suggested that this consultation before the issue of securities may cause the market to anticipate new rates and make upward adjustments beforehand. It is stated that the Treasury should make its own determination of appropriate rates and volume, presumably in secret. On the other side of this issue it has been shown that it is necessary to consult with a large number of people representing many different types of lenders in view of the large volume of financing which the Treasury must undertake. This policy, which has been followed for a considerable period of time, even before this Administration came into power, is correct so long as discretion is maintained and it is understood that the Treasury does not commit itself in advance to the acceptance of any particular suggestion.

<u>Other</u>

1) Finally I note three other issues which I have put in a miscellaneous category, even though, on closer examination, they might be fitted into either of the two major categories I have just described. The first relates to housing and arises from

claim that a reduction in housing starts has been a goal of this Administration. I must say that I was greatly impressed with the answer of Secretary Humphrey to this charge when he clearly defined the issue by pointing out that the reduction in housing starts is a response to the influence of the free market; and was not deliberately planned by anybody. As demand shifts, and interest rates on mortgages become competitive, funds will again move into the housing market.

2) The second of my miscellaneous issues relates to the claim that corporations are somehow immoral if they set prices sufficient to secure a return which will provide funds to finance expansion. It seems to me that it should be self-evident that some portion of its income must be put aside by every corporation for expansion and renewal. All funds used for expansion (other than those secured from equity financing) must come out of income--whether it be from current income or from future income to repay borrowing.

3) My third and final issue in this category relates to the claim that since the Federal Reserve took a substantial portion of the latest Treasury refunding, and since that refunding was at the rate of 4 percent, this must indicate that a constant increase in interest rates can be assumed for the foreseeable future. However, it is impossible to see how this conclusion can be drawn from those facts. Interest rates have always fluctuated considerably, even during the past few years, and there is no assurance that during the next few months they will be either higher or lower than they are today.

This concludes my summary of the issues, Mr. Secretary. Before asking for any comments you might care to make, I should like, again, to express my congratulations on your more than quarter century of service to the Treasury--a service which spans four Administrations. under both political parties. I wish you well in your new task.

The Problem of Inflation

A speech to be delivered
by
Senator Wallace F. Bennett
On the Senate Floor
July 8, 1958

The Senate Finance Committee recently completed its hearings on the financial condition of the United States. The sessions, held from June 18 through August 19 last year and during April of this year, were intended to be the first full-dress examination of our fiscal and monetary policies since the one conducted by the Aldrich Monetary Commission in 1908. As a member of the Committee I sat through nearly every session of the hearings and heard most of the testimony.

In the absence of a formal report, I want to present my own impressions of the material presented to the Committee and the ideas developed in the questioning. I do this in the belief that the material covered in these hearings should be of interest to every member of the Senate. The hearings shed light on some of the most basic problems of our economy, problems with which we in Congress are concerned every day, and which affect every person in the United States. Rather than summarize these hearings in one long statement, I shall make several, of which this is the first.

The purpose of the study was outlined by Committee Chairman Harry F. Byrd in his introductory comments last year:

> to study the existing credit and interest situation and, more important, inflation which has started again with its ominous threat to fiscal solvency, sound money, and individual welfare... This committee can never lose sight of the fact that the Government's integrity depends upon a stable currency.....
>
> It is the comittee's purpose to conduct a objecttive examination to clarify the situation and be helpful in the effort to avoid further inflation, and to establish sound fiscal principles flexible enough to meet possible recessions as well as increasing prosperity.

The study as announced was to examine:

(1) The revenue, bonded indebtedness, and interest rates on all public obligations, including contingent liabilities;

(2) Policies and procedures employed in the management of the public debt and the effect thereof on credit, interest rates, and the Nation's economy and welfare; and

(3) Factors which influence the availability and distribution of credit and interest rates thereon as they apply to public and private debt.

The list of witnesses, both last year and this, was an imposing one. Last year George M. Humphrey and Randolph Burgess, then Secretary and Undersecretary of the Treasury, were the main witnesses; and Federal Reserve Board Chairman William McChesney Martin also appeared. This year the Committee heard from elder-statesman Bernard Baruch; Marriner S. Eccles, former Chairman of the Federal Reserve Board; William McChesney Martin again; Professors Sumner, Slichter and Seymour Harris of Harvard University; and Dean Charles Abbott of the University of Virginia, in that order.

In addition to verbal testimony, the Committee sent a list of 17 questions on basic economic questions to outstanding economist, businessmen, and public leaders. Replies have been received (and published) from the presidents of the twelve Federal Reserve Banks, the presidents of 28 U. S. corporations, 12 trade association leader and 17 economists. The questionnaire was also sent to veterans organizations and to labor leaders John L. Lewis and George Meany, but they did not respond.

It is interesting to note that the two sessions of the hearings, last year and this, were held under entirely different economic conditions. The setting last year was one of inflation, characterized by full utilization of the labor force and a capital goods boom. Since that time we have experienced a business downturn, characterized by a slump in private capital investment and some unemployment.

In setting for itself the problem of investigating so many aspects of the financial condition of the United States, the Committee left the door open for the discussion of a wide variety of issues. Therefore, it is not surprising that virtually every question or topic bearing on the Nation's finances was encountered and discussed. Nevertheless, in reviewing the printed record I have been impressed by the fact that there was a single unifying thread running through all of the discussions; this thread was the problem of inflation.

During last summer's sessions, when prices were rising fairly rapidly and most of our resources were fully utilized, much of the discussion centered around two questions; first, how could inflation be stopped and, second, was anti-inflationary action then being taken necessary or harmful? Concern over inflation did not diminish during the hearings this spring, despite the business downturn and a slowing down of the rate of the price rise. A scrutiny of the testimony and questioning during these later sessions will indicate that the major issues were, first, whether or not the anti-inflationary policy of 1957 was primarily responsible for the current business downturn and, second, the extent to which anti-recession action should take into account the danger of further inflation.

Because the general problem of inflation ran through all the hearings, it has naturally become the central theme of these reports. In fact, I am convinced that it has become our basic long-time economic problem and that until we as a people understand the danger it creates and take the necessary steps to stamp it out, we cannot count on a future of sound growth and prosperity.

The Committee gathered a great variety of material on the general nature of the problem of inflation, and I shall begin by reviewing this background information. Without such a review it seems pointless to consider the separate basic issues developed in the hearings.

To me, the most serious aspect of inflation is the moral one. Inflation is essentially a process by which someone attempts to get something for nothing--a disguised form of theft--in which the poor and helpless are the first victims, but which can eventually engulf a whole economy. It is a narcotic which produces the illusion of prosperity and growth, concealing the real damage. The Committee devoted little or no time to this aspect of the problem, probably because most of its members are in agreement that inflation is an evil whether it be judged on moral or economic grounds. Instead, most of the time was devoted to the definition and mechanics of inflation.

In its search for information in this field, the Committee literally began at the beginning. It sought throughout the entire course of the hearings to find a workable definition of inflation.

Most of the witnesses were asked for, or volunteered, a definition and likewise a request for a definition was included among the questions sent to business and university economists and to the presidents of the Federal Reserve banks. The Committee never attempted to make a final selection from all of these answers, but I think it is probably true that by the end of the hearings it was the simplest of all the definitions which gained the most acceptance; namely, that inflation is simply a general rise in prices.

In looking over all of the definitions of inflation suggested in the hearings, I am impressed by the fact that many of them agreed that inflation is basically a phenomenon of money. For example, Mr. Baruch in his testimony defined inflation as an abnormal and disproportionate increase of money and credit in relation to the production of goods and services. At other times during the hearings, inflation was defined as "a flow of spendings in excess of the flow of goods and services," or "too much money for the goods and services offered," or "too many dollars chasing too few goods." On the other hand, it should also be noted that inflation was described by some witnesses as a result of pressure on costs, particularly wage pressures. Thus, Professor Slichter of Harvard rejected the monetary definition as "inaccurate," adding "the recession is helping the public see more clearly than ever that rising wages are a principal cause of rising prices." Similarly, Dr. Abbott, Dean of the Graduate School of Business Administration of the University of Virginia, emphasized that our current problem is a "wage-push inflation."

Personally, I believe it is possible to oversimplify any specific cause of inflation. For that reason I was impressed with the discussion of the inflationary process in the opening statement of Chairman Martin of the Board of Governors in his appearance before the Committee last summer, which was supplemented by an excellent account of inflationary processes given by Mr. Edward Wayne, First Vice President of the Federal Reserve Bank of Richmond. Neither of these presentations attempted to attribute the blame for inflation to one specific element. As Chairman Martin pointed out, "Inflation is a process in which rising costs and prices mutually interact upon each other over time with a spiral effect. At the same time, demand must always be sufficient to keep the spiral moving."

While they were greatly concerned with the causes of inflation the Committee members spent very little time on questions having to do with its consequences. It is precisely here that its greatest danger lies. We are all against it in theory, as we are against sin; but in practice some of us think we can profit by it. Too often Pope's lines on vice can also be used as an accurate description of our attitude toward inflation:

> Vice is a monster of so frightful mien,
> As to be hated needs but to be seen;
> Yet seen too oft, familiar with her face,
> We first endure, then pity, then embrace.

It is a simple fact that inflation results in a transfer of economic resources. Perhaps in theory we can imagine a situation in which as prices rise all incomes rise at precisely the correct rate and all money contracts change to just the right degree, so that there is no loss suffered by anyone. But in real life, such a situation does not and could not exist. There is simply no way of avoiding the fact that in an inflationary process some gain, on net balance, while others lose; and the losers are those least able to protect themselves or to make their voices heard: pensioners, savers, white collar workers, small businessmen, the great body of unorganized workers. And the thing that hurts is that the transfer is involuntary. Resources are literally stolen from those who have no way of protecting themselves, leaving them no claim to future output, nor even the satisfaction of knowing that, if the levy had been in the form of a tax, others would also be sharing the burden.

If the only consequence of inflation was the slow but insidious transfer of resources from one group to another some of us might possibly resign ourselves to the process and provide for relief by legislation for those affected by it. But inflation has other consequences. It provides a misdirected stimulus for business. Anyone who has been in business knows that sound business decisions are made within a framework of price stability; and that the principal beneficiaries of inflation in the business world are speculators and gamblers. Also, by destroying the use of money as a store of value inflation stimulates the production of other items which can serve the same function. Thus we must devote a part of our energies to producing articles which we would not have needed in the absence of inflation. A good current example is the concentration of investment in partly filled office and apartment buildings in some Latin American countries - which capital is withheld from productive industry.

Finally, a creeping inflation must, in the absence of specific controls or other unwarranted interference by Government become a run-a-way inflation. Even the inflationists fear this. When the time comes that a majority of the people throw up their hands in resignation and accept the inevitability of rising prices, inflation will immediately cease to creep. For just as soon as those who have a stake in inflation can be absolutely certain that society has become resigned to the process, we will see the inevitable development of a completely destructive wage-price spiral. Said Ralph J. Cordiner, President of General Electric, in his reply to the Committee:

> "If creeping inflation were accepted as a permanent feature of American economic life, it would not create jobs; it would only feed on itself in a rising spiral of costs and prices. To accept creeping inflation instead of using every possible means to combat it would be to apply to our economy the greatest of all inflationary pressures--the pressure of inflation psychology. Expecting continued prices increases, businesses and individuals would have a continuing incentive to spend their money before its value depreciated further, and would thus be tempted into a flight from money. The inadequate volume of purchasing characteristic of the current recession would be replaced by an increasingly excessive rate of spending, with far more destructive effects. The volume of savings would continually diminish, cutting off the only real source of investment funds. The efforts of businesses to continue expanding the volume of production and improving the attractiveness of their products, so as to maintain high levels of employment, would require continued expansion of money and credit. Thus the inflationary spiral and the profitless prosperity would be accelerated toward inevitable collapse."

Professor Haberler of Harvard University had this to say regarding the dangerous creeping inflation:

> I admit that the present method of wage fixing and the attitude of the powerful trade unions, which expect every year a large wage rise exceeding the average annual increase of labor productivity, poses a serious dilemma. But the problem cannot be solved by acquiescing in a continuous rise in prices. The trouble is that when prices rise by only 2 or 3 percent per year for a few years in succession, more and more people become alarmed and take steps to protect themselves. The labor unions themselves, whose policy is largely responsible for the continuing rise in prices, will ask for larger wage increases (or insist on escalator clauses) when they see that their wage rises are swallowed up by rising prices. Hence

soon the price creep will become a trot and the trot a gallop. This is simply an application of the homely truth that while you may fool all people some of the time and some (though not the same) people all the time, you cannot fool all people all the time.

It has been objected to that argument that a galloping inflation is impossible in the United States. I am inclined to accept this proposition, but I submit that it misses the point. Why is galloping inflation impossible? Because the Federal Reserve will keep money sufficiently tight to prevent inflation from galloping away. But what the advocates of creeping inflation overlook is that after a while the mere attempt to keep inflation at a creeping pace (to prevent the creep from becoming a trop or a canter) will be suffering /sic./ to bring about unemployment and depression. This is after all what happened last year. The advocates of creeping inflation themselves blame the tight-money policy for the present depression. I personally would say that it was a contributing factor--but let me, for argument's sake, accept the proposition that it was the main cause. Then it is indeniable that a policy which held the inflation at a creep--it did not do more than that--brought on unemployment and depression. If money had been less right, prices would obviously have risen even faster. Sooner or later the price rise had to be stopped or slowed down. It should be observed that if it had been stopped by fiscal measures (tax increases or lower Government expenditures) as some experts had recommended, the reaction would have been the same. In that respect monetary and fiscal policies are not different in their operation. If demand is controlled either by monetary or fiscal measures and wages continue to be pushed up, the consequence must be unemployment.

When I say that there seemed to be general agreement over the proposition that inflation is a situation which must be avoided, I do not mean to be understood as saying that there was total agreement on the degree to which it should be avoided. For example, the testimony of Professors Harris and Slichter quite clearly indicated only slight concern over inflation so long as the rate was slow. In addition, questioning by some of the members of the Committee suggested a similar attitude. I shall expect to discuss this issue in more detail later.

To return now to the consideration of the general nature of inflation as it was developed during the hearings, I must say that one of the most significant conclusions I drew from the testimony is that inflation today as a problem is a great and increasing threat to our economy, with several new aspects.

I do not mean that the present inflation itself is of some hitherto unknown variety but, rather, that the conditions under which we must combat inflation today are very different than anything we have faced before in this country.

The conclusion that our present inflation is dangerous was reinforced, in my opinion, by the testimony of Bernard Baruch. In the midst of a business downturn, when he could easily have been expected to direct his attention towards other matters, Mr. Baruch made the flat statement: "Inflation, Gentlemen, is the most important economic fact of our time--the single greatest peril to our economic development." I think it is important that we look behind this statement to see why inflation remains our number one problem.

If there is one thing which stands out above all else with respect to our recent history, it is the persistency of inflation and inflationary pressures. This development must reflect the fact that we are now facing new economic problems, for, contrary to some opinions, this country has <u>not</u> had a continuing and persistent inflationary condition until recently. I was happy to see this point developed by Chairman Martin during his questioning by Senator Kerr. Mr. Martin placed in the record information on prices which reveal that over the period from 1800 to 1930, the trend of prices was generally downward. In other words, during the major portion of the life of this nation we have had stable or declining prices. I refer my colleagues to p. 1938 of Part 6 of the Hearings.

Although we did not have a persistent inflationary problem during the most of our history, I do not mean to imply that we had no problems at all. The basic difficulty was that the price level changed too suddenly and swiftly - first in one direction and then in another. The erratic movement of prices was terribly serious. On some occasions price increases and consequent declines were so sharp as to stimulate the wildest and most reckless kind of economic activity, when this happened long periods of depression and economic distress always followed and we had "panics" of which the years '73 and '93 are tragic examples.

It is noteworthy that during those periods prior to 1930 when we had price stability - and there were a number of such periods - as well as during some of the periods in which the price level drifted downwards - this Nation enjoyed a remarkable rate of economic growth. Today we hear a lot of loose talk about the necessary relationship between inflation and growth; as if we needed the first in order to have the second. I challenge any one to find any period in the history of this country when we had price stability which was not accompanied by substantial economic growth.

If it is true - as I believe it to be - that we are today facing the old problem of inflation in a new and more dangerous setting, let us see what this setting consists of. In the first place there is the role of organized labor, a factor not present to any important degree before the 1930's and which has only become really significant since World War II. Because of the growth in size and power of labor unions we are now faced with continuous upward pressure on wage costs and thus prices, regardless of productivity increases. This development was cited by most of the Committee's witnesses. For example, Dean Abbott noted that wage increases in excess of productivity "push up prices when, as is the case in this country, there is a flexible money supply." Professor Slichter also took note of this situation, as did former Chairman of the Board of Governors of the Federal Reserve Marriner Eccles, who said, ". . . the main cause of rising prices has been the use which labor union monopolies are making of their power to force up wages and numberous costly fringe benefits far in excess of increased productivity."

There are several other aspects of this problem which,I believe, warrant notice. For example, it is important to note that if organized labor were required to depend only on its bargaining power to force wage increases in excess of productivity the program would eventually fail. That is to say, costs and prices can be pushed up only so far before the public would become unable to purchase all of the output and there would be resulting unemployment. Recognizing this, much of organized labor has placed itself squarely in the camp of the new inflationists, supporting monetary programs which will validate higher wages. Thus we have a two-pronged attack on price stability on the part of organized labor; and I think that we have perhaps paid less attention to labor's devotion to inflation than we should have done.

I do not want to leave this topic by giving the impression that all the blame for the wage-price spiral must rest with organized labor. Industry pricing policies and attitudes must also carry their part of the responsibility. As Mr. Eccles pointed out: "Business generally has been willing to grant excessive demands of labor rather than face a strike, so long as it was able to pass on to the public the increased costs."

Also, we must recognize that some business firms, because of their dominant positions, have the power to set prices which, within limits, are not immediately subject to traditional competititive forces.

It goes without saying that the entire question of the relationship between wages and prices deserves more attention than I can give it today. I am here concerned only with the development of relatively new factors which have made inflation a major problem and one such factor is the rise in the economic power of organized labor, unchecked by the traditional rules applied to business. This is a most significant new development.

Second among the factors contributing to our new inflationary problem is the changed role of Government. In many quarters the Employment Act of 1946 is interpreted as a virtual commitment on the part of the Federal Government to undertake expansionary programs at the first sign of a downturn. The act quite naturally reflected the fears of many people that the long depression of the 1930's would be resumed in the post-war period. Unfortunately the goal of price stability was not included in the objectives of the Act, and because this was not done, the Act seems to have had the effect of requiring the Government to act more vigorously when prices need to be raised, and less vigorously, if at all, when prices need to be lowered. As Dean Abbott put it: "It seems clear that both these objectives [maximum employment and price stability] will not be achieved so long as one has the blessing of the Federal Government and the other does not."

Another facet of the changed role of Government is the large place which Government expenditures occupy in the stream of our total national expenditure. Because so much Government spending is of a nature which cannot easily be changed, a business downturn always results in disproportionately lower tax receipts, and automatically produces a substantial Government deficit. On the other hand, during periods of prosperity in which inflationary pressures may be strong, it is difficult for the Government to have much of a surplus since there are always strong pressures for still larger Government expenditures or tax reductions.

The third factor in our new inflationary problem is in many ways the most important, for it relates to the public attitudes which, in a democracy, ultimately determine our course of action. To put it plainly, inflation seems to be becoming acceptable. We had several illustrations of this attitude during the hearings held by the Committee on Finance. For example, Professor Slichter argued that inflation - as long as it proceeded at a slow rate - was not a particularly worrisome problem. As he put it: "I do not think it is very dangerous. I think we are likely to have it and I think it is an important problem, but I would not use that expression 'very dangerous'. I would describe it as unfortunate." Professor Harris went even further when he appeared before the Committee, indicating that he would be more or less content with a slow inflation so long as there was a larger proportional increase in output. His words were: "I would be very happy with a one percent rise of prices and a five percent rise in output...." On another occasion he made it clear that he was unconcerned over the loss which will be suffered by savers in inflation when he said: "I wouldn't be unhappy about a one percent inflation, even if it does, say over 40 years, wipe out 50 percent of your savings, as it would."

I might remark that although such a development might not make Professor Harris unhappy, the same cannot be said for those millions who depend on fixed incomes, many of them already at minimum levels. I am reminded of a remark made recently by Malcolm Bryan, President of the Federal Reserve Bank of Atlanta:

> If a policy of active or permissive inflation is to be a fact, then we can secure the shreds of our self-respect only by announcing the policy. This is the least of the canons of decency that should prevail. We should have the decency to say to the money saver, 'Hold still, Little Fish! All we intend to do is gut you!'

The importance of this changing attitude towards inflation was reflected in many ways during the course of the hearings. I am sure that I do injustice to no one when I say that the Federal Reserve was quite severely criticized by some of the Senators during the questioning last summer. Many of these criticisms reflected legitimate differences of opinion, but it was nevertheless quite apparent that in the eyes of some members of the committee the major fault of the Federal Reserve was that it was even attempting to fight the inflationary price rise which was then occurring, using the only means at its disposal. It is significant, also, that during the most recent Committee sessions the only criticism which we heard from these same people with respect to the present policy of monetary ease now being followed by the Federal Reserve is that it had not gone far or fast enough. Thus, we had the ironic situation of hearings held to determine what could be done to stop inflation, devoting a large part of the time to criticism of a responsible agency which was attempting to do just that.

The increasing acceptability of inflation - or the opposition to any anti-inflationary program - was also illustrated by the frequent discussion during the hearings of the question of the compatability of a policy of price stability and a policy of maximum employment. For my own part, I am of the firm opinion that the two goals are not only compatible but go hand-in-hand; that we cannot have one without the other. I would agree, for example, with former Chairman Eccles who said: "I think they are equally important.... I would undertake to maintain a stable economy rather than having run-a-way inflation which will wreck employment and production...you have got to use such tools as you have through monetary and fiscal policy to prevent inflation...in the long run /this/ will create more production and employment than if you do not do it." I believe that this viewpoint is shared by most of the witnesses and most of the persons submitting answers to the written questions prepared by the Committee. Nevertheless, it was quite evident that there were some members of the Committee - and perhaps one or two witnesses - who assign a secondary role to the goal of price stability and who believe that any attempt to achieve price stability will result in frequent or continuous unemployment. I merely observe that if you believe that price stability can only be achieved at the cost of unemployment and also believe that maximum employment should be the only goal towards which we should be striving, it must follow that you also are willing to accept inflation as a permanent fact of our economic life.

As I come near the end of this opening statement, I realize that I have not given a complete list of all the factors that have appeared in recent years to give the old problem of inflation a new face. One which was raised by some witnesses - and partially developed in limited question referred to the role of the modern financial intermediaries outside the banking system - savings and loan associations - insurance companies and finance companies. Dr. Abbott described these generally as "important financing institutions often governmentally sponsored, not subject to the credit policies or influence of the Reserve System." Dr. Abbott also called our attention to the problem created by the fact that a large segment of the huge Federal debt has found lodgment in the banking system.

In other statements like this, I plan to discuss the role of the Federal Reserve in dealing with inflation through its responsibility for monetary policy, the effects on inflation of the policies of organized labor, and the impact of the present recession on the continuing inflation.

As I conclude this, the first statement, I want to say again, that the one thing that concerns me above all others is the apparent belief on the part of so many Americans that "easy money" which encourages "easy debt" is a sound and constructive policy. Those who are attracted by this idea denounce any attempt to control inflation by restraining the too rapid growth of the money supply, particularly if it coincides with the heady exuberance of an inflationary boom. The resulting recession is then blamed on the restraint, which actually had dulled its potential damage, rather than on the boom, which had made recession inevitable.

The sad fact is that inflation is no economic fairy godmother. There is no magic in money to produce something for nothing, and when government creates money faster than its citizens create value, it does not create wealth, it only creates inflation, which is the illusion of wealth. While inflation may seem at first to provide some people something for nothing, it is only transferring value from one group to another, and if continued, eventually robs everyone--even the "smart" boys.

When the American people can courageously face up to the fact that there is no such thing as something for nothing; that there is no real security without risk; that money cannot be manipulated to produce wealth; that there is no substitute for human endeavor and individual wisdom and responsibility; then, and only then can we bring America back to economic reality, which in turn will put our feet on the path to sound growth and true prosperity.

Monetary Policy and Inflation
A speech to be delivered
by
Senator Wallace F. Bennett
On the Senate Floor
July 15, 1958

Recently I made the first of a series of statements in which I hope to present my personal impressions and reactions to our Finance Committee hearings on the financial condition of the United States. In that statement I discussed the general nature of the problem of inflation - the central theme of the material developed in this record. Today I would like to continue this unofficial presentation by summarizing the Committee's discussion of the role of monetary policy in inflation and the position of the Federal Reserve System in this process.

Despite the wide variety of topics covered during the hearings, monetary policy claimed the major share of attention. The Committee inquired closely into the activities of the Federal Reserve System during two appearance of Mr. Martin, its Chairman, and much of the questioning of other witnesses related to Federal Reserve operations.

Before discussing recent Federal Reserve policy and the issues developed from it, let me review the high points of our monetary history during the past five years. Throughout 1954, monetary policy was directed towards encouraging recovery from the recession of that year. Discount rates were twice reduced, and reserve requirements lowered. Early in 1955 it became evident that recovery was turning into a boom. Hindsight evidence shows consumer credit rising $6.4 billion in 1955, the largest rise in a single year in our Nation's history. With increasingly strong credit demands the Federal Reserve Board began its change in direction. Margin requirements on loans for purchasing and carrying listed securities were raised twice during that year, to a high of 70 per cent in April, while discount rates were raised three times. When it was seen that these restrictions had failed to dampen the inflationary overtones of the boom, more stringent measures were introduced in 1956 and up to August in 1957. Discount rates were raised twice again, to a high of 3½ per cent in August 1957. Open market operations were directed toward the objective of "restraining inflationary developments in the interest of sustained economic growth."

Yet even early in 1957 there were signs of an approaching business slowdown. This was shown by a fallout in new orders for machinery and equipment in the earlier months of that year and by the development of a margin of excess capacity in some key industries When an expected business upturn failed to develop in the Fall of the year, it became evident that the economy had reached a typical cyclical turning point, and the Federal Reserve began to alter the course of its policies. As Chairman Martin stated in the hearings: "In the latter part of October and early November, open market operations were used to relax somewhat pressures on commercial bank reserve positions. In mid-November, a one-half point reduction in discount rates signaled a decisive change in System policy. From this point on, restraints on bank credit expansion were progressively relaxed."[1]

Within five months the discount rate was dropped from $3\frac{1}{2}$ to 1-3/4 per cent. Margin requirements on loans for purchasing or carrying securities were reduced from 70 to 50 per cent of market value. As additional reserves were provided by two reductions in reserve requirements and through open market operations, member banks reduced their indebtedness at Reserve banks. The easing in bank reserve positions was reflected in a sharp expansion in bank credit and an exceptionally sharp drop in interest rates.

Federal Reserve actions which attracted most attention during the course of the hearings were the restrictive actions taken during 1956-57. These were bitterly attacked as harsh hard money policies, and yet as I look back upon that period one impression seems unmistakeable: the restrictive monetary policy pursued by the Federal Reserve was about as mild a policy as could have been adopted if the System was to make any attempt at all to combat inflation. This is clearly apparent when we realize that prices rose considerably during 1957 - and are still creeping upwards today - despite the fact that the

Federal Reserve has always had it within its power to enforce a contraction in prices.

The changes that occurred both in circulating medium and in interest rates are indicative of the lack of severity in Federal Reserve policy during 1956-57. If we take as a measure of circulating medium total deposits (adjusted) plus currency in circulation outside of the banking system we find that during 1956 and 1957 the rate of increase was about 2½ per cent in each year. Since the rate of use of money (its velocity) was increasing fairly rapidly during this time, these increases were more than sufficient to provide for sustainable economic growth with price stability.

So far as interest rates are concerned, it was made clear during the hearings that at their peak in 1957 rates were still substantially below levels which had prevailed as late as the 1920's and the very early 1930's. As Sumner Slichter pointed out in his testimony this April: "Although one has heard much about the scarcity of savings in recent years, interest rates have been extraordinarily low by historical standards."[2] A chart showing long-term interest rates since 1920 was placed into the record as part of Secretary Burgess' statement last summer, and I refer my colleagues to that chart, on p. 720 of the published volumes, for a graphic illustration of Professor Slichter's appraisal.

In summary, therefore, Federal Reserve policy during 1957, while restrictive, cannot be classed as severe. The very fact that it was not expansionary, but was directed towards combatting inflation, quite naturally resulted in a situation in which more persons and firms than usual were unable to borrow all of the funds which they desired. Therefore we had the cries of "tight" money and "hard" money, which presented a far more harsh picture of the policy than was true in fact.

Federal Reserve policies in general were subjected to a wide variety of criticisms during the course of the hearings, both from Senators and from some witnesses. Some of these complaints were, in my opinion, frivolous; others should receive our full attention.

I should like to list and discuss each of these major criticisms.

1. The first issue in my informal tabulation is one that to me is the least serious, although a surprising amount of time was devoted to it. Briefly stated, this issue arose out of the charge that the restrictive monetary policy of the Federal Reserve was the cause of the inflation and, therefore, the way to stop the rise in prices was to adopt an easy money policy. This claim seemed to rest upon two pieces of evidence: first, that the period during which prices were rising coincided roughly with the period in which the Federal Reserve was following a restrictive monetary policy, and, second, that the pronounced rise in interest rates affected business costs and therefore prices.

This contention with respect to Federal Reserve policy was most frequently heard during the sessions of the Committee last summer. I was therefore interested to observe that none of the witnesses in the Spring session - including some who were quite critical of one or more aspects of Federal Reserve policy - adopted this particular brand of Alice-in-Wonderland logic.

If inflation in 1957 was indeed due to the restrictive monetary policy of the Federal Reserve System and the way to bring prices down was to increase the money supply, then it would seem to follow that in a deflation, as prices are falling, the way to bring prices up is to contract the money supply. At the moment we are in a recession and there is indication that the price level is about to decline, but I have heard no suggestion from the proponents of the view I am discussing that the Federal Reserve should begin to contract the volume of credit.

So far as the effects of interest costs on prices are concerned, the answer given by Secretary Humphrey was, I believe, never successfully challenged, namely, that interest charges comprise only about one third of one per cent of the average sale price of manufactured goods. Of course interest is a cost, but it is ridiculous to attribute a broad inflationary movement such as that of 1956-57 to a rise in this almost insignificant business cost element in the price structure.

I don't think it is necessary for me to devote any time to the contention that the Federal Reserve program caused the inflation because it was being carried out at the same time as prices were rising most rapidly. This is equivalent to say that a disease continues to persist after a course of treatment is begun and the two exist together, then this coincidence is accepted as proof that the cure actually caused the disease. I will agree that a restrictive monetary policy, in its first stages at least, will increase the rate of turnover of money, as firms and individuals attempt to make more efficient use of the circulating medium available to them. To that extent, the job of the central bank is made more difficult, but it is an anticipated consequence in the early application of a restrictive monetary policy. In the final analysis increases in velocity can proceed only so far during a restrictive monetary policy, and they can always be overcome if sufficient pressure is placed on the money supply.

In summary, these arguments that the Federal Reserve's policy caused the inflation fall of their own weight.

2. The second issue I observed developed out of the fact that prices continued to rise during 1957 and into 1958, and relates to the ability of the Federal Reserve to exercise decisive influence over the price level. The claim was advanced that a restrictive monetary policy, which necessarily applies temporary brakes to the expansion of the economy, is indefensible if it cannot at least attain the objective of price stability.

The validity of this claim is hard to appraise. The basic difficulty is that we do not know - as we can never know in such instances - what would have happened if the Federal Reserve had <u>not</u> followed a restrictive policy. The weight of opinion in the testimony was clearly to the effect that if the Federal Reserve had not followed such a policy in 1956 and 1957, the rise in the price level would have been much more severe. As former Board Chairman Marriner

Eccles put it: "the monetary and credit policy did not prevent a certain amount of inflation from taking place, but it certainly curbed the spread of inflation and the extent to which it would have taken place...."[3] Even Professor Slichter, who has been critical of some aspects of Federal Reserve policy, agreed that restraint was desirable. As he put it: "Certainly in 1956 and probably in the early part of 1957 credit restraint was desirable. About the middle of 1957, a relaxation, not a shift to an easy credit policy but some relaxation, would have been desirable."[4] As I have already noted, this relaxation did occur at the end of October so that Professor Slichter's criticism with respect to this point apparently involves a question of timing rather than of direction.

Of the witnesses, only Professor Harris seemed to adopt the view that Federal Reserve was largely ineffective in preventing price increases. He attributed this ineffectiveness to the increasing importance of financial intermediaries, the high liquidity of business concerns, and the tendency of wage rates to rise faster than productivity. These are all important points and it is perhaps regrettable that the Committee was not able to devote more time to each of them. However, it appears to me that Professor Harris weakened his point when he claimed tha the Federal Reserve possesses sufficient power to cause a business contraction, thereby implicitly agreeing that the System and its policies are far from ineffective.

My own view is that Federal Reserve policy definitely prevented the inflation from becoming far more severe than it has been. I am aware that during his questioning Senator Kerr preferred to dismiss such claims as speculation but in this case, as in many others in life such speculation is all that is available to us.

3. The third issue in this tabulation arises out of the charge that Federal Reserve policy hurt only small business and did not affect large corporations. On occasion, this charge was broadened to claim that restrictive monetary policy hurt the "little man," both business and individual, but did not affect the wealthy.

Before discussing this issue I would like to call attention to one apparent inconsistency in this charge. Those who maintain, along with Professor Harris, that Federal Reserve policy "on the whole favored corporations against small business"[5] are generally those who also attribute the current business downturn to the same restrictive monetary policy. I plan to discuss the relation of inflation and recession in a later speech but pause here to observe that the large corporations, producing durable goods, have suffered great shrinkage in volume and this has produced the greatest areas of unemployment. We have seen this reflected in the first quarter earning reports of large corporations, which are down significantly. I do not much care which horse critics of Federal Reserve policy prefer to ride but I do say that they cannot at one and the same time claim that monetary policy did not bear to any extent upon large corporations and also say that it was the cause of the present downturn, which is quite obviously working a hardship on these same corporations.

So far as the charge itself is concerned, I feel that the evidence presented during the hearings were insufficient to support the conclusion that restrictive monetary policy during 1956 and 1957 was directed at, or bore more heavily upon, small business as compared with large business. During the questioning of Secretary Humphrey by Senator Smathers, for example, numerous tables were presented which purported to show that small business was suffering. But as Secretary Humphrey pointed out, in most instances the figures used to illustrate small business distress could not be related solely to the years of restrictive monetary policy, but instead showed long-term trends, running through several periods of easy money policies as well as restrictive policies. As a matter of fact, in a number of instances the Secretary was able to point to the fact that the position of small business improved subsequent to the introduction of restrictive monetary policy. For example, Senator Smather's data showing the percentage of sales going to manufacturing corporations with assets of less than $1 million, as well as the data showing profits after taxes for companies of the same size, revealed that the position of smaller sized business firms had improved in 1956 - a year of restrictive monetary policy - over the years immediately preceding. I refer my colleagues to pages 370-72 of the printed hearings.

So far as business failures are concerned, the trend has been generally upwards for small firms ever since the end of World War II, but this is a development which is to be expected in view of the rapid growth in our economy and the increasing number of business firms. As a matter of fact, in the two years of so-called "tight money," 277,472 new business incorporations occurred, compared with 257,000 during 1954-55, two years of so-called "easy money." And of course, the total number of businesses operating in this country has continued to increase during recent years, totaling 4,232,300 as of June 30, 1955, 4,297,200 as of June 30, 1956 and 4,322,000 as of June 30, 1957.

The question of increasing personal bankruptcies was also raised. The over-extension of credit of which they were the inevitable harvest, most probably occurred during earlier periods when credit was too easy. I have learned this out of my 30 years of experience with retail credit. This is another instance where the cure is confused with the cause.

There is one very important and significant set of facts which is often overlooked by those who charge that restrictive monetary policy bore most heavily on small business. The truth is that the effects of this policy were felt most severely in the large financial centers and in the large banks, and were felt least in small communities and among small banks. We all know that a very important part of the bank financing of small business is done by our small country banks which indeed because of statutory loan limits are unable to loan to any but small businesses. During my questioning of Secretary Burgess, for example, the Secretary called my attention to the fact that: "During the past year, from May 1956 to May 1957, the New York City banks, the Chicago banks, and the

Reserve city banks, which are the other large city banks ...show a minus position on their free reserve ... on the other hand, during that entire period the country banks, month by month, had free reserves ... which is a very interesting indication that this squeeze has come much more in the money centers than it has in the country banks."[6]

Differences in the impact of restrictive monetary policies are also reflected in the deposit changes of Federal Reserve member banks over the period such policies prevailed. For the 22 months beginning with January of 1956 and ending with October 1957 total deposits in central reserve city banks in New York City declined by well over $2 billion and in Chicago by three-quarters of a billion dollars; in the smaller member banks - those classified as "country banks" - total deposits during this same 22 month period of restrictive monetary policies rose by well over $2 billion. While the capacity of big banks to make loans was restricted that of the small banks was increased. For them money became "easier" not "harder."

I should also like to observe that Professor Slichter called our attention to the fact that during this period of restrictive monetary policies, interest charged on large-sized loans went up much faster than interest on small loans. This is to be expected in view of the fact that the monetary stringency was being felt primarily by the large banks. As Slichter pointed out, the spread between these two rates "narrowed during the period of credit restraint ... In 1955 ... there was a 1½ per cent difference. By 1957 the difference had dropped to 1 per cent."[7]

I am of course aware that there are special problems connected with small business which may deserve attention. All I want to say here is that there is no evidence to show that a restrictive monetary policy during 1956-57 either added to or took away from these problems. It might be of interest to note that Professor Slichter made the following observations on this matter during his testimony: "The assertion that the new enterprises as a whole are failing in substantial measure to get the amount of capital which they could put to good use is unproved ... There is some shortage of medium-term loan capital, but there is a greater shortage of attractive risks. ... Attractive investment opportunities suitable for small, medium-term loans are more scarce than investment funds."[8] It was Dr. Slichter's strong contention that there are more fundamental problems than money shortages standing in the way of a more rapid business growth. He made this statement in his testimony: "... the high infant mortality rate among new enterprises shows that a large proportion of business starters have more courage and hope than judgment and skill."[9]

4. The fourth in this tabulation of issues is one of the most important. This issue was present but more or less dormant in the hearings last summer but did not break out into the open until the sessions this year. This is the question of whether the Federal Reserve has any responsibility at all with respect to the maintenance of price stability. For example, Senator Kerr in his questioning of Chairman Martin this Spring made it quite clear that he doubted the Federal Reserve had such responsibility, for after reading the declaration of intent in the Employment Act of 1946 the Senator stated: "You cannot point to any specific language that says to the Federal Reserve bank 'maintain the stable value of the dollar.'"[10] Professor Harris made the charge more specifically when he said: " I might say, Mr. Chairman, that I once wrote a 800-page book on the Federal Reserve System and have not discovered, and have not still, that the Federal Reserve is given any authority to stabilize the price level. Its job is to accomodate trade and commerce.."[11]

Perhaps I was wrong in stating that this is a single issue, for it is quite apparent that a number of very important issues come to focus at this point. For example, what is the duty of the Federal Government as a whole with respect to price stability? Few would quarrel with Senator Byrd's statement at the opening of the hearings: "This Committee can never lose sight of the fact that the Government's integrity depends upon a stable currency."[12] I, for one, am in hearty agreement. Yet if it is to be seriously maintained that the Federal Reserve has no duty in this field, it is not the same as saying that the Government itself has no such duty?

Personally, I did not expect, prior to the hearings, that the right and duty of the Federal Reserve to fight inflation would ever become an issue. As I saw it, there could well be disagreement over the manner in which the Federal Reserve was acting, but not over the goal it sought. In the past, Congressional committees have concluded that the goal of price stability was so well accepted it would be almost redundant to provide for it by legislation. In view of the appearance of this issue, however, I believe that it has become of the utmost importance that the Congress add the goal of price stability to the various other objectives of the Employment Act of 1946, and to the basic Federal Reserve Law in order that there may be no question on this fundamental point.

5. My fifth issue relates to the independence of the Federal Reserve System. It was a big issue seven years ago and I shall not take much time with it now. However, I do not wish to imply that it is unimportant today. During the entire hearings the question of the independence of the Federal Reserve System was never far below the surface. Like the question of the proper function of the Federal Reserve, it really came out into the open during the Spring sessions when Professor Harris stated flatly that he did not believe that Federal Reserve should be independent, a statement which seemed to be concurred in by Senator Kerr and Senator Long.

My own belief is that it would be a tragedy if the Federal Reserve should be made subordinate to another agency or branch of the Government, to such an extent that it would not be free to take quick and effective action when faced with the prospect of either inflation or deflation. I always thought that the fight carried on [redacted] by Senator Douglas and others, which culminated in the restoration of the Federal Reserve's independence in 1951, was one of the most praiseworthy accomplishments in the financial field within recent years. I do not believe that the Federal Reserve can be completely outside of Government but I am firmly convinced that, within Government, it must retain a maximum degree of independence if it is to accomplish its objectives.

Most of the questions I have discussed up to this point were opened up in last year's hearings. Let me now turn to the monetary policy issues which dominated the Spring sessions of the Committee. There were two, which would become numbers 6 and 7 in my tabulation. First, there was the question of the extent to which Federal Reserve policy in 1956-57 was responsible for the current business downturn. Second, there was the charge that Federal Reserve policy today has not gone far enough in providing monetary ease. Let me deal with these one at a time.

6. The question of Federal Reserve responsibility for the current downturn has one very interesting aspect since, Chairman Martin and his critics are in some measure of agreement although for quite different reasons. The critics claim that the Federal Reserve was responsible because, to quote Seymour Harris again, "undoubtedly monetary policy contributed to the recession..."[13] "to stablize prices with a large cost inflation could only be done by inducing unemployment through a restrictive monetary policy. This the Federal Reserve accomplished."[14] On the other hand, Chairman Martin indicated in his testimony before the Committee that he, too, felt that the Federal Reserve should bear part of the blame for the downturn, but not because its policies during 1956-57 were too restrictive. Rather, as he put it, "The real criticism ... is that we were not more aggressive and did not make more of an effort to slow [the economy] down in 1955 and early 1956 when this got out of hand."[15]

If Federal Reserve policy in 1956-1957 did in fact make a significant contribution to the current business downturn then we should be able to trace the influence of that policy to the various segments of the economy which are presently causing the most trouble. The significant characteristics of the current downturn are probably three: (1) a slump in the manufacture and sale of durable goods, particularly automobiles, (2) a decline in new private capital expenditures, and (3) a decline in inventories. I doubt that anyone could seriously argue that the restrictive Federal Reserve policy of 1956-1957 was reflected a year later in the decisions of consumers to hold off on the purchase of automobiles and other durables. Despite the recession, both disposable personal income and the rate of savings remain high; credit was eased before this year began - the buying power is there. There has been no signficant change in the interest rates applicable to automobile or appliance loans, nor has there been any change in the terms of payment which prevail. It appears to me that the real reasons for the slump in this sector of the economy are: (1) high prices, (2) some disenchantment with the product, (3) a shift in buying habits reflected in the fact that consumers have apparently decided to spend less on durables and more on other things.

So far as the downturn in private capital expenditures is concerned, other factors seem to be of more importance than Federal Reserve policy. We should remember that the high level of business expenditures since 1954 led to a situation in which many firms acquired all of the facilities necessary for the next few years, so that some slow-down was inevitable. As Professor Slichter pointed out in his testimony: "The high level of investment activity ... made the economy vulnerable to contraction, since it was natural for enterprises to slow down the increase in their investment spending."[16]

Somewhat the same thing can be said with respect to inventories. A rapid build-up of inventories is a natural consequence of inflation. What we are witnessing today in this sector is a readjustment to a more normal level.

In short, my own view of the particular issue is that Federal Reserve policy necessarily had some effect on the business downturn, but that by no stretch of the imagination can it be assigned the sole, or even a major role. It seemed to me that Professor Slichter provided the Committee with perhaps the most thoughtful and well-rounded discussion of the causes of the present recession. In that presentation he assigned, if I understood him correctly, major responsibility to the drop-off in business capital expenditures. that is, expenditures for plant and equipment. This decline, he felt, reflected decisions made in 1956-57 and was attributable not to Federal Reserve policy but to the perfectly natural tendency for business to take a breather after maintaining a particularly high level of such expenditures. Professor Slichter then went on to point out that other factors, such as Federal Reserve policy, government fiscal policy, and consumer reluctance to accept the new automobiles, were aggravating rather than causal forces. And, in answer to a recent U.S. News and World Report interview on this same point, Professor Slichter said: "No, I think the fundamental causes of the recession lie deeper than Federal Reserve policy."

7. My last issue is one which could only have appeared during the Spring sessions, since it involves the claim that the Federal Reserve has been half-hearted in its recent policy of monetary ease. This charge was made by Professor Harris, who pointed to the fact that since the change in policy in the Fall of the 1957 bank reserves have fallen slightly and holdings of Government securities by the Federal Reserve have risen by only 2 per cent. Professor Harris also cited the activity of the Federal Reserve in 1930-1932 with respect to the purchase of Government securities as an illustration of a genuine policy of monetary ease and suggested the Federal Reserve today follow in the same course.

By the time Professor Harris appeared before the Committee it was quite clear that the major tool which the Federal Reserve was using to provide monetary ease was its authority to change reserve requirements. There had been 3 successive decreases in reserve requirements beginning on February 27 of this year. The last decline took effect on the day Professor Harris testified, although it had been announced much earlier. Now the professor must certainly have known of these reductions, just as I am sure he knows full well that the powerful expansionary effect of a reduction in reserve requirements is through the release of existing reserves for credit expansion and not through a change in the dollar volume of reserves. Thus I am at a loss to understand why Professor Harris mentioned the reduction in reserve requirements only briefly - and then only the first of the three reductions - and chose to appraise current Federal Reserve policy in terms of purchase of Government obligations and the dollar volume of reserves. The only explanation I can think of is that perhaps his statement was written when only the first reduction had taken place, but if this was the case he did nothing to clear this up in his oral testimony. As a matter of fact, in his oral testimony he did not mention even one of the three reductions in reserve requirements and emphasized again that the dollar amount of reserves had not grown.

As I said earlier, we cannot yet pass judgment on whether the Federal Reserve has gone too far or not far enough in its present course, but we can at least review factually what the System has done. Since the decision to ease credit in November, the discount rate has been lowered in four steps, from 3½ to 1-3/4 per cent. These are, presumably what Professor Harris had in mind when he referred to "a few rather inconsequential cuts in rates."[17] a phrase I find somewhat amusing in view of the furror of last summer when these same rates were being raised. Moreover, the three successive reductions in reserve requirements against demand deposits have released roughly 1.5 billion dollars of reserves, or three times the amount mentioned in Professor Harris' prepared statement. This, plus the effect on open market operations, has permitted an easing in the free reserve position of member banks of close to 1 billion dollars since the end of October, in addition to providing the base for a 7 billion dollar expansion in bank assets and deposits. The trend in free reserves has been steadily upward, moving from a negative figure of about $550 million last October to a positive figure slightly more than $600 million in April. (Free reserves are excess reserves less member bank borrowings.)

The easing of bank reserve positions has been reflected in a substantial expansion in bank credit and an exceptionally sharp drop in interest rates. The total of bank loans and investments increased almost $5 billion in the six months ending in March. This expansion of bank credit has been mainly in the form of U.S. Government security holdings, and its effect has been to enlarge holdings of cash balances and to increase the economy's overall liquidity. Business loans outstanding at banks have tended to decline with economic activity. However, loans on securities, which provide important support to the capital markets, have risen.

As Federal Reserve policy shifted from restraint to ease, the financial markets reacted vigorously. The recent drop in interest rates has been as rapid as any in the nation's financial history. For example, the rates on short-term Treasury obligations (maturities under one year) have declined about two-thirds since last fall. In contrast, after the onset of recession in mid-1953, such rates fell only about 45 per cent over a seven-month period from their mid-1953 peaks. Similarly, the rates on prime commercial paper have fallen over 50 per cent recently, but in the comparable 1953-54 period declined only about 20 per cent. Long-term rates too have declined more rapidly in the current than in the earlier recession; for example, the yields on high-grade municipals declined about 25 per cent and 20 per cent, respectively, in the two periods.

The drop in the price of money since September and October has been a good deal faster than was the rise under the preceding conditions of heavy credit demands and restrictive monetary policies. Money market rates - the yields on such instruments as short-term Treasury issues, prime commercial paper and directly placed finance company paper - were last at current levels back in the winter and spring of 1955. It took them thirty months or more to rise as much during the boom as they have fallen during the last seven or eight months. Market rates on money market instruments are now quite generally less than half as high as they were at their peaks.

Market yields on longer-term securities issued by the Treasury, State and local governments and corporate borrowers have not fallen nearly as far as money market rates but nonetheless have declined much faster than they had risen in 1955, 1956 and early 1957. Bond yields have dropped one-half to three-quarters of a point, representing a decline of about one-sixth for long-term Treasury issues, one-eighth for high-grade corporate issues and nearly one-fourth for high-grade State and local government bonds. Most, if not all of these declines had occurred by late January. Thus, in four or five months, bond yields declined as much as they had risen in the previous year.

Before leaving this question of present Federal Reserve policy I cannot refrain from commenting on another of Professor Harris' claims, to the effect that the Federal Reserve today can profit by the example of action taken by the System in 1930-32, action characterized by Professor Harris as "tremendous" and worthy of emulation. I do not pretend to be a student of monetary history but I am aware of no responsible study of that period which attributes a policy of monetary ease to the Federal Reserve between 1930-32. As a matter of fact, even the 1932 annual report of the Federal Reserve itself implied regret over having kept banks short of reserves. What Professor Harris did, of course, was to select one of many factors bearing on reserves - purchases of Government obligations - and with the selection of appropriate dates and a bit of statistical manipulation come up with the conclusion that an equivalent policy today would require officals to purchase Government securities in excess of $50 billion. Both the illustration and the conclusion were utterly ridiculous - as the professor himself seemed to imply - but if so, why mention it at all, unless it was calculated to leave the Committee with the impression that there had been a true policy of monetary ease in 1930-32 and that present policy suffers by comparison. Surely the Committee deserved better than this on such an important question!

With the discussion of this issue I should like to conclude my informal presentation of monetary policy issues raised during the hearings before the Committee on Finance. I am aware that there were other issues and that I have not even covered all of those which properly fall in the area of monetary policy. Nevertheless, I have attempted to cover those monetary issues which seemed, in my opinion, to be fundamental. If I have succeeded, it is my hope that this summary will be of some use to those who have not been able to attend what has been a most interesting and important series of meetings.

FOOTNOTES TO "MONETARY POLICY AND INFLATION"

1. "Investigation of the Financial Condition of the United States," hearings before the Committee on Finance, United States Senate, 85th Congress, p. 1851.
2. Ibid., p. 1816.
3. Ibid., p. 1731.
4. Ibid., p. 1855.
5. Ibid., p. 2015.
6. Ibid., p. 1196.
7. Ibid., p. 1818.
8. Ibid., p. 1817.
9. Ibid., p. 1817.
10. Ibid., p. 1899.
11. Ibid., p. 2022.
12. Ibid., p. 3.
13. Ibid., p. 1988.
14. Ibid., p. 1999.
15. Ibid., p. 1897.
16. Ibid., p. 1822.
17. Ibid., p. 1991.

Labor Unions and Inflation
A speech to be delivered
by
Senator Wallace F. Bennett
On the Senate Floor
July 21, 1958

This is the third in my series of statements summarizing my impressions gained from the testimony developed in the hearings of the Finance Committee on the financial condition of the United States.

In the first statement I discussed inflation as the general theme of the hearings. In the second I reviewed the testimony presented with respect to the role played by the Federal Reserve System in our present economic situation. In this speech I shall try to develop the relationship between increases in wages and the rise of prices. I am focusing attention on the wage problem because this seems to be one of the more important of the recent economic developments making this inflation different from previous ones.

When we define inflation simply as a rise in prices, we are guilty of inadequacy and oversimplification. We need to look deeper at the elements of current price rises to discover what forces play on them to force them up. Each inflation is the result of the interaction of many forces, both psychological and economic. But regardless of the refinements, there are fundamentally two forces at work: (1) a "demand-pull" force, involving excessive spending on the buyers' side of the market, and (2) a "cost-push" force, operating from below on the supply of materials and labor. Today I shall concentrate on the latter, the "cost-push" force.

First, however, let's look at the interaction of the two forces. The demand-pull involves excessive spending by business, government, and consumers for the economy's goods and services. Likewise, as the buyers of the productive services bid in competition for these resources, secondary "demand-pull" elements, which raise prices, are set up. On the supply side, higher wage rates, rising raw material prices (which again may be attributed in large part to wage increases) taxes, and some other factors all operate as "cost-push" forces to raise prices. By far the most important of the "cost-push" forces is wages, which account for 78% of the national income originating in manufacturing.

While most of the witnesses and questionnaire respondents to the Finance Committee named "demand-pull" chief villain in inflation causes, it was recognized by all who testified on this point that "cost-push" forces aggravate or amplify the inflation generated by excessive spending, while many said that the "cost-push" forces may themselves even initiate or be the direct cause of inflation.

I think it is significant that the current wave of inflation, now in its third year, though probably originating in the capital boom of 1955, has gone on in the face of what was up until last Fall a tight monetary policy. It has persisted in fiscal years 1956 and 1957, in the presence of a federal surplus although it has required a huge federal deficit to produce past historic inflations. It was not touched off by a speculative fever in either consumer or producer goods. Rather than an expansion of profit margins which usually accompanies a strictly demand inflation this one was accompanied by a shrinkage of profit margins. Consumer stocks were high rather than depleted by wartime scarcity or rationing. And finally the current recession has not stopped the steady upward climb of prices.

Is there some new force in this inflation which has not received sufficient attention? I think there well may be. To me it is significant that practically every witness who appeared before the Finance Committee made reference to the inflationary power of labor unions. This was the case regardless of the background, philosophy, or politics of the individual witnesses. Practically every respondent to the questionnaire made the same observation about labor. Certainly such an array of testimony is more than mere casual coincidence and deserves more than casual attention.

The Role of Wage Costs in Inflation

Before referring to the testimony of the witnesses themselves, I would like to outline the understanding I have gained of the general role of wage costs in inflation.

Wage rates may operate in several direct and indirect ways to initiate or sustain inflationary conditions.

(1) Wage rate increases, not fully offset by improved productivity in the industries concerned, increase costs per unit which producers will attempt to recover through higher prices. I wish to take a look at this in detail in a few minutes.

(2) Increased labor costs and prices, particularly if they occur in basic or "supplier" industries, will spread as higher non-labor costs (cost of material and components) to other industries, in later stages of production, thus forcing up their prices as well.

(3) Because of wage leadership in collective bargaining and the influence of widening wage differentials on other workers, higher wages will be demanded in the industries not directly involved in the original wage-push.

(4) The prevalence of long-term labor contracts even in segments of the economy remote from each other tend to produce general rigidity and prevent offsetting downward adjustments of cost, and therefore, even though these wages have not risen, they contribute indirectly to the general upward pressures on the wage-price structure.

(5) As prices rise, upward wage pressures become cumulative and self-reinforcing. New wage and salary demands in all sectors are made to offset the rising "cost of living." Escalator clauses in wage contracts tying money wage rates to the Consumer Price Index have become widespread in recent years. These wage increases are significant cost-push forces, whatever the initial or generating cause may have been. It is significant that these escalator clauses are most prevalent in the so-called "strategic" industries--industries which can cause repercussions throughout the rest of

the economy, Examples are the steel, automobile, railroad, trucking and transit, electrical machinery, aircraft and parts, agriculture machinery, meat packing, aluminum, and iron ore mining industries.

How likely it is that these five direct and indirect wage factors will push prices up in a particular situation? Referring to separate action in a single industry, if wages are increased without the creation of additional demand for the products of that industry, one or more of these three things will probably occur: (1) There will be increased unemployment in that industry. (2) There will be a downward pressure on wages in other industries or (3) There will be a downward pressure on prices in the softer or more flexible parts of the economy.

If we are to speak of the effects on these five factors on the economy as a whole, our answer depends on the vigor and elasticity of the demand and on the direction and strength of current monetary and fiscal policies. If the demand is not expansive, increased unemployment will most probably occur. Some authorities lay the present recession to this very situation. While the relative importance of the "demand-pull" and "cost-push" forces differ from one inflationary period to another and from one phase of each inflation to another, the two always exist when inflation is present, as it is now. Referring to the present inflation, Gerhard Colm, chief economist of the National Planning Association, had this to say in response to the committee questionnaire:

> "Thus, I would explain the price rise of 1957, in part as a delayed aftermath of the preceding demand inflation; in part, as a cost inflation resulting from the rise in administered prices and increase in wage rates in excess of productivity gains." 1

That both elements are usually mutually present in each inflation was made clear by Federal Reserve Board Chairman Martin when he appeared last August before the Committee:

"These distinctions present an oversimplification

> of the problem. Inflation is a process in which rising costs and prices mutually interact upon each other over time with a spiral effect. Inflation always has attributes, therefore, of a cost-push. At the same time, demand must always be sufficient to keep the spiral moving. Otherwise the marking up of prices in one sector of the economy would be offset by a reduction of prices in other sectors."[2]

Wages, Productivity and Prices

With the above discussion as benchmark and background, let us turn to labor's role in the "cost-push" inflation. It is my considered opinion, based in large part on my review of the Senate Finance Committee hearings, that a primary factor in the rise of consumer prices since early 1956 has been the increase in payroll costs in excess of increases in productivity. This same testimony was borne out by such men as Marriner Eccles, Dr. Sumner Slichter and others.

Said Marriner Eccles:

> " I believe the main cause of rising prices has been the use which labor union monopolies are making of their power to force up wages and numerous costly fringe benefits far in excess of increased productivity."[3]

And Dr. Sumner Slichter of Harvard pointed out that the recent rise of prices reflects more than the typical strong demand for goods. He related his comments more specifically to the present recession:

> "Wages have continued to rise throughout the recession in the face of falling demand for labor and goods. Thus the recession has given the public a clearer picture than ever of the responsibility of rising wages for rising prices ....
> The more plainly the public sees the relationship between wages and prices, the more carefully it will appraise the demands of unions."[4]

These are the opinions; and I could cite several others; now what are the facts?

At this point, I am inserting in the record a table showing the increases in hourly wages in manufacturing and productivity in manufacturing from 1947-1957. The table shows the percentage increase to 1957 from each year back to 1947. This same table is found on page 2088 of Part 6 of the Finance Committee hearings.

TABLE I

	Hourly wages manufacturing*		Productivity manufacturing	
Year	Average hourly earnings in manufacturing.	Percentage increase from specified year to 1957	Indexes of output per man-hour (index: 1947-49= 100) **	Percentage increase from specified year to 1957
		Percent		Percent
1957	$2.07	---	134.5	---
1956	1.98	4.5	133.5	0.7
1955	1.88	10.1	130.0	3.5
1954	1.81	14.4	125.6	7.1
1953	1.77	16.9	119.7	12.4
1952	1.67	24.0	115.3	16.7
1951	1.59	30.2	111.6	20.5
1950	1.47	41.3	111.8	20.3
1949	1.40	47.8	105.4	27.6
1948	1.35	53.3	99.8	34.8
1947	1.24	67.3	90.5	41.0

* Manufacturing employment totaled 26 per cent of total civilian employment in 1957.

** Computed from data prepared by Department of Labor.

You will observe when you examine the table that the increase to 1957 in average hourly wages in manufacturing has exceeded the increase in hourly output per worker every year since 1947. Over the total period, hourly earnings increase 67.3 per cent, while productivity--the output per man-hour--increased only 41.0 per cent, or a difference of 26.3 percentage points. Professor Slichter of Harvard and A. D. H. Kaplan of the Brookings Institution refer to this spread between wage and productivity increases as the "inflationary gap." It is interesting to compare this so-called "gap" with the rise in industrial wholesale prices over the same period. These increased from an index of 95.3 to an index of 125.6 from 1947 to 1957, or a rise of 32 per cent.

The changes since the beginning of the latest wave of inflation show hourly wages increasing 10.1 per cent in the two years from 1955 to 1957 while productivity increased only 3.5 per cent over the same period, thus creating a "gap" of 6.6 per cent. This corresponds to a wholesale industrial price increase of 7.3 per cent over the period. In one single year from 1956 to 1957 manufacturing wages increased 4.5 per cent while output per man hour increased only 0.7 per cent, creating a "gap" of 3.8 per cent. This compares with an industrial price increase of 2.8 per cent during that year.

Obviously the increase in labor costs in excess of productivity will not neatly match the rise in prices every year. As noted above, demand and other complex conditions enter in. In showing year-to-year changes we find some cases where productivity moves ahead of wage increases, where prices lag behind costs, and where prices take the lead. We can also find that this pattern will vary from industry to industry within the same year. The purpose of the comparison here is merely to prove that "cost-push" forces are present in the overall inflationary process.

Cost-Push Inflation and the Distribution of Income

There is another important aspect of the cost-push inflation which deserves some careful attention. This is founded in the intense desire of unions and workers in every industry and firm to match their particular wage increases with the increase in productivity for their own industry or for the economy as a whole, whichever is higher. Thus the figure for the whole economy becomes the irreducible minimum for all workers in wage negotiations with their employers. To outline the problem created by such misuse of statistics, let me refer to the response of Professor Haberler to the Committee:

> "Technological progress and the rise in output per man-hour is, of course, not uniform over the whole economy. Some industries, let me say, certain branches of manufacturing and perhaps agriculture, display faster technological advances than some others--let me say most service industries. Hence,

> if the overall price level is to remain stable, the prices of the products of the more progressive industries must fall and the prices of the less progressive industries must rise. This presupposes, however, that wages in the more progressive industries cannot rise as fast as productivity in those industries. If stability of the price level and full employment are to be maintained, wages in these industries cannot be allowed to rise faster than average productivity of labor in the whole economy.
>
> Suppose that labor in the progressive industries is organized in powerful unions which force up wages in proportion to the rise in productivity in those particular industries--an assumption which does not seem unrealistic--then, it is true, prices of the products of these industries need not rise. But since the American economy is sufficiently competitive to generalize, sooner or later, such a wage rise, if not fully, then at least to a large extent, over most of the economy, including the less progressive industries which cannot absorb the higher wage cost without a rise of prices at which they sell, the overall price level will go up.
>
> It follows that the policy of wage increases in proportion to (let alone those in excess of) the rise in productivity in each particular industry is highly inflationary." 5

The problem of the wage-price spiral, then, includes the conflict over the distribution of real income, not so much between labor and nonlabor elements, but among various labor groups themselves. Human nature demands that the various groups try to protect themselves by pressuring for higher money incomes. The workers in the least progressive industries will not settle for less than the average, and those in the most progressive industries will certainly not reduce themselves to the average. Strategically placed, highly organized unions usually play a special role as catalysts in this mad scramble. And the union leaders are right there on the spot with the figures for their particular situation using every device and skill to raise the hopes of every worker --and thus create more cost-push pressure.

In our present collective bargaining society, therefore, inflation becomes almost a matter of arithmetic. There is an almost inevitable persistent upward pressure on the cost-price structure. The constantly increasing power of organized labor will continue to put an increasingly heavy burden on our monetary and fiscal policy unless we can find acceptable means of controlling the wage-push factors of inflation.

Profits and wages

The rather popular claim is frequently made that increasing profits rather than increasing wage costs are the real cause of rising prices. None of the witnesses who appeared before the Finance Committee or submitted statements for the record made this "red herring" argument, but it was freely offered by labor leaders and other witnesses related to labor who appeared before another Senate Committee while our Finance hearings were going on, and is frequently presented in speeches by labor leaders and appears in reports of major labor negotiations. Because a few companies have large profits this is frequently used as an argument to apply to business as a whole. Those who accept this fallacy then build a whole economic philosophy on the idea that to increase profits is to diminish "purchasing power" and that the way to cure our economic problems is to increase "purchasing power" by increasing wages, regardless of related increases in productivity.

Before turning to the facts of the case, I wish to point out that the subtle false logic of this argument has great appeal to the ordinary citizen. On the surface this reasoning has its foundation in a sound economic doctrine--the purchasing power concept--but in reality, it merely perverts the idea. For an answer to this false reasoning, I turn again to the able testimony of Professor Haberler:

> "It is one of the most pernicious fallacies that a boost to wages is an effective method of increasing purchasing power and thus alleviate depression. A tax cut or increase in public expenditures strengthens purchasing power. On the other hand, a rise in wages may or may not increase purchasing power of the workers (depending on what it does to employment). But in any case, whether it does or does not raise the purchasing power of the workers concerned, it boosts cost of production, it pushes up prices (or prevents prices from falling) and so reduces the real purchasing power of all consumers, including labor itself, adds to the fires of inflation and thus makes it more difficult for the monetary authorities to relax credit restrictions."[6]

What do the facts say with regard to wages vs. profits as an inflation force? I wish to insert in the Record at this point another table which I had inserted in the Hearings. It shows the per cent increase to 1957 from preceding years of total corporate profits, and total compensation of employees, both, of course, before taxes.

It will be seen by examining the table that [redacted] the increase in wages of employees exceeds the increase in corporate profits before taxes for each year from 1947 to 1956.

TABLE II

Profits and Wages for 1947-57

	Profits		Total Wages	
Year	Total corporate profits before Taxes	Percentage increase from specified year to 1957.	Total Annual Compensation of Employees	Percentage Increase from specified year to 1957
	Billions of dollars	Percent	Billions of dollars	Percent
1957	41.0	----	254.4	----
1956	43.0	-4.7	241.4	5.4
1955	42.5	-3.5	223.1	14.0
1954	33.5	22.4	206.8	23.0
1953	37.0	10.8	208.1	22.2
1952	35.9	14.2	195.1	30.4
1951	41.2	-0.5	180.4	41.0
1950	40.0	2.5	154.3	64.9
1949	26.2	56.5	140.9	80.6
1948	32.8	25.0	140.9	80.6
1947	29.5	39.0	128.8	97.5

During the years of the latest inflation, 1955-1957, you will note that profits increased slightly from 1955 to 1956, but decreased from 1956 to 1957. Profits in 1957 were lower than both 1955 and 1956. On the other hand, employee compensation increased dollarwise and percentagewise between 1955 and 1957. Referring to the table inserted earlier you will see that the same is true for hourly earnings in manufacturing.

Although unincorporated business and professional incomes are not shown in the table, I might point out that from 1955 to

1957 these incomes increased from $27.3 billion to $28.7 billion for a percentage rise of 5.1 per cent. This is less than half of the increase in compensation of employees over the corresponding years.

Yet the question may still be asked: Could not a general wage increase come out of profits? It might for a few companies and for a few years but it could not be true for all companies or for every year. This should be clear from the data already presented; but for additional evidence I have shown in Table III the National income by years from 1947, and the percentage which corporate profits before taxes and compensation of employees are of that income.

TABLE III

Year	National Income	Compensation of Employees As A Percent of National Income	Corporate Profits Before Taxes As A Percent Of National Income
1947	$197.2 billion	65.3 %	15.0 %
1948	221.6 billion	63.6	14.8
1949	216.2 billion	65.2	12.1
1950	240.0 billion	64.3	16.7
1951	277.0 billion	65.1	14.4
1952	290.2 billion	67.2	12.4
1953	302.1 billion	68.9	11.1
1954	299.0 billion	69.2	12.2
1955	324.1 billion	68.8	12.4
1956	343.6 billion	70.3	12.5
1957	358.2 billion	71.1	11.5

Note: The remainder of the distribution within 100% is made up of farm business and professional, rental, and net interest income.

From the above it is obvious that wages have in fact increased their relative share of the national income over the past three years from 68.8 per cent in 1955 to 71.1 per cent in 1957. Corporate profits, on the other hand, have correspondingly declined from 12.4 per cent to 11.5 per cent of national income over the same period.

A general wage increase of even five per cent in 1957 not compensated by an increase in productivity or prices would reduce non-wage income by one-eighth, and if it all came out of corporate profits it would mean a reduction of 31 per cent in this sector. A 16 per cent wage increase would wipe out all profits. Thus, it does not take much imagination to see what an additional profit squeeze would do to the economy.

On the other hand, one of the most potent factors in our economy to dampen inflationary forces is increased productivity. If production is increased as fast as demand is enlarged, price inflation will probably not occur. I submit that productivity will be increased only if profit margins are large enough to provide businessmen with incentive to borrow, and savers with incentive to invest or to lend the funds, to finance the new capital improvements. In this sense, therefore, profit margins are an indirect defense against inflation rather than a cause of inflation.

From the pamphlet "The Mechanics of Inflation," published by the U. S. Chamber of Commerce, I borrow this paragraph:

"If temporarily high profits in expanding industries become the basis for monopolistic wage demands, and those profits are reduced before they can perform their most important economic function, the expansion of the industry desired by consumers is cut off. The whole community is thereby robbed in higher prices, uneconomic use of our resources and foregone improvements in living standards. If a free market is to be preserved, we enforce competition and rely on competition to grind down temporarily high profits. This is not the function of the labor leader, however sincere and public-spirited he may be."[8]

Another point is worth noting here. Normally, profits, being a residual share of national income, increase faster than other income shares in a boom period. On the other hand, they fall more rapidly in a recession--for example 1931 and 1932. They are not inflexible downward, as are wages; nor on the rise do they establish higher rigid cost plateaus as do wages.

Before I leave this discussion of the relative inflationary effect of rising wages and rising profits, I want to turn briefly to a philosophical comment on the subject made by Mr. Theodore O. Yntema, Vice President and Economist of Ford Motor Company, which appears in his testimony before the Subcommittee on Anti-Trust and Monopoly. He said:

> ".....We would like to see the productivity advances in the economy distributed more in lower prices and less in higher money wages of reduced purchasing power.
>
> ".....Certainly, we should not tolerate attempts by any power group to grab such benefits for themselves."
>
> ".....The productivity of society is reflected in the physical volume of output per man-hour worked. This output per man-hour is usually called the 'productivity of labor.' The term, however, is a misnomer because laborers are not responsible for much of the increase in productivity. The increases in productivity come mainly from management's utilizing capital and putting into operation the improvements discovered by scientists, engineers and others. It is somewhat ironical that productivity should be expressed as output per man-hour, and it is most unfortunate that the term productivity of labor should be misinterpreted as productivity attributable to labor."[9]

Conclusions--Recommendations

If the power of labor to exact wage increases in excess of productivity is a major cause of inflation, what course should the government pursue to stem this inflationary force? The monetary authorities, and those responsible for fiscal policy--and a major responsibility for the latter rests squarely on this body--have a mandate to control the demand type of inflation. What forces or agencies have the responsibility to stem the cost-push type of inflation? Fiscal and monetary policy could handle this type of inflation, too, but only at the cost of increased unemployment.

I have not as yet reached any conclusions for myself as to the best course to follow. However, the witnesses to the Finance Committee offered some individual suggestions which are worth considering.

I think it should be obvious to everybody that the place to begin, and in the long run perhaps the only source of a solution is with the public itself--through a program of economic enlightenment. Sumner Slichter concluded his testimony before the Committee with these words: "The more plainly the public sees the relationship between wages and prices, the more carefully it will appraise the demands of the unions. The public is obviously getting tired of the stiff annual rounds of wage increases that far exceed the contribution of the workers to productivity. An atmosphere is being built up in which employers who take long and costly strikes in an attempt to hold wage increases down to increases in productivity will have strong public support."[10]

Gerhard Colm offered these suggestions:

1. Develop more facts on prices, wages and productivity, and a better understanding of these facts.

2. Implement the price stabilization objective of the Employment Act.

3. Give consideration to an annual informal conference of business and labor leaders and research economists, for the purpose of discussing along general lines price and wage policy which would give support to high and rising employment and production without causing inflation or deflation. Whether or not agreement on price

and wage policy is reached at these sessions, the resulting public information would lead at least to a clearer understanding of the areas of disagreement. "A better informed public opinion in itself will exert a restraining influence on price and wage policy."

4. Set up a special government commission on price and wage policy. Require producers and labor leaders to inform the commission of contemplated price increases and new collective bargaining agreements before they become effective. After study by the commission, and review by the Council of Economic Advisors, the President could then approve or suspend the effective date for a period of say 60 days if they are deemed to be contrary to the public interest.[11]

Though Mr. Colm's first three suggestions merit further study, I hope we can reach a solution more in keeping with private free enterprise than his fourth suggestion.

There is one other suggestion which received only a little attention in the Committee hearings, but which also deserves some careful study. The idea has been suggested by many responsible men in other places. It is a call to extend present Anti-Trust laws to cover labor union activity, or in some way limit the size of unions. George Romney, President of American Motors, in testimony before the Subcommittee on Anti-Trust and Monopoly, called for a dividing of the power of national unions. Two of his specific proposals were:

"1. The combining of the national unions for the establishment of common bargaining demands or use of economic power, should be prohibited.

"2. Affiliated unions should be free to combine in bargaining with employers having less than 10,000 employees, but only within prescribed geographical limits. However, those representing more than about 10,000 employees of a single employer should be prohibited from combining to establish collective bargaining demands or exercising joint economic power against more than one company."[12]

Theodore O. Yntema in his response to the Finance Committee questionnaire gave it as his opinion that the most desirable solution to wage inflation, and its cause--the labor monopoly problem--is the development of anti-monopoly laws comparable to those that govern business.

I quote in length from Mr. Yntema's words, both because of their vital nature, and because they summarize my feelings on this matter:

"Competition in business is not perfect--in the everyday sense; it can be and needs to be improved. By and large, however, there is enough competition in most industries to keep prices and profits down to levels roughly equal to those necessary to compensate for the risks of the business...And there are laws on the books prohibiting monopoly and monopolistic practices--laws that have maintained reasonably workable competition in business.

"A different situation exists in labor. Labor unions are monopolies established under the aegis of law. They are given special protection and even immunities and privileges that are not accorded ordinary citizens. They are not subject to much regulation or restraint in the use of their monopoly power.

"During the boom of 1955-1957 and in the recession of 1957-58 the unions have displayed their power to drive up wages faster than productivity and to squeeze profit margins. There is no reason to expect different behavior in the future from labor unions unless their powers are reduced. We can look forward, therefore, to continued and probably accelerated cost-push inflation in the future unless appropriate action is taken.

"....This problem of labor monopoly and cost-push inflation cannot be solved merely by increasing the degree of competition in business.

"....Industrywide organization of business to oppose industrywide organization of labor is not a happy solution.

"....Wage and price controls are still worse as a solution.

"This problem cannot be cured by monetary or fiscal means. Prof. E. H. Chamberlin makes this point clearly in The Economic Analysis of Labor Union Power.

"'To deal with a wage-push inflation by monetary or fiscal policies is certainly not to deal with causes; it is rather an attempt to create a counter push by squeezing businessmen so that they will in turn squeeze labor. It risks economic contraction to say nothing of major industrial strife. An obvious alternative is to diminish the degree of economic power in the hands of the unions, so that the pressure may be reduced at its source.'

"....As a first step, some or all of the legal immunities of labor can be removed, and unions can be made subject to the laws of the land that ordinary citizens must obey.

"....If this first step is not sufficient, the second step would be the development of antimonopoly laws for unions and analogous to the anti-monopoly laws for business. If necessary, it would be possible to limit federations of locals for collective bargaining to a size that does not give them monopoly control of labor and wages in an industry and to prohibit collusion among such federations in economic matters. It may not, however, be necessary to go this far to prevent most wage inflation.

"....What is needed is objective analysis of wage inflation and labor monopoly by competent, disinterested scholars and the publication of their findings. As economists in increasing numbers undertake such analysis, as the economic profession becomes better informed, and as the knowledge spreads to the public, there will develop a basis for action in dealing with labor monopolies."13

Cost-push inflation, though relatively new, is an American economic problem of major proportions. It is a complex problem, and likewise the solutions to it are still beclouded. But the difficulty of our task should not deter us from tackling it. I conclude with the words of Dr. Yntema again:

" Wage inflation is the key economic problem of this country. Solving that problem will make possible high employment, price stability, and dyhamic economic progress. The resulting benefits to union members will far outweigh any possible gains they might achieve by exercise of union monopoly power." 14

Footnote References

1. "Investigation of the Financial Condition of the United States," Comments of Economists, Professors, and others in response to the Questionnaire of the Committee on Finance, United States Senate, 85th Congress, Ch. 5, p. 584.

2. "Investigation of the Financial Condition of the United States," Hearings before the Committee on Finance, United States Senate, 85th Congress, p. 1219.

3. Ibid, p. 1695
4. Ibid, p. 1843
5. Questionnaire, Ch. 5, p. 625.
6. Ibid, p. 623.
7. Computations based on Table II.
8. P. 39.
9. Prepared Testimony of Theodore O. Yntema before the Subcommittee on Antitrust and Monopoly of the Committee on the Judiciary, United States Senate, Feb. 4-5, 1958, pp. 40-41.
10. Hearings, p. 1843.
11. Questionnaire, Ch. 5, pp. 580-581.
12. Prepared testimony of George Romney before the Subcommittee on Antitrust and Monopoly of the Committee on the Judiciary, United States Senate, Feb. 7, pp. 38-39.
13. Questionnaire, Ch. 6, pp. 744-746.
14. Ibid, p. 758.

INFLATION AND THE RECESSION

A speech by Sen. Wallace F. Bennett
from the Congressional Record
August 5, 1958

INFLATION AND THE RECESSION

Mr. BENNETT. Mr. President, this is the fourth of my statements presenting my observations and analysis of the material presented to the Finance Committee in its hearings on the economic condition of the United States.

Today, I shall turn my attention briefly to the place of inflation in the current pattern of our economy, the present phase of which we call a recession.

Interestingly enough, the committee's hearings in 1957 were going on in the last weeks of a boom. They ended in the middle of August, at the beginning of the third quarter—now recognized as the peak of that boom. This year's hearings were held in April, which at this point seems to have been the trough of the following recession. When read against this background, the almost complete reversal of the pattern of testimony and questioning is easily understood. What is not so easy to account for is the vital economic element which was not reversed—the course of the inflation. Prices continued to rise steadily, both during the boom and during the period of decreasing economic activity. Only in the last 2 months, as the general economic indices have slowly begun to turn up again, has the rate of increase in the consumer-price index begun to level off.

Before beginning a discussion of the relation of inflation to economic activity, and particularly to the current recession, I want to call attention to one general problem which exists whenever comparisons are made, and which was glaringly evident in the testimony and questioning in our hearings. The key to the validity of any comparison is the soundness and breadth of the figures which are used as the base and reference point. When every witness or questioner is free to select his own base, it is a rare situation that cannot be manipulated to prove a preconception or a prejudice. The confusion can then be compounded further by translating comparisons into percentages, which permits anyone to select one particular phase of any relationship and exaggerate it. If ours had been a truly objective investigation, we would have sought, first, and always, to establish common bases and reference points to which all comparisons could be referred, as is done in building official economic indices. But the Finance Committee's hearings turned out to be an economic investigation participated in by men whose approach was essentially political. In the hearings of 1957, most of the testimony was from two administration witnesses, Secretary of the Treasury George M. Humphrey and Under Secretary W. Randolph Burgess; and most of the questions put to them came from men who opposed them in political loyalties and economic philosophy. Very frequently, figures covering the same area of information could be—and were—selected to support conclusions which were exactly opposite to each other. To me, this was very unfortunate, and not only largely destroyed the potential value of the hearings, but made it practically impossible for the committee to bring out a meaningful official report.

Of course, in writing these personal reports, I have had to select the bases for my comparisons, and am therefore open to the attack that Shakespeare leveled against the Devil—of quoting scripture to my purpose. I also know that those who read the figures I use will use their own economic set of values in interpreting them. I hope the figures will hold up as being reasonably objective and dependable.

Since I have related the time pattern of the hearings to the present boom-recession cycle in which we still find ourselves, my task today should be first to identify the major points in the sequence of change, and then to measure the extent of the various changes. For purposes of this presentation, I have set the last quarter of 1954 as the beginning of the boom, and the third quarter of 1957 as its peak—a period of 33 to 36 months. Most of the indicators began their rise in the third quarter of 1954, but the boom rise did not become clear until the fourth quarter of 1954. From what we know now, it would seem that the low point of the recession may have been reached in April 1958. Thus the slide covered a period of 8 months, less than one-fourth as long as that of the rise. The extent of the improvement since April has been small, but large enough to mark what seems now to have been the time of the turn.

In order to measure the extent of these movements, I have prepared a table which shows the most important economic figures as of these dates, and I measure the extent of change by showing the percentage of rises against the 1954 base, and the declines against the third quarter of 1957.

At this point in my statement I ask unanimous consent to have printed in the RECORD the table to which I have referred, together with footnotes which follow.

There being no objection, the table was ordered to be printed in the RECORD, as follows:

TABLE I.—*Changes in selected economic indicators (annual rates) quarterly averages 4th quarter 1954, 3d quarter 1957, 2d quarter, 1958*

	4th quarter 1954 (billions)	3d quarter 1957 (billions)	Percent change 4th quarter 1954 to 3d quarter 1957	2d quarter 1958 (billions)	Percent change 3d quarter 1954 to 2d quarter 1958
Gross national product	$370.8	$445.6	+20.3	$428.0	−4.0
Expended for new plant and equipment [1]	26.2	37.8	+44.3	31.4	−17.0
Industrial production [2]	128.0	145.0	+13.3	128.0	−11.7
New construction:					
Total private and public	41.5	48.2	+16.1	47.4	−1.7
Total private	29.5	34.1	+15.6	32.8	−3.8
Total private residential	17.0	16.9	−.6	16.2	−4.1
Farm income, net total	12.1	11.8	−2.5	13.6	+15.3
Personal income	294.2	351.8	+19.5	350.0	−.5
Consumer expenditures:					
Total	243.2	288.3	+18.5	288.0	−.1
Durable goods	33.9	40.4	+19.1	35.6	−11.9
Nondurables	121.0	140.5	+16.1	141.1	+.4
Services	88.3	107.4	+21.6	111.3	+3.6
Retail sales	14.4	17.0	+18.0	16.5	+2.9
Total consumer credit outstanding	32.3	43.3	+34.1	43.0	−.7

[1] Estimates based on anticipated capital expenditures as reported by business in May 1958.
[2] Index numbers. Industrial production index was 130 as of June 1958.

Sources: Economic Indicators, July 1958. U. S. Department of Commerce.

Mr. BENNETT. Because of their complex nature, unemployment figures are not included in table I. Instead I have shown detailed employment and unemployment data over the same time period of the cycle in table II.

I ask unanimous consent to have printed at this point in my remarks a table, with footnotes, which I have marked table II.

There being no objection, the table was ordered to be printed in the RECORD, as follows:

TABLE II.—*Population, civilian labor force, employed, unemployed, 4th quarter 1954; 3d quarter 1957; 2d quarter 1958; quarterly averages, seasonally adjusted*

	4th quarter 1954	3d quarter 1957	2d quarter 1958	June 1958
	In thousands of persons			
I. Basic data:				
Population (all ages) [1]	163,473	171,516	173,652	173,885
Civilian labor force [2]	64,431	67,948	68,818	68,634
Employed	61,092	64,996	63,792	63,707
Unemployed	3,452	2,944	4,948	4,687
	In percentages			
II. Ratios:				
A. As a percent of population:				
Civilian labor force	39.4	39.6	39.6	39.5
Employed	37.4	37.9	36.7	36.6
Unemployed	2.1	1.7	2.8	2.7
B. As a percent of civilian labor force:				
Employed	94.6	95.7	92.8	93.2
Unemployed	5.4	4.3	7.2	[3] 6.8

[1] Population includes members of the Armed Forces. Quarterly data relate to the midmonth of each quarter.
[2] Seasonally adjusted civilian labor force differs somewhat from the sum of the seasonally adjusted employment and unemployment because independent factors were used for each category.
[3] Compares with rates of 7.5 and 7.2 percent in April and May respectively.

Sources: U. S. Bureau of Census. U. S. Department of Labor, Bureau of Labor Statistics.

Mr. BENNETT. The presentation is more elaborate than the usual employment-unemployment data. The comparison with population is included for two reasons. First, it gives a better perspective to the true unemployment situation. It can be seen that, percentagewise, there has been only a small employment variation in terms of population over the cycle. Second, the total population figure is a more stable comparative base than is the civilian work force. The latter is subject to definitional and actual changes.

It is both interesting and alarming that prices have pushed relentlessly upward through both the boom and the recession. In Table III are shown the average monthly changes in the Consumer Price Index over the period of the cycle, fourth quarter October 1954 to the second quarter April 1958.

I ask unanimous consent that the third table, with footnotes, be printed in the RECORD at this point.

There being no objection, the table was ordered to be printed in the RECORD, as follows:

TABLE III.—*Average monthly consumer price changes over business cycle 4th quarter 1954–2d quarter 1958*

Period of business activity [1]	Increase in Consumer Price Index	Length of period (months)	Average monthly price change
I. Long upward trend of general business (October 1954–August 1957)	6.5	34	0.19
II. 1st half of rise, business very active (October 1954–March 1956)	.2	17	.01
III. Last half of rise, business activity tapering off (March 1956–August 1957)	6.3	17	.37
IV. Period of recession (August 1957–April 1958)	2.5	8	.31

[1] Measured in terms of the general trend of the various indicators listed in table I.

Source: Adapted from Consumer Price Indexes. U. S. Department of Labor.

Mr. BENNETT. Mr. President, it is interesting to note that prices rose almost two-thirds again as fast during the eight recession months as during the 34 months of the business rise, and rose nearly as fast as the sharpest rise on the boom side. Prices were stable during the first half of the general business expansion; but they rose sharply during the last half of the general business expansion, and continued their steep climb through the recession.

Concerning the facts shown in table III, three observations are in order. I think these observations disprove, for the present cycle at least, some commonly held notions about the relationship of price increases and general economic activity. Note in the table that—

First. Price increases were not generating factors to the business boom. Thus, those who argue that a small inflation is conducive, or even necessary, to business expansion, are expressing hearsay, not facts.

Second. When prices were in their steep climb, general business activity was in the generally tapering phase of the rise.

Third. Sharp price rises have persisted through the recession. Apparently, then, there are inflationary forces at work which bear no relation to general business conditions.

As I outlined in my first and third speeches in this series, there are at least three forces at work: (a) the power of unions; (b) the psychological, if not the material, effects of the Employment Act of 1946; and (c) the fact that inflation has become acceptable among so many of our citizens and public leaders.

I wish to add that although price increases did not play a part in generating the business expansion, because prices did not rise during this early period, they did play an important role in bringing on the subsequent recession. I wish to discuss this further when I come to a consideration of recession causes.

It has been assumed in the analysis I have given that the second quarter, and specifically April, was the bottom of the cycle. I have shown in table IV reliable, widely used data which bear out this assumption.

Recent business cycle analysis, based on the pioneer efforts of the National Bureau of Economic Research, and adapted by other groups, draws statistics from 21 different areas covering the important segments of the economy—production, employment, income, et cetera. The basic 21 are broken down into three groups, called the leasing group, the coincident group, and the lagging group.

The leading series is the most important because it generally gives the first indications, usually 3 to 8 months in advance, as to where the economy is going, rather than where it is, or where it has been. In table IV I have shown the leading group as a separate series, but I have also shown the composite indexes of the other groups for the total picture.

I ask unanimous consent that table IV be printed at this point in the RECORD.

There being no objection, the table was ordered to be printed in the RECORD, as follows:

TABLE IV.—*Trends in economic indicators, 1958*

Indicator	Changes from preceding month				
	February	March	April	May	June
LEADING SERIES					
1. Business failure liabilities [1]	Up	Down	Down	Up	Down.
2. Industrial stock prices	Down	Up	Down	Up	Up.
3. Durable goods, new orders	[2]	Up	Down	Up	Up.[3]
4. Residential building construction awards	Down	Up	Up	Up	Up.[3]
5. Nonresidential building construction awards.	[2]	Down	Up	Up	Up.[3]
6. Average hours worked	Down	Up	Down	Up	Up.
7. New incorporations	Down	Down	Up	Up	Up.
8. 22 wholesale commodity prices	Up	Down	Down	Up	[2]
COMPOSITE INDEXES					
8 leading series	Down	Up	Down	Up	Up.
8 coincident series	Down	Down	Down	[2]	Up.
5 lagging series	Down	Down	[2]	Down	Down.[3]
21 composite series	Down	[2]	Down	Up	Up.

[1] Inverted.
[2] No change from previous month.
[3] Estimated.

Source: Statistical Indicator Reports, July 23, 1958. Great Barrington, Mass.

Mr. BENNETT. I think it is significant that this is the shortest of the three postwar recessions. The 8-month 1957–58 recession was just slightly deeper than the previous 2; but, based on most key indicators, it was approximately 2 months shorter than the 1948–49 decline, and approximately 4 months shorter than the 1953–54 drop.

At this point I probably should make it clear that in using the word "recession" in this particular paragraph I am referring to a period during which business activity continues to fall off. Many persons assume the word "recession" covers the whole period between one peak and the next one. The word itself, meaning to withdraw or to turn back, would indicate that, technically, it refers only to the period of the slide.

The administration deserves great credit for the wisdom and foresight shown in the economic policies announced early this year during the decline. By resisting the clamor for panic programs, which certainly would not have helped the present situation, the administration prevented a great increase in the risk of damage to the economy that would have resulted from more rapid inflation.

I come now to the causes of the recession as developed from the testimony and statements placed in the record of the Finance Committee.

Since we are still in the low side of the total cycle, the direct interest in the 1958 hearings, and in the responses to questionnaires sent out this spring, has been in the recession and the probable causes which produced it. A careful review of the committee's record revealed more than 20 specific ideas of probable causes, all but one of which—somebody suggested the epidemic of Asiatic flu as a cause of the recession—can be correlated within four areas:

First. Policies of the Federal Government.

Second. Policies and problems of the business and industrial community.

Third. Economic policies and problems of the individual.

Fourth. Inflation.

Within the area of Federal responsibility such ideas as these were suggested as contributing to the recession:

(a) The policy of the Federal Reserve Board in restraining the rate of growth in the money supply in 1956–57.

(b) Increasing Government interference with the private sector of the economy.

(c) Cuts in defense spending in 1957.

(d) Inadequate economic leadership from the White House.

(e) Decline in the confidence in peaceful international conditions.

(f) The present administration's management of the public debt. There was much more discussion on this in the 1957 hearings than in 1958.

I am not going to discuss all of these in detail, but this last one—the present administration's management of the public debt—deserves a special comment here. This consumed most of the time in the 1957 hearings, and generated most of the heat. From my point of view, it rarely rose above the political level, and the "hard money—easy money" debate was largely slanted at the development of a political issue and conducted in an atmosphere of personal attack and defense, involving post-mortems in judgment after all the effects of an action could be measured. It was like Monday morning quarterbacking by the opposing team. I felt that all these aspects destroyed any significance it might have had, so have not devoted any time to it in these statements.

In the industrial and business field, these factors as causes of the recession were noted:

(a) Effects of previous overexpansion in both productive capacity and sales effort.

(b) Decline in investment spending.

(c) Decline in volume of inventory.

(d) Rising costs and declining profits.

(e) Improper division of national income between wages and profits—this was attacked from both points of view.

Turning to the problems and decisions of the individual, these were suggested:

(a) Failure of consumer purchasing power to expand fast enough.

(b) Reduced consumer expenditures in some fields.

(c) Shift of buyers away from some fields, particularly from durable goods, and more specificially from houses and automobiles.

(d) Earlier unwise increase in consumer debt volume, created by excessive use of personal credit resulting first in excess sales and later in necessary reduction in volume.

Referring to the fourth and final field, inflation, it was recognized that this was involved in all the others, but two phases of it were emphasized:

(a) The continuing increases of wages at a rate greater than the increase in productivity.

(b) The general lack of—and need for—sound understanding of inflation, both in terms of previous historical American business booms and busts and its general causes, effects and cures.

If we further consolidate our material relating to all economic activity, we soon discover that most of these many factors are part of one basic idea. The idea is that, under our system of privately owned and privately managed capital operating in free markets, we shall always have periods of overexuberance and overexpansion, followed by compensating periods of normal and necessary readjustment. This is a typical business cycle and is represented by the period covered in table I. From fourth quarter, 1954 to the second quarter, 1958. It is the third such cycle since the end of World War II.

If one reads the record, this is the testimony directly or indirectly of nearly all the witnesses. Of course, there is no common pattern of definite and individual statements. Some merely listed areas of decline—without relating them. For example, we have the total reply of Prof. Paul Samuelson, of Massachusetts Institute of Technology, to the committee questionnaire in this short, terse statement:

The 1957 recession came from (1) cuts in defense spending, (2) cuts in fixed investment spending by business, (3) inventory decumulation, and a number of minor factors.[1]

But there are many other replies which were more definite in referring to the process of readjustment.

Dr. Sumner Slichter made one of the most comprehensive analyses of causes of this recession, and I would like to draw on his expert knowledge first. He said:

There are two ways of looking at the recession which are not contradictory, but it is useful to use each of them.

One way is to regard the recession as a normal adjustment to a slower rate of growth aggravated by some unfortunate outside events such as credit policy, procurement policies of the Defense Department, and, later in the recession, introduction of the 1958 cars which the public didn't seem to care for.

The high level of investment activity attained in 1956 made the economy vulnerable to contraction, since it was natural for enterprises to slow down the increase in their investment spending.[2]

Note that he said the three outside influences were only aggravating influences on a more basic cause—that of a boom readjustment. He continues:

Now there is another way of looking at the recession, which is not in conflict with the first way, and that is to regard it as the result of the failure of new dynamic influences to develop to replace old dynamic influences that were petering out.

You can regard the economy as being kept going by a collection of shots in the arm from this, that and other new dynamic influence. These shots in the arm occur rather irregularly. Hence one must expect the level of activity in the economy ot reflect this irregularity of these shots in the arm.[3]

Chairman William McChesney Martin, of the Federal Reserve Board, made it perfectly clear that he believes that the old basic law "every action brings an equal and opposite reaction" applies to economics when he cited the figures pertaining to the boom and now the adjustment:

Now the current recession is a reaction to both investment boom and the inflation which accompanied it. The growth of business capital spending beginning in early 1955 was at a rate that was unsustainable. An economy with a long-run upward growth trend of about 3 or 4 percent per year cannot sustain for long an increase in business investment of about 10 percent per year in real terms such as we experienced in 1955–56 The investment spending even if prolonged by inflationary trends, had at some point to slow down.[4]

R. G. Rincliffe, president of the Philadelphia Electric Co., along this same line, said:

Our present economic recession stems from an oversupply of goods created by overinvestment in facilities without a corresponding increase in the demand for goods. The high inventory situations of many of our basic industries have been accumulated as a result of overspeculative production.[5]

H. J. Livingston, president of the First National Bank of Chicago, offered the following:

Thus, with the benefit of hindsight, it can be suggested that the current recession is in part the result of an unsustainable rate of increase in consumer spending which in turn tended to stimulate too rapid an increase in capital spending. One byproduct of these two developments has been an adjustment in inventories which began to develop early in 1957 and accelerated in the final quarter. A further contributing factor to declining production was the reduction in the Federal Government purchases of goods and services and the slowdown in contract payments and new Government orders that occurred in the latter part of 1957.

Such excessive economic activity inevitably is followed by a period of adjustment.[6]

J. S. Rockefeller, president of the First National City Bank of New York, said:

The current recession is a natural reaction to an over exuberant boom.[7]

Many other quotations should be repeated here, but I think the brief and succinct statement of Bernard Baruch is both a perfect summary of this idea and an excellent introduction to the discussion of the part inflation has played. He said:

We are now suffering a hangover after a long inflationary binge.[8]

In commenting further Mr. Baruch said that, this being true, the way out of the recession could be found in price reductions. I quote:

Nothing would be more effective in turning the tide than to halt the never-ending spiral of wages and prices. The best stimulant to our economy would come from price reductions. The consumer, who has no lobby or bargaining agent, is belatedly rebelling against having every wage and cost increase passed on to him. If industry and labor continue to push up wage, price, and profit levels, they will price themselves out of the market. Consumer resistance will grow, further depressing economic activity and adding to unemployment. Foreign goods will enter our markets in increasing quantities, with unsettling effects on our domestic economy, our tariff policies and our allies and friends.[9]

His point of view was supported by a number of other witnesses who expressed the belief that the rise in prices—at both consumer and supplier levels—was not only one of the fundamental forces that created the boom, but also the one that finally broke its back, and brought on the recession.

Mr. K. S. Adams, chairman of the board of Phillips Petroleum Co., made the following statement to the committee:

The direct causes of the current recession include a shift from accumulating to liquidating inventories, a decline in the business investment boom, and a lag in consumer spending, especially for automobiles. Underlying these is the sustained rise in prices.[10]

And J. S. Jerome, president of the Seattle First National Bank, stated his understanding of this chain reaction as follows:

The major reasons for this recession are reductions in expenditures for capital goods and business inventories. These in turn reflect a rapid increase in productive capacity and the reluctance of consumers to absorb the increased output at current prices. In a large sense, what we are undergoing is a rebellion against rising prices.[11]

The experience of the automobile industry during the period covered by our chart is an interesting example of the cyclical movement we have been discussing, and the effect of inflation on it. In this industry, 1955 was the high year for American manufacturers, when [illegible] million passenger cars were produced. Volume has been dropping ever since, with 1958 running at a rate 34 percent below 1957 and 4[illegible] percent below the 1955 peak. In

[1] Investigation of the Financial Condition of the United States, Compendium of Comments to the Finance Committee Questionnaire, U. S. Senate, 85th Cong., p. 676.

[2] Ibid, hearings, p. 1822.

[3] Ibid, p. 1826.

[4] Ibid, p. 1848.

[5] Ibid, compendium, p. 311.

[6] Ibid, pp. 287–288.

[7] Ibid, p. 315.

[8] Hearings, p. 1635.

[9] Hearings, p. 1637.

[10] Compendium, p. 166.

[11] Compendium, p. 225.

spite of falling volume both the size and complexity of the cars—and the level of prices for them—kept increasing, as did the cost of gasoline required for their expanding horsepower. At the same time cheaper, smaller, and more economically run foreign cars, were increasing their penetration of our market. The one American manufacturer who saw this trend in time is the only one for whom 1958 has been a year of gain, not recession. Rambler sales are currently running 70 percent above 1957 levels.

The example of this industry demonstrates again the the consumer has the last word, and unless price, design, and specifications attract him, he will not buy. That he is exercising this sovereign right in 1958 was suggested both by academic economists like Dr. Slichter and businessmen like Fowler P. McConnel, president of Sears-Roebuck & Co. Dr. Sclichter said:

Although poor automobile sales are partly a result of the recession, the unattractiveness of the 1958 cars appears to be an independent contributing cause of the recession. In spite of the recession, the drop in the buying of houses and most household durables is much less than the drop in the buying of cars.[12]

Mr. McConnel wrote the committee:

The reduced demand for consumer durable goods was particularly evident in the case of automobiles. Consumer resistance to higher prices, lack of enthusiasm for the new models, and probable unwillingness to add to a record high burden of installment debt, are all involved.[13]

A decline in consumer purchasing such as this has a compound force in producing recession—not only multiplying its effects at every level of production and distribution—but contributing to debilitating inventory liquidation, and the reduction of capital investment. Both of these have occurred in the past year. And speaking of capital investment, falling volume also produces falling profits, which in turn weakens not only the incentive for further investment of capital, but also dries up the funds from which to finance it. Adequate profit is necessary as a base for capital investment for all of it must either come from retained earnings or the sale of new stocks and bonds whose attractiveness is largely measured by previous earnings records.

In my third statement, I discussed the effects of rising wages on inflation—when they rise faster than productivity. The higher costs they produce push prices up, and inflation results. But the last 10 months have shown us again that when consumers will not pay the higher prices, volume drops, unemployment rises, profits shrink, and the recession results.

This pressure against profits has persisted ever since the crash of 1929—even when times were good and profits rose—when this happened the pressure to cut them down again increased. This has been true in the period we are discussing. In the boom phase—from 1955 to 1957—employee compensation increased 14 percent—productivity rose only one quarter as fast, 3.4 percent; and profits shrank 3.5 percent. That this pressure on profits has helped to bring on recession was recognized by several businessmen witnesses. I shall quote the statements of three.

First, Mr. Milton Lightner, president of Singer Sewing Machine Co., and president of National Association of Manufacturers wrote the committee:

The present economic situation shows the following characteristics:

1. Recession, as indicated by rising unemployment and falling industrial output.
2. Inflation, as indicated by price rises.
3. Impaired prospects for long-term growth as indicated by the low level of net growth of business capital and dependance on inflation to support the load of business debt.

One of the causes of the economic condition which is revealed by the above symptoms is the stagnation of profits and the declining prospect of profitability commensurate with effort and risk in business ventures. * * * The source of the squeeze on profits has been the upper millstone of labor costs rising at a faster rate than national productivity and the nether millstone of restrictive money policy.[14]

Newton L. Thomas, president of the National Coal Association, gave this opinion:

The major causes of the current recession are:

(1) Excessive use of consumer debt, bringing about curtailment of consumer expenditures until the current obligations are liquidated;

(2) Narrowing profit margin for producers and distributors, brought about in large part by increasing wages and other costs, on the one hand and relatively fixed revenues on the other; and

(3) Heavy Government expenditures due in large part to defense needs, but which have the effect of preventing free communication of economic forces on the operation of factors which would adjust our economy between excessive inflation and deflation.[15]

Harlow Curtice, president of General Motors, said:

A factor that contributed to the downturn in business activity was the wage-cost push which began to squeeze profits.[16]

I recognize that thus far these are the words of businessmen with perhaps a special ax to grind. However, the same observations were made by some of the leading college economists. Charles R. Whittlesey, professor of finance and economics at the University of Pennsylvania, ascribed, among other causes relative to the overextension of 1955, the following as a recession cause:

Shortsighted price and wage policies for which both employers and union leaders are responsible.[17]

With these comments I shall conclude my presentation of the thesis that this recession is the normal and necessary readjustment after an unsustainable boom whose forces were operating during 1957. Both the boom and the recession have been aggravated by the continuing forces of inflation. These forces, most of which were generated in World War II, and some of which were strengthened in postwar economic policies, seem still to be with us.

Dr. Gottfried Haberler, of Harvard, describes our present situation as chronic inflation. He said:

If the boom (of 1955-57) had not occurred in a period of chronic inflation, the Federal Reserve could have afforded to act more promptly and more vigorously once it became clear that the back of the boom had been broken.[18]

Today our American economic body is suffering from two diseases—recession and inflation. In the past these two have rarely been present at the same time. In fact, recession usually helped cure inflation. But with both present, we have some basic decisions to make as a people and as a government. First, we must decide which is the more serious problem, and which solution is to take precedence, in case attempts to cure one may tend to aggravate the other.

To me there is one obvious answer. The economic cycle is natural in a free economy, reflecting our own very human tendency to recurring periods of overexuberance and necessary readjustment and restraint. When we work too hard, we have to rest. When we are extravagant, we have to go through a following period of penny pinching. These readjustments are more or less automatic. But inflation is a dangerous retreat from reality, an attempt to escape the consequences of our own mistakes, a hope of something for nothing. It has the quality of a narcotic, requiring ever larger doses.

If we recognize inflation as the more serious problem and concentrate on curing it, the cure of the immediate recession may be delayed. But if we consider recession the greater evil, and deliberately whip up more inflation as a means of speeding up the rate of the already developing recovery, we will not only increase the malignancy of the monetary disease but we will also weaken our power to cope with it. If this happens, I am sure we will be setting the stage for another and inevitably more serious depression, which a wilder inflation will make worse.

PROPOSALS FOR CURING THE RECESSION

Earlier this year it was painfully evident that many people in and out of Government wanted the short-run economic benefit of rapid recovery even at the expense of long-range inflationary damage. Though this is shortsighted, it is very human. In the upswing of the cycle we are dazzled and blinded by our hope that this will never stop. On our way down we stumble in darkness, thinking that we may be slipping into a bottomless chasm calling anxiously for help, eager to grasp at anything.

Earlier this year we heard a rumble for massive Government intervention to prevent a full-fledged depression. This phrase came from Arthur Burns, former Chairman of the President's Council of Economic Advisers, who asked for just such action last February. Although the clamor has died down somewhat in recent weeks, it still crops up in various high places.

[12] Prepared testimony of Sumner Slichter, p. 10.
[13] Compendium, p. 890.
[14] Ibid, pp. 439-440.
[15] Ibid, p. 510.
[16] Ibid., p. 202.
[17] Ibid., p. 709.
[18] Ibid., p. 627.

As recently as June 25 the distinguished Senator from Illinois, a member of the Finance Committee which conducted this study, in an article in the ADA World, gave this gloomy forecast and plea:

We are in a very serious recession. It is potentially more dangerous than either the 1948–49 or 1953–54 recessions, because it gives all the appearances of being a capital goods or investment recession rather than only an inventory recession, as the others were. In such a situation there is always the danger of a cumulative breakdown of the economy. While I am not predicting that this will happen, there is a real danger that it can happen. With employment, investment, and production at decreasing levels, the recession could snowball and avalanche downward very quickly. If that happened it would take massive applications of tax reductions, public works, monetary policies, and Government expenditures of all kinds to bring an upturn.

I know there are those who denounce any effort to make the facts known. It is said that this rocks the boat and destroys confidence. I do not subscribe to this point of view. I believe that those who cause the difficulty are the blind optimists who try to administer soothing sirup to the public. It is time for the administration to wake up to what has happened and to stop trying to bamboozle the people.[19]

That statement was made on June 25. It seems now that the turn came about the first of May.

There is much material in the record of the committee in 1958, and more in the record of the Senate itself, which indicates that this was the point of view of most people earlier this spring. There was a call for a two-pronged attack on the recession. Many of us were eager to forget all thoughts of sound fiscal policy and move in both directions away from a balanced budget, by simultaneously cutting taxes drastically, and stepping up Federal spending in all directions, particularly in the field of public works. At the same time, increases in public and private debt were to be encouraged and hastened by soft money policies. Among those who held this general view, the only disagreement was as to whether one or all methods should be used, and which should be emphasized.

There were many tax cutters and many public spenders. But in their answers to the committee's questionnaire, by far the overwhelming majority of the respondents favored a tax cut over increased spending for public works. Among the most commonly mentioned arguments against public works were these:

First. They are irreversible in nature.

Second. They would not get started in time, and might come into the next boom phase of the cycle and add to inflation.

Third. They tend to enlarge the size of basic government and its bureaucracy.

Fourth. They are inefficient in effect because they seldom occur in centers of existing unemployment. Detroit needs no new dams.

At the same time, it was pointed out that expenditures made in education and research would have long-range value. Unfortunately, in these fields, we have a shortage, not a surplus, of trained people. But even with these limitations, there were responses favoring public works which can be represented by the statement of Dr. Andreas G. Papandreou, chairman of the department of economics at the University of California, who was in favor of more spending, when he wrote:

I am much more impressed by the likelihood of success (success in the sense of cushioning the recession) of public expenditures. Public expenditures can be structured along regional lines in a fashion which will provide relief exactly where it is needed. Admittedly it takes time to begin spending appropriated money, but if my guess is correct that the recession will have depth and length this should not be a serious obstacle. It is not necessary for me to detail the nature of public expenditures which might be undertaken. Military projects, highway construction, and school-building programs should provide the major outlets. So far as the magnitude of the required expenditures is concerned, one can only guess. It seems to me that additional expenditures of between 5 and 8 billion dollars over the next 2 years will be adequate in providing a high floor to the current recession.[20]

I might add that already this year we have legislated an estimated $12 billion deficit for the current fiscal year of 1959.

Among the more numerous suggestions for tax reductions, there was a wide variety of specific proposals. Many different suggestions for tax changes affecting business were made. Prof. Charles C. Abbott of the University of Virginia suggested the elimination of all Treasury regulations affecting depreciation allowances. He wrote:

Let business management use its own judgment—so long as practice was consistent from year to year—a great stimulus would be given to business investment, one of the major keys to increased employment.[21]

Others urged long-range revisions such as those suggested in the Sadlack-Herlong bill.

In the field of personal income taxes many temporary programs were offered, including:

First. Suspension of the withholding feature for a limited period;

Second. A cut in rate on the first $2,000 of income;

Third. A refund of 10 percent on 1957 taxes.

One witness, Mr. S. C. Beise, president of the Bank of America National Trust and Savings Association, even suggested delegating to the President some power to alter tax schedules. These were his words:

Study the possibility of delegating to the President or Secretary of the Treasury (possibly with the concurrence of the appropriate committees of the Congress), the authority to reduce or raise personal or corporate income taxes when in his, or thier judgment this seems desirable.[22]

While this record was being developed in the committee, Congress was acting. Its decision was against massive tax cuts or major changes in tax philosophy, and in favor of increased spending. Professor Slichter recognized this in his personal appearance before the committee on April 18, 1958, in saying:

It seems to me that perhaps without really facing up to this issue Congress has decided it, because if Congress were to use the device of the tax cut, the time to have done that would have been early in 1958. Furthermore, it would have been desirable, in connection with the tax cut, to have gone easy on increasing spending.

But Congress did nothing about taxes. Congress provided for various increases in expenditures, and now, I think, we are going to need all of the money which our present tax rates will yield.

I do not object to a deficit in the cash budget if circumstances are appropriate for it. I think, as I said a little while ago, that we shall need in the next year a deficit of somewhere around 5 or 6 billion in the cash budget, but I am not prepared to advocate making large additions to that deficit by making important tax cuts.[23]

Congress has accepted to a degree the thesis that the recession is more serious than the inflation, and that to cure one, we must be willing to increase the other. Congress, by voting new spending programs in the face of falling revenues helped to create the deficit of $2.8 billion in fiscal 1958 and has committed the Government already to a deficit for fiscal 1959 variously estimated at $10 billion to $12 billion, or even more. Ironically, the upturn had apparently already commenced a month or more before fiscal year 1959 began. Only when that year ends can we measure how much true recovery we made, and at what a price in the reduced purchasing power of the dollar. We probably will have to wait much longer than that before we can return to a balanced budget again and measure the full sweep of the new inflationary spiral. If the next economic cycle is like the last two, we can expect the next recession in about 4 years, and unless we take more heroic efforts to dampen the inflation between now and then than we did in the recent boom, our problems will be greater, and our power to meet them may well be less.

Of course, in making this statement I realize that there was considerable testimony given to the committee to the effect that in times of recession, Government deficits are not inflationary, because they are merely an offset to weak consumer demand. In the present recession I find two weaknesses in this reasoning.

First. Consumer demand, as a whole, has held up very well through the current recession. I refer to the figures in the table at the beginning of this statement. There has only been a shift in demand from durables to soft goods and services. A Government deficit, of any size, is not going to strike at the basic problem here, a shift in consumer desires.

Second. Taking into account reduced tax revenues due to the recession, we already have legislated a deficit about twice as large as most of the committee witnesses suggested as necessary.

Then, too, I think there is danger in misinterpreting the responses to the committee's question No. 14, which asked:

How much of a factor in your opinion, has deficit spending by the Federal Government since the end of World War II been in contributing to or producing inflation?

[19] ADA World, June 25, 1958.

[20] Committee compendium, p. 670.

[21] Committee hearings, p. 2062.

[22] Compendium, p. 182.

[23] Hearings, p. 1836.

Most of the committee respondents recognized only a minor role from Government deficits since World War II. The following reply by F. W. Ecker, president of the Metropolitan Life Insurance Co., may be regarded as typical:

Directly, deficit spending by the Federal Government has not been a major factor among the forces contributing to monetary expansion during the period since World War II. For the most part, deficits were not financed by expansion of commercial or Federal Reserve bank credit. They were financed largely by nonfinancial corporations and individuals.

Monetary expansion within the period was very largely the result of borrowing by individuals and business. Indirectly, Government deficits did contribute to inflationary pressures. Financing of Government deficits by individuals and businesses absorbed funds which might otherwise have gone to finance a portion of the requirements of private enterprise which were financed by commercial banks.[24]

However, both the question and the replies need analysis. Note that the question asked for deficit spending since the end of World War II. At this point I should like to insert a table showing the year-to-year deficits from 1947 through 1958. Over the period the net total deficit is $15.3 billion, or an average of approximately $1¼ billion per year. Compared with the prospective deficit for fiscal 1959, the average annual deficit since World War II has been negligible. In fact, for the years 1958 and 1959 we face deficits of as large as those accumulated in all previous postwar years put together.

Mr. President, I ask unanimous consent that table V may be printed at this point in the RECORD.

There being no objection, the table was ordered to be printed in the RECORD, as follows:

TABLE V.—*Federal deficits*

[In millions of dollars]

Fiscal year	Budget receipts	Budget expenditures	Surplus (+) or deficit (−)
1947	39,786	39,032	+754
1948	41,488	33,069	+8,419
1949	37,696	39,507	−1,811
1950	36,495	39,617	−3,122
1951	47,568	44,058	+3,510
1952	61,391	65,408	−4,017
1953	64,825	74,274	−9,449
1954	64,655	67,772	−3,117
1955	60,390	64,570	−4,180
1956	68,165	66,540	+1,626
1957	71,029	69,433	+1,596
1958	69,083	71,897	−2,813

NOTE.—Total net deficit 1947–58, $15,304 million. Average annual deficit over the period, $1,275 million.

Source: Bureau of the Budget.

Mr. BENNETT. Mr. President, several witnesses, of whom Professor Haberler is typical, acknowledged that while deficits have not been large enough to be inflationary, large-scale Government spending itself, even with a relatively balanced budget, is inflationary. Likewise the ever-ready philosophy under the Unemployment Act of 1946 is a potent psychological inflationary factor. I quote from the professor:

I do not think that deficit spending by the Federal Government since the end of the war has been an important inflationary factor. But it cannot be denied that the large size of the budget (even if balanced) and the fact that the Government is ready to incur a deficit in periods of depression so as to counteract the decline in output and employment is, at least from the long-run standpoint, a highly inflationary factor.[25]

Others acknowledged that the good record since the end of the war does not cancel the pent-up inflationary pressures of the war years themselves. I quote from H. B. Arthur and Porter M. Jarvis, of Swift & Co., who replied as follows:

Deficit spending has, of course, been a contributing factor. However, much of the deficit spending that has shown up in the past decade in the form of inflation was actually spent or "planted" during the war itself. In other words, there was a great deal of spending and many commitments that could have been mopped up or liquidated in the early postwar period when deferred individual and corporate spending were being expanded so rapidly.[26]

If Messrs. Jarvis and Arthur are right, and now 12 to 17 years later, we are still reaping the harvest of inflation planted during the war years, how long will the new crop flourish which we are planting in the rich soil of the known deficits for fiscal 1959, and the expected deficits in the years immediately following?

Because this will probably be the last statement in this series of personal reports, I have two tasks to perform before I close it:

First. I must summarize this fourth statement as a separate unit.

Second. And in final conclusion, I want to summarize the whole series, and express my personal ideas about the solution of our inflation problem.

To summarize this particular statement on the relationship between the present recession and the continuing inflation: After analyzing all the ideas suggested as being causes of the recession, I believe they all bear out the basic assumption that this has been a typical period of readjustment following an economic boom. Of course, it is different in detail from the other two post-war cycles of boom and recession. This one has been spotty, with respect to certain industries, and clearly reflects a change in the buying pattern of consumers. While the personal disposable income has dipped only very slightly, consumer use of it has so changed as to bring a serious drop in the volume of consumer durables. While this was going on, industry, after an investment boom, was reacting with a drop in expenditure for capital durables. From these, and other less important factors, consequent recession touched most of the economy.

In spite of this, and largely because we have had a continuing pattern of wage increases outstripping increases in productivity, inflation has persisted even in the face of the downturn, and though dormant since the upturn, has not permitted the downward price adjustments which usualy occur in times of lowered economic activity.

The presence of both these economic diseases at the same time has posed a serious problem for us, and apparently we have decided that the short-time, close-range recession was more serious than the inflation, because we have embarked on a vast new Federal spending program and created our greatest peacetime deficit, totalling more than $12 billion, which will not be felt until after the economy has turned upward. Recent statistics from the National Bureau of Economic Research show that the "lead" indicators have been rising for 2 months now, yet the large Government deficit is still to come.

The time has come to fit this into the whole picture of this series. In the first statement, I identified inflation as the most serious problem revealed by the hearings, and their central theme. In the second, I discussed the monetary policies used to check the force of the inflation, and discussed the reasons they were not completely successful. In the third, I reported on the role of wage policies in producing the cost-push force in the inflationary spiral, and tried to focus attention on the central problem here—the fact that over the past dozen years, wages have risen faster than productivity. And in this fourth discussion, I pointed out how inflation helped create this recession, how it persists in spite of the economic downturn, how it is being started off again, under the guise of a cure for the recession. Through all this it must be obvious to those who read these statements that I believe inflation has been, and still is, our No. 1 economic problem, and that unless we face it and control it soon, it will do immeasurable damage to our economic future.

What can we do about it? Where shall we begin?

No one seriously concerned about the threat of present and continuing inflation to the economic solvency of the future could fail to get some ideas about the answer to these questions from the committee's record. For what they are worth, here are some of mine:

First. We cannot find our answer entirely in Government policies and programs. We cannot pass laws to cure inflation. Rather than curing it, increased Government interventions tends to sustain and intensify it. Certainly, that is the record of the last quarter century; and I believe that will be the result of many actions taken by this last session of the 85th Congress. When we try to give help without cost, greater spending without added taxes, special privileges for special groups, we are not creating something out of nothing. Rather, we are being political Robin Hoods in reverse, creating inflation which robs the poor for the purpose of rewarding political supporters. Inflation robs the past and future for the present. Once we intervene for one group, we are soon called upon to equalize this inequity by another intervention. Thus, we are always giving, but seldom counting the cost. The elected representative who tries to stem this tide risks being swept out of office by it. And the man who has courage to stand up to it is scorned and castigated.

Second. The fires of inflation can only be brought under control by the people themselves, beginning in the manage-

[24] Ibid., p. 217.

[25] Compendium, p. 626.

[26] Ibid, p. 240.

ment of their own lives and money. The problem is essentially a moral and spiritual one. We Americans have a lot of illusions to sweep away before we can see our economic future clearly.

Included among these illusions are these:

(a) That money is wealth, rather than a measure of wealth. True wealth is the result of work and thrift.

(b) That inflation creates wealth.

(c) That inflation creates and nurtures progress.

(d) That one individual can profit from inflation without harming another.

(e) That money can provide escape from personal responsibility.

(f) That debt creates wealth and raises living standards.

(g) That government can create wealth and values that people cannot create for themselves.

(h) That it is better to receive than to give.

(i) That life ever provides something for nothing.

Will the American people ever be able to throw off these illusions, and return to sound, realistic economic thinking? I have faith that they will. In fact, I believe they have already begun to do so. While some Members of Congress have been trying to whip this current mild recession into an excuse for a whirlwind of frantic Government economic action, there has been no great supporting public outcry. Of course, there have been some special-interest groups who have tried to take advantage of the apparent mood of Congress to push their particular programs, either tax cuts or spending programs beneficial to them. But while this has been going on, the ordinary people have been quietly going about their individual and personal programs, putting their own economic houses in order. These people have been stepping up the payments on their debts, saving more, and stretching out the life of their cars and other durables. By these policies and by exercising caution, prudence, and self-reliance in their buying of consumer goods, they are using the safest and most powerful kind of inflation control in the world. Perhaps we might call their actions the only true and effective method. At least we can be sure that unless backed up by such personal programs, no Federal programs will ever work successfully.

Since June 18, 1957, when the Finance Committee started on its hearings on the financial condition of the United States, we have seen both phases of the third post-war business cycle. We saw it rise to its peak in the third quarter of 1957. From then until April of this year, we lived through the natural adjustment which followed, which we call a recession. Now it looks as though we have begun the longer and slower climb to another summit—either in steady, sustainable growth or in a headlong rush to another boom and bust. What lies ahead we cannot tell. But so far as the cycle of 1954–58 is concerned, we can now feel that the worst is over. But while we may be on our way out of the woods on the current recession, the greater of our twin problems is still with us. The inflation born in World War II has persisted through three such cycles of both boom and recession—and while its fires seem dormant now, the deficits created by this very Congress may well be storing up the fuel which will cause them to flare up again soon in a wilder and more consuming flame.

As the hearings developed, the risks and problems of inflation became their central theme. Now as they close, it remains our dominant economic threat. If our country is to continue to grow in sound prosperity, control of inflation must be our chief economic goal. To me, this is the ultimate meaning and lesson of the Finance Committee hearings of 1957–58.

This concludes my formal statement.

Mr. President, I ask unanimous consent that there be printed in the RECORD, in connection with the statement, certain footnotes which identify quotations used in my speech.

The PRESIDING OFFICER (Mr. MORTON in the chair). Without objection, it is so ordered.

Mr. LAUSCHE. Mr. President, will the Senator from Utah yield to me?

Mr. BENNETT. I am happy to yield.

Mr. LAUSCHE. I wish to express to the Senator from Utah my commendation for his very masterly and sobering presentation of the problems which today confront the people of the United States. It would have been well if the Nation as a whole could have heard the analysis made by the Senator from Utah of the two vital problems of the recession and inflation. I am of the belief that if the people of the country had heard his speech, the approach to our problems would be far more encouraging than what is occurring today.

On yesterday, in the course of a radio program, I was asked what would be the issue in the 1958 campaign. It was suggested that the issue would be unemployment and recession. I would look with fear upon such a psychological approach by the people of the Nation to the problems confronting them today. The problem of inflation is no less important for consideration as an issue by the voters when they go to the polls.

I wish to subscribe to the statement of the Senator from Utah that actions taken by this Congress, contemplating a leveling of conditions and a stopping of the recession, have gone so far that the eventual sufferings of the public will be far greater than the good the Congress will have done by means of those actions. Congress pretended to provide a tonic, but the fact is that Congress built up a $12 billion deficit which will reflect itself in increased inflation. The stock market has gone utterly wild. It has been generally understood that those who are dealing in the stock market are anticipating a runaway inflation. When that happens, God pity the poor families. The present situation is Robin Hood in reverse, as has clearly been stated by the Senator from Utah—namely, robbing the poor to help the rich.

So, I wish to commend the distinguished Senator from Utah for his address. I am glad that, by chance, I happened to come to the Senate floor while he was speaking.

While I ask the people of the Nation to learn of what the Senator from Utah has stated—and, in that connection, I may suggest to the press that they could render no better service than to acquaint the public with the highlights of the address which has been delivered today by the Senator from Utah—I suggest that we, who are the Members of the United States Congress, study the address which the distinguished Senator from Utah has delivered.

STATEMENT BY SENATOR HARRY F. BYRD (D. VA.), CHAIRMAN OF THE SENATE FINANCE COMMITTEE, OPENING THE COMMITTEE'S EXAMINATION OF FISCAL AND MONETARY POLICIES. For release upon convening of the Hearings at 10 a.m., Tuesday, June 18, 1957.

The Senate Finance Committee, by resolution, today is undertaking to make a complete study of the financial condition of the United States, including --

(1) The revenue, bonded indebtedness, and interest rates on all public obligations, including contingent liabilities;
(2) Policies and procedures employed in the management of the public debt and the effect thereof on credit, interest rates and the Nation's economy and welfare, and
(3) Factors which influence the availability and distribution of credit and interest rates thereon as they apply to public and private debt.

This will be the first full dress examination of our fiscal and monetary policies since the one conducted by the Aldrich Monetary Commission in 1908.

The immediate occasion for this study is the existing credit and interest situation and, more important, inflation which has started again with its ominous threat to fiscal solvency, sound money and individual welfare.

Legislative matters relating to federal revenue and debt, tariff and trade, and social security and pensions are under the jurisdiction of this Committee. In the discharge of its direct responsibilities with respect to these subjects, the Committee has become convinced that serious conditions exist in the areas to be studied, and that these conditions have exceedingly dangerous potentialities.

It is the purpose of the Committee to explore these areas, examine the conditions, determine the cause, and so far as possible find the remedies.

To make such a study complete, the Committee must examine fiscal and monetary policies, mark the distinctions between them, and study their relationships, one to the other.

The hearings incident to this study are opened today against a background of historical facts, documented developments, and obvious conditions which are of grave concern to the Country and to every individual citizen.

Some of these facts, developments and conditions which necessarily must be examined by the Committee may be summarized as follows:

Generally speaking, the United States maintained itself on a pay-as-you-go basis until 1932. The principal exceptions were periods of war, and until World War II we hastened to pay off our war debts. For example, after World War I we paid our war debt down to $16 billion. But for the quarter of a century since 1932, the Federal Government has been virtually on a deficit financing basis in all but five years. We have been at peace three-fourths of that period.

Debt

Now our direct federal debt is $275 billion. This direct debt is practically even with the statutory debt limit which this Committee has preserved as a safeguard against even greater excessive spending.

In addition to the $275 billion in direct debt there are more than $250 billion in contingent liabilities, and effort will be made at this time to determine to what extent these contingent liabilities may become an actual charge on the Treasury.

State and local debt have been rising steadily since 1946. All public debt, federal, state and local, is now estimated to total more than $325 billion.

Debt increase has not been confined to public operations. Private and corporate debt also has been on a constant rise. Commercial bank loans are now at their all time high.

All debt in this country estimated as of last December totals nearly $800 billion:

Corporate	$253 billion
Private	213 billion
Federal	277 billion
State and local	50 billion
TOTAL	793 billion

This is an increase of $200 billion, or about 33 per cent, in four years.

Expenditures

With only temporary exceptions to the rule, federal expenditures have been rising continually, and in recent years -- since 1954 -- the greatest increases have been in strictly domestic-civilian programs; not military and foreign aid. State and local governments have been following suit. Combined federal, state and local expenditures from tax revenue, miscellaneous receipts and borrowing are running to a total of more than $132 billion annually.

Taxes

In the past 25 years we have raised federal taxes to their all-time high in both rate and take. Now, four years after the Korean War, we are still practically on a war-time federal tax rate.

State and local taxes are rising steadily. Total receipts -- federal, state and local -- are nowestimated at approximately $110 billion for fiscal year 1958, as compared with the pre-World War II total of $14.6 billion in 1940. (These figures exclude state and local miscellaneous receipts from such sources as business-type activities.)

As a measure of magnitude, it may be noted that taxes are now nearly equivalent to one-third of the national income as reported by the U. S. Department of Commerce.

This Committee is vitally concerned with the question as to how long our economy can absorb taxation of these proportions and still provide the stimulus of the profit motive necessary to the free enterprise system. When the currently continuing Korean War taxes were imposed on corporations, Mr. C. E. Wilson, formerly president of General Electric Company, said these rates could not be endured indefinitely by American industry. Mr. Wilson made this statement in testimony before this Committee as Chairman of the Office of Defense Mobilization.

The Committee is equally concerned over the question as to whether we can risk even higher taxation or debt which is likely to result from increased spending at either the federal, state or local level, or all down the line.

Inflation

In its consideration of the debt resulting from all of the easy credit, both public and private, which we have been experiencing for nearly a quarter of a century, this Committee can never lose sight of the fact that the Government's fiscal integrity depends upon a stable currency.

This involves not only the value of the money with which the Government redeems its own bonds, but it involves also the savings, pensions, life insurance, etc., of the people of the Nation which can be kept intact only by a stable dollar.

When the Government increases expenditure programs, it contributes to the inflation spiral and thereby increases costs, and perhaps the cost of living, taxes and debt. Secretary of Defense Wilson recently demonstrated the effect of inflation on the cost of government. He said it will take $38.5 billion in fiscal year 1958 to buy what $33.4 billion bought for defense in 1954.

The Committee cannot overlook the fact that responsibility for sound currency is a prime responsibility of the central government. Yet, the value of the American dollar dropped more than 47 cents in 12 years, between 1940 and 1952 -- more than 9 cents in one year, 6 cents in another year, and another 9 cents in another year, etc. Generally speaking, it stabilized at around 52 cents in 1953, 1954 and 1955. Now it is losing value again. From April 1956 to April 1957 it lost nearly 2 cents, and now it is worth 49.8 cents as compared with the 1940 dollar. The indications are that inflation is continuing, and perhaps accelerating.

The squeeze of this inflation, even at this point, is being felt seriously by individuals of fixed incomes, and in businesses which can not pass on inflated costs. The cost of living has increased steadily for eight consecutive months.

Actually, confidence in the American dollar is the principal deterrent in the world today to Russian aggression. The pages of history detail the stories of nations which have been wrecked by unsound fiscal policies and debased currencies. If the value of the dollar continues to drop at the rate of 2 cents a year, as it has in the past year, it will be worth only 25 cents in 12 years, as compared to the 1940 dollar.

This Committee wants to know the causes of this new inflation, and it wants to find the remedy before the consequences become disastrous.

Interest

The Committee has reason to be concerned also over the fact that the cost of money is rising. The Federal Government offered 3-5/8 per cent interest on a recent five-year bond issue which was taken only in small measure despite the highest interest rate in 34 years.

The Committee has been watching the cost of interest on the federal debt for some time. Interest is now taking more than 10 cents out of every tax dollar collected from American citizens. If the federal debt were refinanced at 3-5/8 per cent interest, it would cost taxpayers $10 billion a year.

Interest paid by the Federal Government is taken as a standard, and refinancing any substantial part of the nearly $800 billion total debt in the country at a percentage of increase in interest comparable to that already offered by the Federal Government is a matter of general concern. It would place new burdens on all consumers.

General

There is obvious need for appraisal in all of the areas covered by the resulution under which the Committee is working to determine to what degree the present prosperity is sound.

The Committee would be remiss in its duty if it did not examine the possibility of a recession even though it may be a minor one. Few people realize the great effect levels of income have upon budget receipts. For example, if present corporate and personal income levels dropped to the level of only two years ago, that is the 1954-1955 level, the budget surplus we have today, according to estimates by the Joint Committee on Internal Revenue Taxation, would be converted to a deficit of $12 billion.

With the federal debt at its present precarious heights, miscue in its management can be costly. The same sort of tremendous responsibility rides on every action through the Federal Reserve System.

It is easy for a nation indulging in excessive expenditures, taxation, debt and credit to close its eyes to reality. It is easy to charge the whole matter off to growth. But our growth is not commensurate.

In this statement I have touched on only some of the matters of vital concern which prompted this study. From its years of experience with the fiscal affairs of the Nation, the Senate Finance Committee is acutely aware of the importance and complexity of its work, and it approaches the undertaking with a consciousness of its implications.

It is the Committee's purpose to conduct an objective examination to clarify the situation and be helpful in the effort to avoid further inflation, and to establish sound fiscal principles flexible enough to meet possible recessions as well as increasing prosperity.

As Chairman of the Committee, it will be my purpose to see that each member is afforded opportunity to develop all phases of the vital questions before us. It is the desire of the Chairman that the discussion at public hearings be completely free, so that out of the wisdom of the individual Senators may come helpful contributions, and out of the collective wisdom of the Committee may come constructive recommendations.

The fact that the Committee is composed of men of great capacity, and long training in business and fiscal affairs is a source of pride and confidence to the Chairman. We open these hearings sincerely hoping that the effort will be worthwhile.

For the record, and the information of the witnesses and the public, the Committee has agreed to the following rules of procedure:

1. The witness will not be interrupted while he is presenting his prepared statement.

2. Questioning by members of the Committee will be in order of seniority, beginning with the Chairman, followed first by the ranking Democratic member, then the ranking Republican member, and so on until each member has had an opportunity to interrogate.

3. No limitation on time will be imposed on a Senator during the first round of questioning of the first witness.

4. No Senator will be asked to yield part of his questioning time to another member. However, one Senator may yield his entire time to another member for questioning if he so desires. The Senator yielding will take the turn of the member to whom he yields.

The Chair takes the liberty of making one further suggestion. In the interest of a compact record, it is suggested that statistical matter and other documentary type material be placed at the conclusion of the testimony in the record for each day's hearing.

The first witness is the Honorable George M. Humphrey, Secretary of the Treasury.

STATEMENT BY SENATOR HARRY F. BYRD (D. VA.), CHAIRMAN OF THE SENATE FINANCE COMMITTEE, OPENING THE HEARING OF WILLIAM McCHESNEY MARTIN, CHAIRMAN, BOARD OF GOVERNORS, FEDERAL RESERVE SYSTEM, IN THE COMMITTEE'S EXAMINATION OF FISCAL AND MONETARY POLICIES. For release upon convening of the Hearing at 10 a.m., Tuesday, August 13, 1957.

Mr. Martin, the Chair assumes that you know the Senate Finance Committee is undertaking to make a complete study of the financial condition of the United States, including -

(1) The revenue, bonded indebtedness, and interest rates on all public obligations, including contingent liabilities;

(2) Policies and procedures employed in the management of the public debt and the effect thereof on credit, interest rates and the Nation's economy and welfare; and

(3) Factors which influence the availability and distribution of credit and interest rates thereon as they apply to public and private debt.

This study has been undertaken as a result of conditions confronting the Committee in the discharge of its direct responsibilities for legislative matters relating to federal revenue and debt, tariff and trade, and social security and pensions.

These conditions involve the existing credit and interest situation and, more important, inflation which has started again with its omninous threat to fiscal solvency, sound money and credit, and individual welfare.

The Committee is exploring these areas and examining the conditions in a serious effort to determine the causes, and so far as possible find the remedies.

To make such a study complete, the Committee must examine fiscal and monetary policies, mark the distinctions between them, and study their relationships, one to the other.

In the discharge of its more direct responsibilities, the Committee is necessarily more familiar with other policies involved than it is with monetary and credit policies. The record at this point in the study contains the testimony of the Secretary and the Under Secretary of the Treasury as a basis for consideration of fiscal policy and debt management.

The Federal Reserve Board determines general monetary and credit policy and, as a basis for consideration of this aspect of the conditions which confront us, the Committee would be pleased to have your testimony, as Chairman of the Board, with respect to these and related subjects.

You are invited to procede in your own way to a discussion of conditions, policy and action in this area, but for the record it would be appreciated if, at the outset, you would briefly -

1. Summarize the provisions of the Federal Reserve Act, as amended;

2. Outline the powers, facilities, functions, and responsibilities of the Federal Reserve System and the Board;

3. Describe their organization;

4. Review their relationships with the fiscal agencies and policies of the government, and the banking system of the nation; and

5. Explain the purposes of monetary and credit policy, how it is made, why and when it is changed, and how it is implemented.

In addition, it would be helpful to the Committee if, in the course of your statement, you would discuss the following questions:

1. What, in your own words, is the best simple layman's definition of inflation?

2. Are we in a period of inflation now and when did it start?

3. Do you regard inflation as our greatest domestic problem at this time?

4. What are the factors which ordinarily cause and contribute to inflation?

5. What caused the value of the dollar to decline between 1940 and 1952?

6. Why did it stabilize between 1952 and April 1956?

7. With basic production generally equal to or in excess of demand, and in the absence of deficit financing, what caused the decline in the value of the dollar to be renewed in April 1956, and the continual decline since that date?

8. Can present inflation be traced in any degree to increased federal spending started in fiscal year 1956, and the easy availability of federal loans, and federal guarantees and insurance on mortgages, since that time?

9. To what extent is this inflation being caused by increasing labor costs in a degree out of proportion to labor's increase in productivity?

10. To what extent is this inflation being caused by increasing interest costs in a degree out of proportion to the increased productivity of the money borrowed.

11. Is inflation being accelerated now? If so, what is the cause? If not, what is the stabilizing influence?

12. If inflation continues, how far can it go, and what will be the effects in the process?

13. Once inflation is started, how can it be stopped and can the value of the dollar ever be regained?

14. Generally, will you distinguish between fiscal policy (embracing expenditures, taxes and debt), and monetary and credit policy, and then relate them, one to the other?

15. How does Federal Reserve policy accelerate or control inflation? Roughly, will you list in chronological order the major Federal Reserve policy actions in this respect since World War II?

16. Is fiscal policy action usually necessary as a complement to Federal Reserve policy action with respect to money and credit? If so, will you list recent instances of such policy combinations, cite the occasions, and evaluate the effects or results?

17. I quote Section 2 of the so-called Full Employment Act of 1946:

   "The Congress hereby declares that it is the continuing policy and responsibility of the Federal Government to use all practical means consistent with its needs and obligations and other essential considerations of national policy, with the assistance and cooperation of industry, agriculture, labor, and state and local governments, to coordinate and utilize all its plans, functions, and resources for the purpose of creating and maintaining, in a manner calculated to foster and promote free competitive enterprise and the general welfare, conditions under which there will be afforded useful employment opportunities, including self-employment, for those willing, and seeking work, and to promote maximum employment, production, and purchasing power."

   Will you estimate and describe the weight of this statutory requirement on Federal Reserve decisions? Will you estimate and describe the weight of this statutory requirement on the combination of monetary, credit, and fiscal policy decisions?

18. What are the Federal Reserve plans further to combat inflation and decline in the value of the dollar?

In your testimony it is not necessary that you take these questions in the order I have listed them; please treat them in any combination better arranged for clarity of discussion but I would like a written statement concisely answering these questions - to be submitted at the conclusion of your testimony.

MARTIN--flannel board
text and statements

1957

August 19

Note:

On appearing before Committee on August 19
Mr. Martin read portions of the attached
statement--

Paragraph II on page 2; then paragraphs III and IV

to the end of the memorandum.

August 19, 1957.

There are four lines of inquiry pursued by Senator Long in his questioning on which I would like to comment:

Assertion I--The American economy today is not characterized by a shortage of manpower.

Assertion II--The American economy today is not confronted with a shortage of physical capacity to produce.

Assertion III--Consumer disposable income, at its present purchasing power, has not grown during the past year.

Assertion IV--More production is the best cure for inflation.

I would like to take up these four questions separately and point to the pitfalls.

I. It is true that the percentage of unemployment today is higher than in 1951, 1952, and 1953, but this does not mean that the current rate of employment is not pressing on our manpower resources. As I said in my statement, "Despite the existence in some lines of reduced employment and slack demand, many employers have rising costs when they seek to expand activity by adding appreciably to the number employed. Often the manpower required has to be bid away from other employers." In other words, under current conditions of very high employment, further efforts to stimulate output on the scale suggested would soon spark a further rise in costs which would accelerate the inflation spiral. I am appending a technical appraisal of the unemployment figures cited in the hearings. It throws considerable light on the problem.

II. My statement pointed out that specific bottlenecks in capacity that impeded growth in production a year ago have been largely relieved and that individual bottlenecks are no longer the cause of bidding up of prices of individual commodities because of limited availability. This does not mean, however, that materially higher utilization of current plant capacity would not entail rising costs. The extent of the upward pressure would vary from one line to another depending upon the technical efficiency of the reserve capacity, as well as many other considerations. The direction would be toward higher costs and higher prices everywhere.

III. The assertion that consumer disposable income has not increased during the past year disregards the inflation which is our problem, by stating it in terms of ex-inflation dollars. Consumer personal income available for spending has grown appreciably both in absolute amount and on a per capita basis during the past year. It is the largest single component, by far, of the total spending stream that has sustained the continued rise both in wholesale prices and in the cost of living. If consumers had saved a larger proportion of this income, it would have been available for the financing of schools, highways, and capital plant without contributing further to inflation and the reduction in the value of their spending dollars. As it is, the inflation that has actually occurred has offset in large part the buying power of the increase in consumer disposable income.

This sort of development is not exceptional during a period of inflation. For example, practically all of the gains in real weekly earnings in manufacturing industries since World War I have come in periods of price stability. From mid-1946 to mid-1948, a period of sharp inflation, both consumer prices and average weekly earnings rose by close to 25% and there was little gain in real wages. From mid-1948 to mid-1950, however, there was little change in prices, but a gain in the purchasing power of weekly earnings of about 10%. From mid-1950 to the spring of 1952 sharply rising prices again offset rising weekly earnings. During the ensuing long period of stability in the cost of living, lasting until early 1956, the rise in money earnings was reflected in comparably large gains in real wages. Since that time further large wage increases have been largely nullified by the inflation. Thus during the whole period since the war, the appearance of inflation has coincided with a leveling off of real wages.

IV. Increased production per se does not cure inflation. Money income is generated in the process of production and becomes part of the spending stream. As was pointed out on Tuesday, one man's expense is another man's income. Consequently, increases in production in themselves add to the flow of spending as well as to the flow of goods. Increased output to the full extent permitted by our capabilities is good, provided, of course, that it is the right production and is financed in such a way as to promote continued prosperity. However, if there is excess money demand present in the economy at a time when resources are actively employed that excess will cause a rise in prices. Increased production under these circumstances will add to the spending stream as well as to the stream of goods and services. It will not, therefore, eliminate the excessive money demand that is the cause of rising prices. For inflation to be curbed, excess money demand must be absorbed from the spending stream. This may come about by the development of a budget surplus, by increased planned savings, by curtailed borrowing from banks or by a slowing down in the growth of the money supply or in its turnover. It does not result automatically from increased production.

No one would maintain that a cessation of production--the reverse of this proposition--would stop a deflation. Likewise, an increase in production does not in and of itself stop an inflation. The unhappy condition of France today is a standing example of this fact. It sharply increased its production as well as its productivity but it failed to take measures adequate to reduce the excess money demand that was necessary to avert a crisis.

Attachment--"Factors Accounting for Differences in Unemployment; 1951-mid-1953 and 1957" (prepared by Murray Wernick)

August 16, 1957.

Factors Accounting for Differences in Unemployment;
1951 - mid-1953 and 1957

Current unemployment

First, in terms of perspective, it is worthwhile examining current levels of unemployment. In July 1957 unemployment totaled 3.0 million, or 4.3 per cent, of the civilian labor force based on new definitions which were adopted starting January 1957. If old definitions were used (and data on the old basis are the only data comparable with earlier periods), unemployment in July would have been reported as 2.7 million, or 3.8 per cent, of the labor force. The summer months tend to be the high months in the year in respect to unemployment because of a large influx of students and graduates looking for summer jobs. As students leave the labor force in September and as the usual fall expansion in industrial activity gets under way, unemployment drops rather sharply. Between July and October unemployment can usually be expected to decline by 700,000 to 800,000. Thus, if only season factors affect unemployment between now and fall, the number of workers seeking jobs in October of this year will be only about 2.2 million (new definition).

Since early 1955 seasonally adjusted unemployment has remained virtually unchanged with the unemployment rate moving within a one-half per cent range and with no consistent trend in either direction.

During this period over 3 million workers were added

etc.

Copy read from Aug 13

Our country has been experiencing a period of unusual prosperity, featured by heavy spending, both governmental and private. As a nation, we have been trying to spend more than we earn through production, and to invest at a rate faster than we save. The resulting demands, strong and incessant, have pressed hard upon our resources, both human and material. In consequence, prices have been rising, and the purchasing power of the dollar has been falling.

It is of the utmost importance to bring to bear on this critical problem all of the information and intelligence that we can muster. That is what you are seeking, and that is why this opportunity to appear here is timely and most welcome. We are not facing a new, or an insoluble problem--it is as old as the invention of money--and history is marked with both defeats and triumphs in dealing with this invisible but deadly enemy of inflation. The question is not whether we can solve the problem, but how best to deal with it under our form of government and free enterprise institutions. Solve it we can--

solve it--and

and must.

You have been inquiring particularly into fiscal policies, and it is equally important to inquire into credit and monetary policies. They are closely interrelated, and are the two paramount and time-tested means available to the Government in combatting inflation. There are undeniably practical limitations of timing and scope upon both, but they are the most effective weapons in the arsenal against this destructive invader. In fact they are indispensable.

By way of preface and for the record I should like to outline first the general structure and organization of the Federal Reserve System. Then I want to go into the nature and the character of the problems the nation is now facing. in this area.

Federal Reserve Structure

The Federal Reserve Act of 1913 was the outgrowth of prolonged Congressional study of the history of central banking in other countries and of our own experience, particularly with the First and Second Banks of the United States. The Congress, seeking to avoid either political or private domination of the money supply, created an independent institution which is an ingenious blending of public and private participation in the System's operations under the coordination of a public body -- the Federal Reserve Board -- here in Washington.

This question of "independence" has been thoroughly debated throughout the long history of central banking. On numerous occasions when amendments to the Federal Reserve Act were under consideration the question has been reexamined by Congress and it has reaffirmed its original judgment that the Reserve System should be independent -- not independent of Government, but independent within the structure of the Government. That does not mean that the reserve banking mechanism can or should pursue a course that is contrary to the objectives of national economic policies. It does mean that within its technical field, in deciding upon and carrying out monetary and credit policy, it shall be free to exercise its best collective judgment independently.

The Reserve System is an instrument of Government designed to foster and protect the public interest, so far as that is possible through the exercise of monetary powers. Its basic objective is to assure a monetary climate that permits economic growth together with stability in the value of our money. Private citizens share in administering the System but, in so doing, they are acting in a public capacity. The members of the Board of Governors and the officers of the Federal Reserve Banks are in a true sense public officials. The processes of policy determination are surrounded with carefully devised safeguards against domination by any special interest group.

Broadly, the Reserve System may be likened to a trusteeship created by Congress to administer the nation's credit and monetary affairs -- a trusteeship dedicated to helping safeguard the integrity of the currency. Confidence in the value of the dollar is vital to continued economic progress and to the preservation of the social values at the heart of free institutions.

The Federal Reserve Act is, so to speak, a trust indenture that the Congress can alter or amend as it thinks best. The existing

System is by no means perfect, but experience prior to 1914 suggests that either it or something closely approximating it is indispensable. In its present form, it has the advantage of being able to draw upon the knowledge and information of the directors and officers of its 12 banks and 24 branches in formulating and carrying out credit and monetary policies.

Board of Governors

The Board of Governors, as you know, is composed of seven members appointed by the President and confirmed by the Senate, each for a term of 14 years. In appointing the members of the Board, the President is required to give due regard to a fair representation of the financial, agricultural, industrial, and commercial interests, as well as the geographical divisions of the country. From among these members the President designates a Chairman and a Vice Chairman for terms of four years. Some of the functions of the Board of Governors are (1) to exercise supervision over the Federal Reserve Banks; (2) to fix, within statutory limits, the reserves which member banks are required to maintain against their deposit liabilities; (3) to review and determine the discount rates which are established biweekly at each Federal Reserve Bank, subject to approval of the Board in Washington; (4) to participate, as members of the Federal Open Market Committee, in determining policies whereby the System influences the availability of credit primarily through the purchase or sale of Government securities in the open market; (5) to fix margin requirements on loans on stock exchange collateral; and (6) to perform various supervisory functions with respect to commercial banks that are members of the System and to administer Federal Reserve, Holding Company, and other legislation.

Federal Reserve Banks

Each Federal Reserve Bank has a board of nine directors, of whom six are elected by the member banks. Of these, three are bankers, one from a large, one from a medium, and one from a small bank. Three more must not be bankers, but must be engaged in some nonbanking business. The other three members are appointed by the Board of Governors in Washington, which also designates one to be the Chairman and another the Deputy Chairman. None of these three may be an officer, director, employee, or stockholder of any bank. The directors of a Reserve Bank supervise its affairs. Subject to approval of the Board of Governors, they appoint the President and First Vice President. Subject to review and determination by the Board of Governors, they establish discount rates.

The stock of each Federal Reserve Bank is held by the member banks of its district. This stock does not have the normal attributes of corporate stock; rather, it represents a required subscription to the capital of the Reserve Bank, dividends being fixed by law at 6 per cent. The residual interest in the surplus of the Federal Reserve Banks belongs to the United States Government, not to the Bank's stockholders.

Federal Open Market Committee

The Federal Open Market Committee consists, according to law, of the seven members of the Board of Governors, together with five Presidents of the Federal Reserve Banks. Four of these five Presidents serve on a rotating basis; the fifth, the President of the Federal Reserve Bank of New York, is a permanent member of the Committee. Since June, 1955, when its Executive Committee was abolished, this Committee has usually met at three-week on a number of occasions 2 weeks intervals to direct the sale and purchase of securities in the open market. In practice, all twelve Presidents attend these meetings and participate freely in the discussion, although only those who are members of the Committee vote. —

Federal Advisory Council

The Federal Reserve Act also provides for a Federal Advisory Council of twelve members. One is elected by the Board of each Reserve Bank for a term of one year. The Council is required by law to meet in Washington at least four times each year. It is authorized to confer directly with the Board of Governors respecting general business conditions and to make recommendations concerning matters within the Board's jurisdiction. /

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Judging Economic Trends

The work of the System requires a continuous study and exercise of judgment in order to be alert to the way the economy is trending and what Federal Reserve actions will best contribute to sustained economic growth. Such decisions are often hard to make because of the existence of cross-currents in the economy. Even in generally prosperous times, some parts of the economy may not fare as well as others. Credit policy must, however, fit the general situation and not reflect unduly either the condition of certain industries experiencing poor business, or that of other industries enjoying a boom. Residential construction illustrates this point. In 1956 and so far in 1957 demand pressures on available resources have been generally strong and prices have been moving up, but housing construction has receded considerably from its 1955 peak. The home-building industry undoubtedly could supply housing at a faster rate than is now prevailing. But even at the current volume, building costs continue to increase. The prices of some building materials have fallen, it is true, but the over-all cost of housing construction has increased appreciably even in the face of moderately lower demand. The explanation is to be found in the fact that expenditures for all major types of construction except residential have been maintained at or above record levels. This example shows why credit policy must take account of the over-all situation, and can not be deterred unduly by special cases that are not typical of the whole.

which complicates

Another factor complicating economic interpretation is that even in a period of broad advance and upward pressure on prices, there may be lulls when conditions seem to be stabilizing and the next turn of events is difficult to appraise. The flexible character of monetary policy permits prompt adaptation to changed circumstances.

Purposes

The objective of the System is always the same -- to promote monetary and credit conditions that will foster sustained economic growth together with stability in the value of the dollar. This goal may be thought of in human terms. The first part may be considered as concerned with job opportunities for wage earners; the latter as directed to protecting those who depend upon savings or fixed incomes, or who rely upon pension rights. In fact, however, a realization of both aims is vital to all of us. They are inseparable. Price stability is essential to sustainable growth. Inflation fosters maladjustments. In some periods these broad aims call for encouraging credit expansion; in others, for restraint on the growth of credit. The latter is what is required at present, for clearly the most critical economic problem now facing this country, is that of inflation, or put in the terms of the man on the street, it is the rising cost of living.

The Current Problem of Inflation

This problem is far different from the one that beset us during the depressed 1930's, and left an indelible impression on our thinking. The problem then was one of drastic deflation with widespread unemployment, both of men and material resources. Today's problem has persisted through the years since World War II. It consists of inflationary price increases and the economic imbalances that have resulted.

This is the overriding problem that faces the Federal Reserve System today, for a spiral of mounting prices and wages seeks more and more financing. It creates demands for funds in excess of savings, and since these demands can not be satisfied in full, the result is mounting interest rates and a condition of so-called tight money. If the gap between investment demands and available savings should be filled by creating additional bank money, the spiral of inflation which tends to become cumulative and self-perpetuating would be given further impetus. If the Federal Reserve System were a party to that process, it would betray its trust.

Conflicting Views on Causes

There is much current discussion of the origin of inflationary pressures. Some believe they reflect a recurrence of demand-pulls, similar to those present in the earlier postwar period. Others believe they originate in a cost-push engendered by administered pricing policies and wage agreements that violate the limits of tolerance set by advances in productivity.

These distinctions present an oversimplification of the problem. Inflation is a process in which rising costs and prices mutually interact upon each other over time with a spiral effect. Inflation always has the attributes, therefore, of a cost-push. At the same time, demand must always be sufficient to keep the spiral moving. Otherwise the marking up of prices in one sector of the economy would be offset by a reduction of prices in other sectors.

There is much to be said for the view that contractual or other arrangements designed as shelters or hedges from inflation have the effect of quickening its tempo. The 5 per cent rise in the cost of living which we have experienced over the last two years has probably reflected and been reflected in more rapidly rising wage costs because of the prevalence of cost of living clauses in many modern wage contracts. Cost plus contracts tend to have the same quickening effect on the inflationary spiral.

The spiral is also, however, a demand spiral. At each point of time in the development of the inflationary spiral, there must be sufficient demand to take the higher-priced goods off the market and thus keep the process moving.

The Inflationary Spiral

The workings of the spiral of inflation are illustrated by the economy of the moment. As has been brought out at some of the earlier hearings of this Committee, we are now faced with the seeming paradox that prices are expected to continue to rise, even though the specific bottlenecks in capacity that impeded the growth of production in 1956 have now been largely relieved, and investment in productive facilities continues at very high levels. Houses, automobiles, household appliances, and other consumer goods, as well as most basic materials, are all readily available--at a price. The problem is no longer one of specific shortages or bottlenecks causing prices of individual commodities to be bid up because of limited availability but rather it is one of broad general pressure on all of our resources. In other words, aggregate demand is in excess of aggregate availabilities of these resources at existing prices.

Taking the situation as a whole, as individuals, corporations, and governments proceed with their expenditure plans, buttressed by borrowed funds, they are in the position of attempting to bid the basic factors of production -- land, labor, and capital -- away from each other and in the process the general level of costs and prices is inevitably pushed upward. Recently, this general pressure has been expressing itself particularly in rising prices for services as compared with goods. Despite the existence in some lines of reduced employment and slack demand, many employers now face rising costs when they seek to expand activity by adding appreciably to the number employed. Often, the additional manpower required has to be bid away from other employers. As a result, many current plans for further expansion of capacity place great emphasis on more efficient, more productive equipment rather than on more manpower.

This generalized pressure on resources comes to a head in financial markets in the form of a shortage of saving in relation to the demand for funds. A considerable volume of expenditure is financed at all times out of borrowed funds. When these funds are borrowed from others who have curtailed their own expenditures, no additional demand for resources is generated. On balance, however, demands for funds by those who have wanted to borrow money to spend in excess of their current incomes have outrun savings. Those who have saved by limiting their current expenditures, and thus made funds available for lending, have still not kept pace with the desire of governments, of businesses, and of individuals to borrow in order to spend.

Just as an intense general pressure on available resources manifests itself in rising wages and prices, a deficiency of savings relative to the demand for borrowed money manifests itself in an increase in the price of credit. In such circumstances, interest rates are bound to rise. The rise in rates might be temporarily held down by creating new bank money to meet borrowing demands, but this, as I have said, would add fuel to inflation and bring about further increases in demands. In the end, as prices rose ever faster, interest rates could not be held down. In summary, whatever the special features of the current inflation, the important fact is that it is here, and that it has created demands for borrowed funds in excess of financial savings, even though these have grown appreciably. Any attempt to substitute newly created bank money for this deficiency in savings can only aggravate the problem and make matters worse.

Effects of Higher Interest Rates

The response to higher interest rates is complex. One result is that some would-be borrowers draw on cash balances to finance projected expenditures or lenders draw on their balances to lend at the higher rates, thus reducing their liquidity and increasing the turnover of the existing money supply. In recent years, with the large volume of Federal Government securities outstanding, many holders of these securities -- both institutions and individuals -- have liquidated their holdings in order to shift funds to other uses. This has been an important influence in bringing about the decline in bond prices. To the extent that accumulated cash balances or other past savings can be used more actively, expenditures remain high relative to available resources and prices tend to rise, but the reduced financial liquidity eventually exerts restraint on borrowing and spending.

Another result of higher interest costs, together with greater difficulty in obtaining loans, is that many potential borrowers revise or postpone their borrowing plans. To the extent that expenditures are revised or deferred, inflationary pressures are reduced.

The most constructive result is the encouragement of a volume of savings and investment that permits continued expansion of productive facilities at a rate consistent with growing consumption demands. Only in this way can the standard of living for a growing population be improved and the value of savings be maintained.

Such constructive adaptations, if made in time at the onset of inflationary pressures, need not be large in order to restore balance between prospective demands and the resources available to meet them. It is essential, however, that the adjustment be made. Otherwise prospective expenditures will continue to exceed the resources available and the pressure of excess demand will foster an inflationary spiral.

Expectations of Continuing Inflation

Once such a spiral is set in motion it has a strong tendency to feed upon itself. If prices generally are expected to rise, incentives to save and to lend are diminished and incentives to borrow and to spend are increased. Consumers who would normally be savers are encouraged to postpone saving and, instead, purchase goods of which they are not in immediate need. Businessmen, likewise, are encouraged to anticipate growth requirements for new plant and equipment. Thus, spending is increased on both counts. But, because the economy is already operating at high levels, further increases in spending are not matched by corresponding increases in production. Instead, the increased spending for goods and services tends to develop a spiral of mounting prices, wages, and costs.

Unfortunately, during the past year, as price indexes gradually rose, some segments of the community apparently became reconciled to the prospects of a "creeping" if not a "runaway" inflation. One of the baneful effects of inflation stems from the expectation of inflation. While a price increase, in itself, may cause serious dislocations and inequities, other and more serious effects occur if the price rise brings with it an expectation of still other increases. Expectations clearly have a great influence on economic and financial decisions. In fact, decisions to spend or to invest too much in a given time are a direct cause of inflation. Also, if further inflation is expected, speculative commitments are encouraged and the pattern of investment and other spending--the decisions on what kinds of things to buy--will change in a way that threatens balanced growth.

"Creeping Inflation"

The unwarranted assumption that "creeping inflation" is inevitable deserves comment. This term has been used by various writers to mean a gradual rise in prices which, they suggest, could be held to a moderate rate, averaging perhaps 2 per cent a year. The idea of prices rising

2 per cent in a year may not seem too startling--in fact, during the past year, average prices have increased by more than 2 per cent--but this concept of creeping inflation implies that a price rise of this kind would be expected to continue indefinitely. According to those who espouse this view, rising prices would then be the normal expectation and the Federal Reserve accordingly would no longer strive to keep the value of money stable but would simply try to temper the rate of depreciation. Business and investment decisions would be made in the light of this prospect.

Such a prospect would work incalculable hardship. If monetary policy were directed with a view to permitting this kind of inflation--even if it were possible to control it so that prices rose no faster than 2 per cent a year--the price level would double every 35 years and the value of the dollar would be cut in half each generation. Losses would thus be inflicted upon millions of people, pensioners, Government employees, all who have fixed incomes, including people who have part of their assets in savings accounts and long-term bonds, and other assets of fixed dollar value. The heaviest losers would be those unable to protect themselves by escalator clauses or other offsets against prices that were steadily creeping up.

Moreover the expectation of inflation would react on the composition of savings. A large part of the savings of the country is mobilized in savings deposits and similar claims that call for some stated amount of dollars. If people generally come to feel that inflation is inevitable, they will not save in this form unless they are paid a much higher interest premium to compensate them for the depreciation of their saved dollars. It is for this reason that it is impossible, in a period of demand in excess of savings, to maintain lower interest rates through a policy of "easy" credit. The country is experiencing a period of generally high employment in which investment outlays remain high, but if fears of inflation cause people to spend more of their incomes and save less, the result could only be more rapid inflation and still less saving in relation to income. Such saving as remained, furthermore, would be less and less in the form of loanable funds to finance homes, highways, school construction, and other community needs.

Effects on Productive Enterprise

An inflationary psychology also impairs the efficiency of productive enterprise--through which our standard of living has made unparalleled strides. In countries that have had rapid or runaway inflations, this process has become so painfully obvious that no doubt remained as to what was happening to productivity. In the making of decisions on whether or not to increase inventory, or make a capital investment, or engage in some other business operation, the question of whether the operation would increase the profit from inflation became far more important than whether the proposed venture would enable the firm to sell more goods or to produce them at lower cost. The incentive to strive for efficiency no longer governed business decisions .

and the consumer is the man who suffers.

Productivity--Key to Sustained Prosperity

Why have real wages in this country risen to the highest levels in the world, thus permitting our standard of living to rise correspondingly? Certainly, it is not just because wages have risen as the cost of living has risen. The big source of increase has been the increasing productivity of our national economy. Real incomes have gone up because the total size of the pie, out of which everybody receives his share, has grown so magnificently. What has enabled the productivity of the American economy to achieve the levels that make all this possible? One vital factor has been the striving by so many people, each in his own field, for better and more efficient ways of doing things. Equally important has been the willingness to set aside a part of current income to provide the machines, tools, and other equipment for further progress. Both are essential if our standard of living and material welfare are to go on advancing.

Effects of Inflation

Inflation does not simply take something away from one group of our population and give it to another group. Universally, the standard of living is hurt, and countless people injured, not only those who are dependent on annuities or pensions, or whose savings are in the form of bonds or life insurance contracts. The great majority of those who operate their own businesses or farms, or own common stocks or real estate, or even those who have cost of living agreements whereby their wages will be raised, cannot escape the effects of speculative influences that accompany inflation and impair reliance upon business judgments and competitive efficiency.

Finally, in addition to these economic effects, we should not overlook the way that inflation could damage our social and political structure. Money would no longer serve as a standard of value for long-term savings. Consequently, those who would turn out to have savings in their old age would tend to be the slick and clever rather than the hard-working and thrifty. Fundamental faith in the fairness of our institutions and our Government would deteriorate. The underlying strength of our country and of our political institutions rests upon faith in the fairness of these institutions, in the fact that productive effort and hard work will earn an appropriate economic reward. That faith cannot be maintained in the face of continuing, chronic inflation.

There is no validity whatever in the idea that any inflation, once accepted, can be confined to moderate proportions. Once the assumption is made that a gradual increase in prices is to be expected, and this assumption becomes a part of everybody's expectations, keeping a rising price level under control becomes incomparably more difficult than the problem of maintaining stability when that is the clearly expressed goal of public policy. Creeping inflation is neither a rational nor a realistic alternative to stability of the general price level.

"Pegging" the Market

It has been suggested, from time to time, that the Federal Reserve System could relieve current pressures in money and capital markets without, at the same time, contributing to inflationary pressures. These suggestions usually involve Federal Reserve support of the United

States Government securities market through one form or another of pegging operations. There is no way for the Federal Reserve System to peg the price of Government bonds at any given level unless it stands ready to buy all of the bonds offered to it at that price. This process inevitably provides additional funds for the banking system, permits the expansion of loans and investments and a comparable increase in the money supply--a process sometimes referred to as monetization of the public debt. The amount of the inflationary force generated by such a policy depends to some extent upon the demand pressures in the market at the time. It would be dangerously inflationary under conditions that prevail today. In the present circumstances the Reserve System could not peg the Government securities market without, at the same time, igniting explosive inflationary fuel.

Do Rising Interest Rates Add to Inflation?

We must be clear in viewing these relationships to distinguish cause from effect and not to confuse them. It is sometimes said that rising interest rates, by increasing the costs of doing business, lead to higher prices and thus contribute to inflation. This view is based upon an inadequate conception of the role of interest rates in the economy, and upon a mistaken idea of how interest costs compare with total costs. In municipal government budgets, it is about 2 per cent; in many utilities, it is 3 to 5 per cent. Thus, as an element of cost, interest rates are relatively small; but as a reflection of demand pressures in markets for funds, interest rates are highly sensitive. As previously explained, rising interest rates result primarily from an excess of borrowing demands over the available supply of savings. Since these demands are stimulated by inflation, under these circumstances rising interest rates are an effect of inflationary pressures, not a cause. Any attempt to prevent such a rise by creating new money would lead to a much more rapid rise in prices and in costs than would result from any likely increase in interest rates. Such an attempt, moreover, would not remove the need for a fundamental adjustment in the relation between saving and consumption and would probably fail in its purpose of stabilizing interest rates.

Basic Factors in Recent Inflationary Pressures

A major cause of recent inflationary pressures has been the attempt to crowd into this period a volume of investment greater than the economy could take without curtailing consumption more than consumers have been willing to do. In fact, there has been some increase in consumption on borrowed funds. Increases in interest rates naturally come about under such conditions; they are the economy's means of protecting itself against such excessive bunching of investment or the building up of an unsustainable rate of consumption. While the effect of a moderate change in interest rates on the cost of goods currently being produced and sold is small and relatively unimportant, changes in interest rates do assume importance as a cost in the planning of new investment outlays. These costs do not affect current operations or add to upward price pressures to any substantial extent. They do tend to deter the undertaking of new investment projects and to keep the amount of investment spending that is being undertaken in line with the economy's ability to produce investment goods. To maintain artificially low interest rates under these conditions, without introducing any other force to restrain investment, would be to invite an unbridled investment boom, inflation, and an inevitable collapse later.

It is necessary to emphasize that there are many influences, other than monetary policies and interest rates, that affect the volume of consumption, investment, and saving and their relationships. Monetary policies operate directly through the volume of bank credit and bank-created money. The volume of current saving out of income and the uses made of new and outstanding savings have a more important bearing upon the availability of investment funds than bank credit. Interest rates, therefore, are influenced by the relationship between investment demands and the availability of savings, independently of monetary policies. Interference with these relationships through monetary policies, in fact, may prevent necessary and healthy adjustments that help to maintain equilibrium in economic growth.

In a Nutshell

A. An inflationary spiral is always characterized by:

   1. An interaction between rising costs and rising prices; and

2. An increase in over-all effective demand sufficient to keep the spiral going. As prices generally keep rising, a larger and larger volume of demand (in dollar terms) is needed to sustain the same volume of transactions (in physical terms).

As long as it persists, therefore, an inflation will always show evidence of both demand pulls and cost pushes with their relative manifestations shifting as the inflation runs its course.

B. The tempo of interaction between rising costs and rising prices will be speeded up if the situation is characterized by:

1. The release of a previously created overhang of pent-up money demand (such as existed when direct controls broke down or were relaxed at the end of the war).

2. The creation in volume of new money demand through excessive credit expansion and/or activation of existing cash balances (such as happened when war broke out in Korea).

3. The widespread existence in the economy of escalators which act automatically to transfer rising costs or prices into rising prices and costs (cost of living clauses in collective bargaining agreements, cost plus contracts, etc.).

4. The degree to which a speculative psychology backed by effective demand pervades business decisions.

C. The tempo of interaction between costs and prices will also be affected by the degree to which administered prices and wage rates are prevalent in the economy. These effects are not always in the same direction. The net effect of the many and various factors influencing administered prices and wages sometimes tend to slow up and sometimes to accelerate price movements, depending upon the particular circumstances.

D. Whatever the mix of the above ingredients, an inflation once under way will tend to persist as long as the credit necessary to finance the rising level of costs and prices is forthcoming. Credit may be supplied through new bank credit expansion or by activation of already existing money.

E. Whatever its antecedent characteristics, an inflation will tend to feed upon itself and be accentuated once the investing and saving public come to think of further inflation as the prospect.

F. It is the nature of inflation hedges to act as aggravating rather than equilibrating factors.

G. No one suffers more than the little man from the ravages of inflation.

H. A monetary authority dedicated to promoting the public welfare must not relax restraints in the face of continuing inflationary pressures, since any efforts to relax merely add to the forces tending to keep the inflation in motion.

What More Can Be Done?

How, then, may further inflation be restrained? Bluntly, the answer is to be found in a moderation of spending, both governmental and private, until the demands for funds are balanced by savings. This prudence must be coupled with sound fiscal policy, which means a larger budget surplus as well as effective monetary policy to restrain the growth of bank credit.

Among the factors influencing saving and consumption are those fiscal policies relating to taxes and governmental budgets. These require special attention because they are not as responsive to changes in the availability of credit and interest rates as are private activities. Untimely fiscal policies can create or aggravate imbalance in the economy and thus dilute the effectiveness of monetary policies. On the other hand, fiscal measures that help to maintain balance can reduce the degree of restraint that monetary policies might otherwise have to exert.

Experience over the centuries has demonstrated that there is no tolerable alternative to adequate fiscal and monetary policies, operating in an environment of open, competitive markets under our system of human freedoms. Neither an economic dictatorship nor complacent acceptance of creeping inflation is a rational or tolerable way of life for the American people.

There is no panacea, no magical means of assuring orderly economic growth, nor are we much more likely in the future than in the past to achieve perfect performance in the timing and execution of policy and action. We have every reason to believe, nevertheless, that we can discern and follow the right path. Thus, it is clear that the present situation calls both for a larger budgetary surplus than we have had or have in prospect, and a continuance of restraint upon creation of new supplies of money.

Action Required

Let us not follow the defeatist path of believing that widespread unemployment is the alternative to inflation.

There is no question that the Federal Government and the American people, pulling together, have the power to stabilize the cost of living. The only question is, whether there is the will to do so.

If the will is there, and it is demonstrated convincingly to the American people, the cost of living can be stabilized, interest rates will relax, and a sufficient volume of savings will be encouraged to provide for the economic growth needed in this generation and the next.

This Committee and the Congress can contribute greatly to that end by declaring resolutely--so that all the world will know--that stabilization of the cost of living is a primary aim of Federal economic policy.

The goal of price stability, now implicit in the Employment Act, can be made explicit by a straightforward declaration and directive to all agencies of the Government that anti-inflationary actions are to be taken promptly whenever the cost of living begins to rise.

The Executive and Legislative branches of Government, in conjunction, can assure adjustment of Federal revenues and expenditures so that, in times when total spending threatens to burst the bounds of capacity and drive up the cost of living, the Federal Government will set an example of restraint in outlays and at the same time produce a surplus to counter inflationary pressures from any quarter.

The Congress and the Executive can take steps to assure that free and vigorous competition is maintained in all segments of the economy as the bedrock of our free enterprise system.

The Federal Reserve System, itself a creation of the Congress, can--and I assure you that it will--make every effort to check excesses in the field of money and credit that threaten the cost of living and thus undermine sustained prosperity and growth of our economy.

In all of these ways we can, if we have the will, set the face of the nation so resolutely against inflation as to keep that enemy from our gates.

No greater tragedy, short of war, could befall the free world than to have our country surrender to the easy delusion that a little inflation, year after year, is either inevitable or tolerable. For that way lies ultimate economic chaos and incalculable human suffering that would undermine faith in the institutions of free men.

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INTRODUCTION

It is not our purpose here to forecast the future of the dollar nor to predict the course of economic events in the months that lie ahead. We propose merely to recall for you certain basic facts and fundamental economic principles with which the monetary authorities and all thinking citizens should be, and are, vitally concerned.

The first basic fact with which we are confronted is that America has been thrust into a position of world leadership. I use the term "thrust" advisedly for I am sure that the responsibilities inherent in this position of leadership are not particularly welcomed by the average American. Nevertheless, we find ourselves the principal bulwark against further communistic encroachment. American economic strength is the principal defense of the free world against engulfment by the forces of Soviet Russia. And certainly we must concede that the keystone of America's economic strength is the value of the American dollar. Thus it behooves us to protect the value of our dollar with all the capacity and sagacity at our command, both against attacks from without and attacks from within. Your money's worth has meaning for peoples throughout the world.

The second basic fact is that in the past several decades our economy has undergone a fundamental shift - from an economy with a deflationary bias to one with a distinctly inflationary bias.

From the days of the earliest settlers of this country until a mere four decades ago one of the prime limiting factors in the Nation's fabulous growth was our money supply. As the population grew and spread the country was plagued with a series of so-called "money panics" - our money supply just could not adjust itself with sufficient rapidity to the growing needs of the economy. Following the last of these panics in 1907, the National Monetary Commission was created. Its recommendations were largely the basis for the Federal Reserve Act, one of the stated objectives of which was to establish an elastic currency. Certainly in the years following we have not suffered from a short money supply; as a matter of fact, our problem in recent years has been too much money.

In the past couple of decades we have accelerated this shift to an inflationary bias through numerous measures which have gained wide acceptance and many of which have been written into the law of this country - unemployment compensation, minimum wages, "escalator clauses" in wage contracts, old age benefits, a program of farm price supports, production controls, "peril-point" tariff provisions. In addition to these anti-deflation curbs which we have built into our economy, the Congress has declared it to be the established policy of this nation to exercise the powers of government to achieve and maintain employment and production at maximum sustainable levels. In other words, we are now confronted and must deal with an entirely different situation. As the economists say, we now have a new "frame of reference".

The third basic fact is that in the last several years this inflationary bias has been intensified by the pressures of World War II, the Korean conflict and other developments, with the result that your money's worth has been under severe attack. The ensuing inflation has cut its value almost in half - it is now a "49 cent" dollar.

Much that we shall have to say today will be couched in terms of inflation. But not because of the short-run outlook. We do so for three reasons:

(1) Today was born yesterday! If we are to understand how we got to where we are, we must review the road we have traveled.

(2) In the interest of conserving time we shall treat only one side of the picture. Deflation is essentially the reverse of inflation. As we proceed, we shall see that the causes of each are but the opposite of the other; even the remedies are essentially reverse applications of the same medicines.

(3) No matter what the short-run outlook, the long range prospect is inflationary.

Well, just what has the patient's history shown? Let's take a glance at INFLATION'S FEVER CHART

(INFLATION'S FEVER CHART)

for the period since the Japanese surrender. Let's see just how deeply the virus of inflation has infected the bloodstream of our economy. In the relatively short time since the close of World War II, prices consumers pay have risen 55 %.

(PRICES CONSUMERS PAY UP 55 %)

Of course, rapidly rising prices are no more a cause of inflation than fever is the cause of a patient's illness; both are but manifestations of an ailment - but both are very good indicators of the extent of the disorder. Let's see just what has been taking place in the postwar period.

In August 1945,

(AUGUST 1945)

the Bureau of Labor Statistics' Index of Consumer prices stood at 78, based on the 1947-49 period as 100. Business was then busily converting to peacetime production. Controls were still in effect and in the succeeding ten months

(JUNE 1946)

consumer prices rose only 2 points.

At the end of June 1946, most direct controls were lifted.

(LIDS OFF)

BINGO! We got almost immediate proof that controls do not prevent inflation; controls merely dam up - postpone - the demand. When the flood gates are again opened - before consumer goods become plentiful - this pent-up demand bursts upon the market with the effect of a tidal wave; business spending pours into the market, seeking inventories, plant expansion and more equipment; and prices are forced higher and higher. The inevitable happened - prices spiraled. By August, 1948,

(AUGUST 1948)

the index hit 105 - a 25 point rise in just 26 months.

By then, however, much of the overhanging consumer demand had been satisfied. Certain fiscal and monetary actions were taking effect. Inventory accumulation had about run its course - in fact, many businesses found themselves overstocked and the pipelines were full. Business activity began to slow and, somewhat later, a relatively mild recession got under way and continued through 1949 - the BLS index sliding to 100 as of February 1950.

(FEBRUARY 1950)

In the first half of 1950, a strong upward pressure was again evident. In spite of decreased Federal spending and a substantial rise in production, the consumer price index crept up another point or two. And then, what happened? KOREA!

(KOREA)

On top of this high level of business activity, we superimposed a huge war and military aid budget. With plants already going full-blast, with labor scarce, with consumers mindful of shortages in the recent war and possessed of abundant disposable income and liquid savings, another buying wave was on and prices spiraled.

Then, selective controls were imposed on instalment and real estate credit; other monetary and fiscal measures were taken; "scare buying" subsided somewhat; the balanced inventory position blunted the edge of consumer buying; and higher prices, themselves, brought buyer resistance. These and other factors induced a lull in the feverish rise of consumer prices and the index leveled out in March and April at about 110.

(APRIL 1951)

During the next six years, our nation enjoyed the most sustained period of price stability in its history, with consumer prices rising five points in six years.

(APRIL 1956)

But prices started edging upward in the spring of 1956, and consumer prices had risen to 120 by June of 1957.

(NOW)

A rise in prices is just another way of saying the dollar has depreciated in terms of purchasing power in some base period. Since our chart is based on the 1947-49 average, an index figure of 120 means that in terms of prices then, a dollar today is worth only 83 ¢. However, in terms of prewar purchasing power, say in comparison with 1939 average prices, the dollar is worth only 49 ¢.

The real question that all this poses is: how will our Fever Chart read six months or a year from now?

(ARROW - ?)

Will we be able to maintain our present sidewise movement? Will deflationary tendencies bring a real downturn?

(TIP ARROW DOWN)

Or will resurgent inflationary pressures push our Fever Chart even higher?

(TIP ARROW UP, THEN LEVEL)

These are the questions confronting not only the monetary authorities but every one here in this room.

In a gathering such as this I know it is not necessary to dwell on WHO GETS HURT BY INFLATION?

It's the fixed income groups - beneficiaries of trusts and life insurance policies, widows and pensioners.

It's the savers and investors - the <u>real</u> value of their holdings steadily declining.

It's the businessman - caught in the cost-price squeeze.

It's the white collar workers and all salaried employees.

It's the taxpayer - getting less and less for his tax dollar.

It's all of us - some suffering more than others.

But <u>whoever</u> gets hurt you may be sure of <u>who'll</u> get the blame - the banker!

(FINGER OF BLAME - BANKER)

Deprivation, suffering and hardship follow in the train of inflation whether or not it reaches the runaway proportions that wrecked the economies of Germany and France and China; whether or not it brings a flight from the dollar as in the case of the Italian lira and Greek drachma. Inequities and maladjustments grow and savings and investments shrink just as surely in the less spectacular forms of inflation such as this country has been undergoing.

Inflation creates such an aura of prosperity and national well-being, and works to undermine the nation's economy in such insidious ways, that it presents one of the chief threats to the defense of the dollar and our way of life. Inflation rears its head in so many places and its effects vary so among different groups that confusion is bound to result whenever we look only at the <u>effects</u> of inflation. For that reason I think we should look very closely at the nature of the disease and its spread.

Perhaps we might best begin by defining our terms. For our purposes we have adopted a fairly simple but thoroughly sound definition: "INFLATION IS A FLOW OF SPENDINGS IN EXCESS OF THE FLOW OF GOODS AND SERVICES."

(INFLATION IS A FLOW OF SPENDINGS IN EXCESS OF THE FLOW OF GOODS)

Conversely, <u>deflation is a flow of spendings too small to support the flow of goods and services</u>.

(EXHIBIT CARD WITH DEFINITION OF DEFLATION)

I find it easier to understand this concept by remembering that one man's expense is another's income.

(ONE MAN'S EXPENSE IS ANOTHER'S INCOME)

Let us assume that this factory

(FACTORY)

is typical of any and all industry and that this machine operator

(MAN)

represents not only the plant's labor costs

(SHORT BROAD ARROW)

but all other expense as well. What is <u>expense</u> to the factory is <u>income</u> to the worker. In turn, the worker's expenses -

(LONG BROAD ARROW)

his suit of clothes from the merchant, for example - become income to the retailer

(RETAIL STORE)

and others from whom he buys. The merchant then incurs expenses for clerks and replenishments of inventory,

(SHORT BROAD ARROW)

his expenses becoming income to the employees, the factory and others. Here we have the flow of spendings, carrying with it the flow of goods and services. If there is no change in the flow of spendings or in the flow of goods, then there is no pressure on prices.

It is an economic truism that income may never exceed spendings. Whether by consumers, business or Government, only that which is spent can become income. On the other hand, spendings may be either more or less than current income. We can spend more by withdrawing savings -

(BANK; SMALL ARROW)

the spending of income of a prior period; or by borrowing -

(SMALL ARROW)

anticipating future income. We can spend less than current income by saving part of it,

(SMALL ARROW)

or by paying off debt.

(SMALL ARROW)

This is as true for business and industry as for the consumer.

Government

(HAT)

derives its income primarily from taxes

(THREE SMALL ARROWS)

and it can levy its taxes at any point of this income flow. Normally, the taxing - in and of itself - is deflationary; it draws dollars from the spending stream. On the other hand, expenditures by the Government for goods and services adds money to the spending stream.

(THREE SMALL ARROWS)

These two processes, however, are distinctly separate.

Just as in the case of individuals and business, Government can spend less than it takes in taxes - running a surplus or retiring debt as it did in the first few post-war years. Also, Government can spend more than it takes in taxes - or need I mention that? Of course, deficit financing - spending in excess of taxes - puts pressure on prices.

In a period of mobilization - of military build-up and extensive foreign aid - the Government not only may be spending more than it takes in taxes,

(TWO SMALL ARROWS)

but the diversion of strategic and scarce materials into defense production tends to limit the flow of goods available for consumers. Thus, additional funds are flowing into the hands of defense workers and others at a time when the supply of consumer goods cannot be correspondingly increased. The result is twin pressures on prices - more dollars chasing fewer goods. To the extent that these spendings can be diverted into savings,

(MOVE SMALL ARROW)

siphoned off into the purchase of savings bonds, for example, the pressure on prices is relieved. That's why bond purchases are such effective anti-inflation medicine.

(ASSISTANT REMOVES FEVER CHART)

In spite of appearances, one vital aspect has been left out of this picture. What makes possible this flow of spendings? More important, what makes possible an increase in the spendings flow such as we had during the war and since? Of course, I am talking about the supply of money and the turnover of money, that is, the rate at which funds are being used over and over again. Don't underestimate the importance of the turnover of money - an increase in the velocity or rate of turnover has the same effect on the flow of spending as an increase in the money supply. The flow of spending cannot increase without an increase in the rate at which we use our money, or an increase in the money supply itself. Just a couple of points about the money supply.

(OUR MONEY SUPPLY)

First, when we speak of money we don't mean <u>just</u> "folding green." Our nation's money supply includes not only "currency in circulation" but "deposit money" as well. You can spend by check even more readily than in cash. As a matter of fact, 90% of the business of the country is done by check today.

Second, banks add to the money supply whenever they make a new loan or purchase securities from other than a bank. Let's see how this has worked out in practice.

In 1939,

(1939 CHART)

"currency outside of banks"

(CURRENCY)

was slightly more than $6 billion, while deposits

(DEPOSITS)

in the hands of the public - so-called deposit money - totaled about $57 billion. Shortly after the end of the war, year-end 1945,

(1945 CHART)

currency in circulation had jumped to $26 billion, while privately owned bank deposits had shot up to more than $124 billion - an increase in the money supply of nearly $88 billion or 140%. This increase, more than three-fourths of which was in deposit money, laid the foundation for out postwar inflation.

Nor did the growth stop with the close of the war, in spite of expectations to that effect. Today

("NOW" CHART)

our money supply totals $220 billion - a rise of almost [redacted] 300% since 1939. And all of this postwar increase came from deposits, for currency in circulation has remained fairly constant at $26 to $28 billion.

The increase in the money supply did not cause inflation, but it did make it possible. The question, then, is how did we get this increase in the money supply?

The money was created as credit was demanded of and granted by the banking system

(LOANS AND INVESTMENTS)

of the country. Every security purchased from outside the banking system and every new loan granted by a bank means a corresponding increase in deposits; not for the individual bank in all cases, but for the banking system as a whole. In 1939

(1939 CHART)

loans and investments of banks totaled $51 billion, of which $19 billion were U. S. Government securities,

(U. S. SECURITIES)

$9 billion were other securities,

(OTHER SECURITIES)

and $22 billion were loans.

(LOANS)

By 1945

(1945 CHART)

banks had increased their holdings of Governments, in helping to finance the war, to $101 billion. Holdings of other securities were unchanged, loans were up slightly, to $30 billion, the total was at $140 billion. Since then,

(1954 CHART; ASSISTANT CLEARS BOARD WITH SPENDINGS FLOW)

holdings of Governments have declined to $ 63 billion, other securities have risen from $9 billion to $ 21 billion, and loans have more than tripled, rising from $30 billion to $ 114 billion.

Credit extended during the war years was primarily through purchase of Government securities. Credit extended in the postwar period was in response to demands for loans by business and consumers. However, it makes no difference in the effect on the money supply whether the credit resulted from an expansion of public debt - through the purchase of Government securities - or an expansion of private debt - through loans to business and individuals.

The parallel and causal relationship between the rise in bank loans and investments and the growth of the money supply is apparent. It is equally clear that while the growth of the money supply through bank credit did not cause inflation, it made possible the excess spendings which did cause inflation.

These are important questions for every citizen, but they are particularly significant for the monetary authorities and others, who are charged with endeavoring to attain and maintain economic stability. Monetary authorities are concerned primarily with the cost and availability of money as a means of influencing the spending stream; attempting to moderate swings in the economy by indirection - by influencing the economic climate - and leaving to individuals the freedom of choice as to specifics.

(ASSISTANT CLEARS BOTH BOARDS)

The objectives, of course, are to create "easy" money conditions when business is depressed and to restrain the growth of the money supply in boom times. The Federal Reserve authorities, for example, can create conditions of ease in the money market, but they cannot make banks lend nor business borrow. Monetary policy is less effective in stimulating recovery than in putting restraint on a boom, but even in the latter case, the application of restraints cannot be made without due concern for the financing needs of Government and the management of our national debt. There are both inherent and practical limitations to the effectiveness of available tools of monetary policy.

To indicate the magnitude of the forces with which we must contend and to list the medicines for arresting further spread of the virus of inflation, it is my pleasure to present

YOUR MONEY'S WORTH

In continuing the diagnosis of the patient's illness, I'd like to convert this spendings flow into dollars and cents figures.

Spendings of consumers,

(CONSUMER)

business

(BUSINESS)

and Government

(GOVERNMENT)

make up the total of our spending flow. By tracing their movements relative to the flow of goods and services you can get a much clearer picture of the nature and extent of our postwar inflation. By looking ahead to probable future spendings of each component, relative to prospective changes in output, you can make a reasonable stab at predicting the course of the patient's illness in the months that lie ahead.

Let's take a close look at the first few postwar years. Our patient felt pretty rough. His fever was mounting rapidly from year-end 1945 through the first quarter of 1951.

During this period of five and a quarter years, spending of consumers jumped from an annual rate of $128 billion to an annual rate of $210 billion.

(SET DIAL)

Business investment jumped from $14 billion to $57 billion.

(SET DIAL)

Government spending at year-end 1945 included $49 billion of war spending, and totaled $55 billion, but was falling fast. By first quarter 1951 Government spending had climbed back to $52 billion,

(SET DIAL)

including $27 billion for war. Total spending

(TOTAL SPENDING)

for output has risen from $197 billion to $319 billion,

(SET DIAL)

up $122 billion.

In physical terms -

(PHYSICAL OUTPUT)

this is, in dollars of 1945 purchasing power - we were able to increase our flow of goods and services in the same period from an annual rate of $197 billion to about $228 billion.

(SET DIAL)

Of the $122 billion increase in spending, about $31 billion went into increased purchases of goods and services; $91 billion was wasted in higher prices.

(CONSUMER PRICES)

The consumers' price index jumped from 78 to 110, as ____________________ pointed out.

(PUT MERCURY IN THERMOMETER)

<u>This is inflation</u> - a flow of spending which increases faster than the flow of goods and services. The excess spending inevitably spills over into higher prices; there's no other place for it to go.

This increase in the flow of spending could not have happened without either an increase in our money supply,

(MONEY SUPPLY)

or an increase in the rate at which it is being used -

(TURNOVER)

the turnover of the money supply.

From year-end 1945 through first quarter 1951 our money supply rose from $151 billion to $172 billion.

(SET DIAL)

But people had also been using their money faster. That $10 bill that you got yesterday and spent again today will be "turned over" many times before the end of the year. It's rather difficult to measure the turnover of currency, but we can measure the turnover of checking accounts, and they're money too. The turnover of checking accounts in 338 centers throughout the country had jumped from 13.5 times a year at year-end 1945 to 19

(SET DIAL)

times a year in early 1951.

These are the factors which permitted the growth in spending which caused the upward pressure on prices. The swollen spending stream relative to the flow of goods and services is the inflation. The inevitable result is an increase in prices.

Now let's look at another period of about the same length - the 6 1/4 years since the first quarter of 1951. The permissive factors moved up again - they had to, to permit growth in the economy. The money supply, $172 billion in 1951,

?

(SET BOTH HANDS AT 172)

is now $ 220 .

(SET DIAL)

Turnover has also increased, from 19

(SET BOTH HANDS AT 19)

to 23 times a year.

(SET DIAL)

Each of the components of spending has increased. Consumer spending has gone from $210 billion

(SET BOTH HANDS AT 210)

to $ 278 ;

(SET DIAL)

business expansion from $57 billion

(SET BOTH HANDS AT 57)

to $ 69 ;

(SET DIAL)

Government spending from $52 billion

(SET BOTH HANDS AT 52)

to $ 87 .

(SET DIAL)

Total spending has risen 36%, from $319 billion

(SET BOTH HANDS AT 319)

to $ 434 .

(SET DIAL)

But during <u>this</u> period of roughly five years the flow of spending was held in a more reasonable relation to the flow of goods and services our nation could produce. Output rose from $319 billion

(SET BOTH HANDS AT 319)

to $ 386 .

(SET DIAL)

Of the $ 115 increase in spending, $ 67 was matched by the rise in output. Only $ 48 found its way into prices. Consumers' prices rose only 10 points.

(SET THERMOMETER)

Whatever the future holds for our patient, the chills and fever he faces from time to time arise from a common cause - a flow of spending too large or too small in relation to the flow of goods and services our productive machine can turn out.

With this, we have completed the diagnosis of the patient's illness. Now let's take a look at what is available to treat the illness; what are our PRESCRIPTIONS FOR STABILITY?

(PRESCRIPTIONS FOR STABILITY)

Logically, the most desirable treatments fall under the heading of NATURE'S REMEDIES.

(NATURE'S REMEDIES)

Most frequently mentioned as an anti-inflation medicine is increased PRODUCTION.

(PRODUCTION)

We've seen that the basic problem involved in inflation is the flow of spendings relative to the flow of goods and services. We as individuals or as businessmen can contribute directly to the fight against inflation to the extent that we can increase production. Increased production, of course, adds to the flow of goods, and offsets some of this excess spending stream that's bidding up prices. However, increased production does not necessarily provide a solution to the inflation problem. Take for example increased production brought about by time-and-a-half payments for overtime work, which may well add more to the spending stream than to the increase of output.

The real contribution in this area is from increased PRODUCTIVITY -

(REMOVE PRODUCTION: PUT UP PRODUCTIVITY)

increased output per man-hour. This increased productive capacity is brought about by business investment. While business is spending for the acquisition of capital assets, it is actually adding to the inflation problem by pouring additional spendings into our spendings stream. However, once this additional capacity becomes available, the larger flow of goods and services serves to offset some of our excess spending.

The second of nature's remedies is INCREASED SAVING.

(SAVING)

By saving, I mean not spending. We save by building up our liquid savings, but we also save by repayment of debt. A dollar saved - pulled out of the spending stream - is one dollar which does not continue to go around bidding up prices.

Increased saving also contributes to a long-run solution of the problem, by making available savings which can be used to build up the capital stock of our country, and thereby increase tomorrow's productivity.

This can be too effective. Back in 1933 we were saving every dollar we could get our hands on, and we saved enough to shrink the spendings stream until it wouldn't support our flow of goods and services.

It has been effective in a more helpful way in the past 6 years. Remember where this fever chart ____________ had up here leveled off in the Spring of 1951? It was just about that time that consumers decided to stop spending so much, and save a little bit. They had been saving about 3½ cents out of every dollar of income after taxes. By the end of the year, it had jumped to 9 cents out of every dollar of income after taxes. Since then, the rate's dropped back to about 7 cents out of a dollar - about 2 times the rate in first quarter 1951. This was one of the very important factors contributing to that leveling off of the price index.

If nature's remedies do not prove adequate

(PULL DOWN RIBBON BY "NATURE'S REMEDIES")

to solve the problem of inflation, the next logical step is the use of PREVENTIVE MEDICINES.

(PREVENTIVE MEDICINES)

These fall under the headings of FISCAL POLICY

(FISCAL POLICY)

and MONETARY POLICY.

(MONETARY POLICY)

Fiscal policy relates to any action taken by Government in the field of taxing, spending, and management of the public debt. DECREASED SPENDING

(SPENDING)

of Government is a very effective anti-inflationary medicine. To the extent that Government can cut down on the number of dollars it adds to the spending stream, a contribution has been made toward solving the problem of inflation. Defense spending, which accounts for most of the Federal budget, is well below its peak, but is expected to move up slightly from present levels.

INCREASED TAXES

(TAXES)

are within limits directly deflationary. Taxation pulls dollars out of the spending stream, and thus directly serves to reduce it. After the beginning of hostilities in Korea, taxes were increased to the highest levels in United States history, peace or war. Subsequently taxes have backed off from these record levels.

The MANAGEMENT OF THE PUBLIC DEBT

(DEBT MANAGEMENT)

has an important role in the treatment of the virus of inflation. To the extent that our national debt can be placed with nonbank investors, we avoid the creation of new money which so frequently accompanies Governmental deficits. It is important that the debt be so "tailored" that it will be attractive to bona fide investors who will hold the debt to maturity, rather than dump it on the market where it may be picked up by the banking system, thus swelling our already overgrown money supply. It is also important that the debt be so "tailored" that it attracts funds which would have been spent otherwise, rather than attracting savings, which would have had an effect of their own.

As far as the relationship of these two

(POINT AT "TAXING" AND "SPENDING")

is concerned - and that does not cover the entire field of Government action which influences inflation or deflation - it is difficult to realize that from year-end 1945 through 2nd Quarter 1957 the Treasury took in - in cash - $ 18 billion more than it paid out.

($________________)

The most important medicines of monetary policy fall under the heading of GENERAL

(GENERAL RESTRICTIONS)

treatments which mark out the limits of play, but do not restrict the actions of individual players. The indirect influence of these general treatments is brought to bear through member bank reserves, which are the key to the money creating ability of banks. By affecting the access of banks to reserves, these general monetary medicines influence the cost and availability of money, which in turn exert an influence on the flow of spending. This influence is in no way punitive; no individual is told what he can or cannot do. It merely seeks to help bring about a flow of spending just adequate to support the maximum sustainable flow of goods and services so that there is no excess spending to be wasted in higher prices and no wastage of resources in idleness. These influences are applied in three different ways.

First, RESERVE REQUIREMENTS.

(RESERVE REQUIREMENTS)

The laws of the Federal Government and of the several states prescribe certain reserves which must be maintained by banks. These requirements determine the extent to which banks can create money on the basis of a given volume of reserves. Actually, it is these excess reserves which determine how much banks can lend, and the focal point of general monetary medicines is excess reserves. The Federal Reserve System, whose member banks hold 85% of the banking resources of the country, can vary reserve requirements between certain legal limits, as can certain state authorities. Reserve requirements were reduced somewhat following the period of credit stringency which developed toward the middle of 1953, and again in mid-1954. They have remained unchanged since that time.

An increase in reserve requirements has a double-barreled deflationary effect: Here's how that works.

(DEPOSITS)

Under current conditions, $1 of reserves will support about $6 of deposits. Banks usually carry some excess reserves.

(PUT UP EXCESS RESERVES, TO ONE SIDE)

An increase in reserve requirements serves to wipe out some of these excess reserves, by making them required reserves.

(MOVE EXCESS RESERVES AGAINST REQUIRED RESERVES; LEAVE BRIEFLY; DISCARD)

Secondly, an increase in reserve requirements reduces the expansion potential, it reduces the volume of deposits which can be created on the basis of a given amount of new reserves. Whereas now the banking system can create \$6 of deposit money for each new dollar of reserves, if reserve requirements were increased from an average of 16% to an average of 20%, then a dollar of new reserves would permit the creation of only \$5.

(BLACK OUT LAST "DEPOSITS" BLOCK)

Banks can borrow reserves, increasing their excess reserves, and increasing their lending power on a 6 for 1 basis. Our second medicine is the REDISCOUNT RATE,

(REDISCOUNT RATE)

the cost to banks of borrowing reserves from the Reserve System. To the extent that a higher rediscount rate discourages member bank borrowing, it also discourages creation of bank reserves, as borrowings from the Reserve System take the form of member bank reserves. Even when banks are not borrowing extensively, an increase in the rediscount rate has a psychological effect in that it is usually interpreted as a caution signal. Further, an increase in the rediscount rate is usually followed, fairly quickly, by an increase in the rates of interest which banks charge their customers. This may discourage demand for funds.

In the early 1920's this was the most important monetary medicine. As a matter of fact, at one time member banks were borrowing more from the Federal Reserve System than their total reserve requirements. Later, as excess reserves became more common in the 1930's, there was little borrowing. In the last few years borrowings have again become substantial, and the rediscount rate has regained something of its traditional effect.
SINCE EARLY 1955 HAS BEEN SIX 3%
~~Last year~~ the rate ~~was~~ increased ~~four~~ times from 1 1/2% to ~~2 1/2%~~.

Banks as a rule are reluctant to borrow, and quick to repay when they do borrow. When the need to borrow becomes widespread, the rediscount rate acts as a flexible drag on the growth of the money supply. This medicine works very closely with open market operations, which increase or decrease the needs of banks to borrow.

Under current conditions, OPEN MARKET OPERATIONS

(OPEN MARKET)

are the most effective monetary medicine. As Mr. __________ pointed out earlier, purchases of securities in the open market by the Federal Reserve System are paid for by the <u>creation</u> of an equivalent amount of reserves. Sales of securities destroy reserves, in the same amount. Thus, by purchase and sale of securities, the Federal Reserve can create or destroy bank reserves, making it easier or more difficult for banks to lend.

Let's assume that institutional investors -

(INSTITUTIONS)

say life insurance companies - are dumping large quantities of Government bonds

(BONDS)

on the market.

(MARKET)

This will create a downward pressure on bond prices. This pressure on prices is perfectly normal; it happens in any free market when selling pressures build up.

If these bonds are picked up

(BONDS)

by nonbank investors - say the individuals

(INDIVIDUALS)

group - then the immediate effect is a transfer of deposits.

(BANKS)

The check in payment for the bonds increases deposits

(DEPOSITS)

of the seller. Then the check is charged against the account of the buyer

(DEPOSITS)

and his deposits are reduced. There is a direct transfer of funds from one group of investors to another group. There is no change in the total money supply.

If these bonds are bought by banks,

(CHANGE "BONDS" ARROW FROM "INDIVIDUALS" TO "BANKS")

then the check offered in payment again increases deposits of the seller.

But there is no corresponding reduction

(REMOVE "DEPOSITS" ARROW FROM "INDIVIDUALS")

of deposits. There is, instead, a creation of deposit money on a one-for-one basis.

If the Federal Reserve System

(FEDERAL RESERVE)

enters the picture, there is, in addition to the creation of deposit money, a creation of bank reserves. If the bonds are bought by the Federal Reserve System,

(CHANGE "BONDS" ARROW FROM "BANKS" TO "FEDERAL RESERVE")

the check offered in payment again increases deposits of the seller when it is deposited in his bank. When the bank presents the check for collection, collection is effected by crediting the reserve account

(RESERVES)

of some member bank - a creation of reserves which did not previously exist. If, on the other hand,

(REMOVE "BONDS" ARROWS)

the System sells bonds

(BONDS)

to any purchaser - say the "institutions" group -

(BONDS)

there is an equivalent destruction of reserves and of deposit money. The Federal Reserve receives the check given in payment for the bonds and presents it to the bank for collection, which is effected by charging a member bank reserve account - a destruction

(REMOVE "RESERVES" ARROW)

of existing reserves. The check is then charged against the deposit account

(REMOVE "DEPOSITS" ARROW)

of the buyer, reducing the money supply by an equal amount.

This medicine is very flexible in its use. Open market operations can be conducted on a weekly, daily, or hourly basis. They can operate in opposite directions on the long- and short-term ends of the market. They carry a leverage of six for one on the money supply.

(FLASH "DEPOSITS" CARD BRIEFLY)

However, open market operations inevitably have an effect on prices of Government securities, and are in turn affected by the sheer magnitude of the Federal debt and of Treasury financing. Although this is your most effective medicine, it cannot be used lightly or frivolously.

These medicines can be applied separately or in combination. As anti-inflation medicines, the prescription would read: an increase in reserve requirements, sales of securities, and an increase in the rediscount rate.

In addition to general restrictions, two other monetary medicines should be mentioned. First, in recent years, at the direction of the Congress, the Federal Reserve System has made some use of SELECTIVE medicines, selective controls which are designed to limit expansion of particular kinds of credit. These have included controls over stock margins, consumer credit, and real estate credit.

Second, VOLUNTARY ACTIONS of lenders in restraining credit expansion were tried during the Korean period.

March [illegible]

If our patient becomes sufficiently violent,

(PULL DOWN RIBBON TO RIGHT OF "PREVENTIVE MEDICINES")

we may have need to resort temporarily to the strait jacket of direct CONTROLS.

(CONTROLS)

Such a need might arise in case of an emergency such as a full-scale war. Or, we may place our patient in this strait jacket even though he shows no signs of becoming violent. Controls - holding the lid on prices,

(PRICES)

holding down wages,

(WAGES)

and doling out allocations of materials -

(ALLOCATIONS)

these controls can be made to work, particularly under the stimulus of patriotic motives, as in wartime. However, to the extent direct controls are effective, they are apt to substantially diminish the incentive to produce, and may actually intensify the inflation problem by cutting back on production. Further, to the extent these controls are effective, the decisions are taken away from 171 million Americans and are placed in the hands of some central planning group. In any event, direct controls serve to conceal and defer, rather than to cure, inflationary pressures.

With these, we have completed the inventory of our anti-inflation prescriptions. We also have here the diagnosis of the patient's illness in the last 1 1/2 years. For an appraisal of the progress made in treating the patient's illness, and of the probable need for further treatments, I am pleased to present our practicing physician - Mr. ____________________.

1958

For release on delivery

Statement of

William McChesney Martin, Jr.

Chairman, Board of Governors of the Federal Reserve System

before the

Committee on Finance

United States Senate

April 22, 1958

The Battle Against Recession

Since my appearance before this Committee last August, the United States economy has passed from an inflationary to a recessionary phase of the business cycle. For the third time since World War II the strong growth trend in this country has been interrupted by a downturn.

The troubles now confronting us are traceable in many respects to the excesses of the preceding three-year boom with its creeping inflation overtones.

Recession as an effect of boom

Between the summer of 1954 and the summer of 1957 real output of goods and services in the United States increased about 12 per cent. But prices also rose. Consequently, the dollar value of total output, or gross national product, increased 22 per cent. This gap of 10 per cent between the real and monetary increase in total product roughly gauges the magnitude of the inflation in that period.

The three-year expansion of the economy represented at first recovery from the 1953-54 recession, sparked by active consumer buying of houses and automobiles. This surge of consumer buying, which was encouraged by the ready availability of mortgage funds and consumer instalment credit on sharply eased terms, was followed by a wave of business spending for plant and equipment that transformed the 1954-55 upswing into a boom. The classic acceleration principle of business cycle history found confirmation once more. In the process, inflationary pressures were generated as aggregate demand came to press against productive capacity. The upward price movement so generated received further impetus from the mutual interaction of prices and costs.

The current recession is a reaction to both the investment boom and the inflation which accompanied it. The growth of business capital spending beginning in early 1955 was at a rate that was unsustainable. An economy with a long-run upward growth trend of about 3 or 4 per cent per year cannot sustain for long an increase in business investment of about 10 per cent per year in real terms, such as we experienced in 1955-56. The investment spending, even if prolonged by inflationary trends, had at some point to slow down.

Throughout our economic history, investment spending has tended to come in waves, closely associated with cyclical variations in over-all economic activity. These periods of rapid growth in our capacity to produce have been followed by cutbacks in investment spending, usually with secondary effects on total incomes and output. One of the goals of stabilization policies is to attempt to mitigate the effects of such cycles without inhibiting underlying growth forces.

In the 1955-57 investment boom, inflation aggravated the tendency toward overexpansion as well as the subsequent decline. Inflation, as I have said, was the result of an excess of total demands at existing prices over what the economy was producing, and apparently able to produce under the existing organization and use of resources. But once prices started up and expectations of additional price and cost increases were engendered, spending was stimulated further. With prospective costs rising, business had every incentive to enlarge its productive capacity at today's rather than tomorrow's prices. And when investment plans are made on this basis, a certain amount of uneconomic productive capacity is likely to be created; that is to say, capacity which does not reflect a basic pattern of demands undistorted by expectations of rising prices.

Monetary policy in the boom

In cyclical processes, monetary management has a responsibility to use such powers as it possesses over economic events to dampen excesses in economic activity. If this responsibility is exercised wisely and effectively, it should help to foster a relatively steady and sustainable rate of economic growth and longer term price stability. Perfection in monetary management and economic stabilization, however diligently sought, is unattainable. Nevertheless, over the years progress has been made and further progress will be made.

Last August monetary policy was in a restrictive posture, as it had been for two years. As I stressed before this Committee at that time, the inflationary pressures that had developed in the boom had also given rise to the disturbing notion that creeping inflation had become an inevitable condition of modern economic life. This idea took nourishment from the steady upward movement in consumer prices in 1956-57 as well as from the substantial rise in all prices since prewar years. The creeping inflation idea was, in turn, conspiciously reflected in the sharp rise in prices of common stocks, the most popular hedge against inflation. Thus in July 1957, for the first time in two decades, the average dividend yield on stocks was bid below the average yield on high grade corporate bonds.

In that atmosphere, Federal Reserve discount rates were raised one-half percentage point in August in order to relate them more closely to market rates which had been rising for some time and in this way to maintain their effectiveness in restraining bank credit and monetary expansion. That action also served as an indication to the business and investment community that the Federal Reserve rejected the idea that creeping inflation was inevitable.

On the financial side, the three-year expansion under conditions of monetary restraint had reduced markedly the liquidity of the business community and of the commercial banks. The money supply had increased but little after 1955. Its velocity of circulation, however, had quickened appreciably; that is, money holdings had been lowered in relation to the growing gross national product. Indebtedness of consumers and businesses had increased relative to incomes.

Inflationary sentiment was a factor not only in the domestic economy but in other industrial economies as well. Widespread expectations had developed in world markets that failure to arrest inflation in key countries, especially in Europe, would result in important changes in international currency values. Despite actions taken by various countries over the summer to strengthen their anti-inflation programs, speculative movements of funds continued to dominate exchange markets. The crisis was not resolved until late September, after the Bank of England raised its discount rate from 5 to 7 per cent and the German Bundesbank, almost simultaneously, lowered its discount rate from 4-1/2 to 4 per cent, thereby lessening the incentive for short-term funds to move from sterling into deutschemarks. These actions made it clear that inflationary trends would be strongly resisted and that key foreign currency values would be maintained.

We are now aware that the economy was to reach a cyclical turning point in the fall. This is not to say that there were no earlier signs that the economy might be getting into an overextended position. This was shown by a fall off in new orders for machinery and equipment in the earlier months of 1957 and by the development of a margin of excess capacity in some key industries. In the spring, however, consumer buying took on renewed strength as business investment was being maintained, encouraging expectations of further economic expansion and of continued upward price pressures. Consumer buying, particularly of nondurable goods and services, rose through August. On balance, it looked as if an extension of rolling adjustments at a high level of activity would continue to be the prospect.

During the fall, expansive forces gave way and downturn set in. Business inventory holdings had been at a high level for a long period in which the price trend had been upward. Hence, they were vulnerable to the emergence either of eased conditions of supply or of relaxed market demands. This occurred as Government defense orders, which had been expanding in the spring, were cut back in the summer and fall to conform to the budget program and the ceiling on public debt. At the same time a decline in business spending for plant and equipment set in, in recognition that productive capacity had risen more rapidly than final demand and output.

Monetary policy and recession

As evidences of downturn developed the Federal Reserve System began to alter the course of its policies. In the latter part of October and early November, open market operations were used to relax somewhat pressures on commercial bank reserve positions. In mid-November, a one-half point reduction in discount rates signaled a decisive change in System policy. From this point on, restraints on bank credit expansion were progressively relaxed.

Through the first quarter of this year, as reserves were provided through open market operations and by two reductions in reserve requirements, member banks reduced their indebtedness at Reserve Banks and accumulated some excess reserves. Between September and March, member bank borrowing at the Reserve Banks declined from about $1 billion to less than $150 million, while excess reserves rose more than $100 million. Thus net reserve positions shifted by almost $1 billion. Discount rates were reduced in two further steps and at the end of the quarter stood at 2-1/4 per cent, compared with 3-1/2 per cent in the autumn.

Just last week the System took additional action to ease credit conditions. Reserve requirements were reduced further, releasing about $450 million from required reserves. Discount rates were lowered an additional 1/2 percentage point, bringing them to 1-3/4 per cent at seven Federal Reserve Banks.

The easing of bank reserve positions has been reflected in a substantial expansion in bank credit and an exceptionally sharp drop in interest rates. Over the six months ending in March, for example, the total of bank loans and investments has increased almost $5 billion. In the corresponding six-month period a year ago, the growth of bank credit was less than $1 billion. The expansion of bank credit has been mainly in the form of Government security holdings, and the effect has been to enlarge holdings of cash balances and to increase the economy's over-all liquidity. Aside from temporary spurts of bank loans to business in December and March, business loans outstanding at banks have tended to decline with economic activity. However, loans on securities which provide important support to the capital markets have risen.

As Federal Reserve policy has shifted from restraint to ease over the past six months, financial markets have reacted strongly. Short-term interest rates fell more rapidly in the three months following the first reduction in Federal Reserve discount rates than in six months following the 1953 turning point. By mid-April, Treasury bill yields, an indicator of the availability of funds in the money market, had declined to about 1-1/4 per cent, compared with more than 3-1/2 per cent in October.

Longer term market yields are down about three-fourths of a percentage point. This decline has met with remarkable demand response in the long-term security markets and the total volume of corporate, State, municipal, and foreign borrowing has reached record levels. In the first quarter of this year, State and local governments issued $2-1/4 billion of new securities. This was almost 25 per cent more than in the same period of 1957 and represented a new record high for the quarter. Corporate business raised $3.1 billion in new capital through the securities markets. Although smaller than a year ago when business investment outlays were still rising, this volume of flotations exceeded that of any other first quarter on record. New issues of foreign and international borrowers amounted to an estimated $360 million, twice as much as in the first quarter of 1957.

It should be stressed that the Federal Reserve has been pursuing an active, not a static, policy and using all its instruments in the process, as indicated by the attached record of policy actions since last fall. Banks have been expanding their assets and deposits. Their reserve needs have increased, requiring that their reserve positions be strengthened. This has been done by means of open market purchases, lower discount rates, and reductions in reserve requirements.

Thus, monetary policy has contributed to an increase in the availability and a reduction in the cost of borrowed funds. This has permitted a sizable expansion in bank deposits. In this way monetary policy is helping to increase the liquidity of the economy, which is an essential financial prerequisite to recovery and renewed economic growth.

The problem of public policy

No one can predict with certainty the course of the present recession. It is already deeper than the two which preceded it. Nevertheless, experience over the long history of the United States supports the belief that, except for occasional cyclical readjustments, our economy is one of continuing long-run growth and strength. Hence, governmental measures to deal with such cyclical readjustments ought to be shaped so as to be consistent also with the longer run trend.

This is not a prescription for inaction or immobility at times of recession. It is, rather, a recommendation for discretion and flexibility in selecting and implementing stabilization policies so that measures undertaken to deal with today's problem do not aggravate those of tomorrow. At the same time, public policy needs to keep alert to any tendency for downward movements to become cumulative.

A second observation relates to the use of resources. As I have said earlier, a part of our present problem stems from overexpansion or misdirection of investment in particular lines of industry. In some cases, excess capacity exists in part because producers have misjudged the market or the long-run rate of growth of demand for their products. To some degree, this is inevitable in a free market economy. It can be mitigated, however, to the extent the Government is able to stabilize aggregate demand around a steady growth curve and thus to provide a general economic climate that facilitates shifts in resource utilization as these are dictated by free markets.

The human problem

In discussing economic problems, we should never forget that what we are really dealing with are human problems--human problems of a very important kind. In combatting inflation and deflation, what we are really doing is combatting human misery that springs from economic causes.

Every recession is serious: this one and all the others that preceded it. The best time to recognize that fact is before a recession starts, for the best way to prevent a recession is to forestall the inflation that precedes it. When the next economic turn comes, as assuredly it will, let us try harder to remember that--and act accordingly.

Today we are concerned, and properly so, with fostering the recovery everyone wants from a recession that nobody wants. That's fine. But let's also keep in mind that, vital as it is to achieve recovery, it is also vital to insure that it will be a recovery that lasts; a recovery that does not merely provide ephemeral jobs, but lasting jobs.

We must recognize that enduring prosperity is not a question simply of the dollar volume of spending. It is also a matter of equilibrium and balance of costs and prices within the economy. Lasting prosperity rests upon the efficient production and distribution of goods and services at prices that people are willing and able to pay. It has to be earned. It can't be provided as a gift, by the Government or anyone else.

Concluding observations

By fostering conditions conducive to prosperity, the Government can help a lot. But it can't do it all. That is why the Employment Act of 1946 pledges the Government's efforts to create and maintain "conditions under which there will be afforded useful employment opportunities, including self-employment, for those able, willing and seeking to work." And it is why the same Act says the Government's efforts to that end shall be applied "in a manner calculated to foster free competitive enterprise and the general welfare."

Monetary policy is undertaking, within its inherent limitations, to provide such a climate for recovery. It is not omnipotent, but I can assure you that the System is approaching the problem of combatting recession with just as much vigor as it exhibited in battling inflation. On both the up and the down side of the business cycle, the System is striving constantly to promote economic stability and growth.

-0-

April 21, 1958

PRINCIPAL POLICY ACTIONS OF FEDERAL RESERVE SYSTEM, MID-OCTOBER 1957 TO MID-APRIL 1958

Date	Action	Purpose of Action
1957--Mid-Oct.-Dec.	System holdings of U. S. Government securities increased by $1 billion, including substantial amounts of securities held under repurchase agreement. Member bank borrowings declined from an average of about $1 billion to an average of less than $750 million.	To increase the availability of bank reserves for seasonal purposes and also to cushion adjustments and mitigate recessionary tendencies in the economy.
1957--Nov.-Dec.	Reduced discount rates from 3-1/2 to 3 per cent at all Reserve Banks.	To reduce the cost of borrowing from the Reserve Banks and eliminate any undue restraint on bank borrowing in view of the decline in business activity and evidences of economic recession.
1958--Jan.	Limited net reduction in holdings of U. S. Government securities to $900 million, more than half of which represented securities held under repurchase agreement at end of year. Member bank borrowings declined to an average of $450 million.	To ease reserve positions by absorbing only part of the reserves made available by the seasonal return flow of currency from circulation.
1958--Jan.	Reduced margin requirements on loans for purchasing or carrying listed securities from 70 to 50 per cent of market value of securities.	Stock prices and the volume of credit in the stock market had declined to levels near or below those prevailing at the time of the previous increase in requirements.

Date	Action	Purpose of Action
1958--Jan.-Feb.	Reduced discount rates from 3 to 2-3/4 per cent at 11 Reserve Banks.	
1958--Feb.	Reduced reserve requirements on demand deposits from 20 to 19-1/2 per cent at central reserve city banks; from 18 to 17-1/2 per cent at reserve city banks; and from 12 to 11-1/2 per cent at country banks, thus freeing an estimated $500 million of reserves.	To reduce further the cost of borrowing from the Reserve Banks and increase further the availability of bank reserves in order to encourage monetary expansion conducive to resumed growth in economic activity.
1958--Mar.	Reduced discount rates from 2-3/4 to 2-1/4 per cent at 11 Reserve Banks and from 3 to 2-1/4 per cent at one Reserve Bank.	
1958--Mar.	Reduced reserve requirements on demand deposits from 19-1/2 to 19 per cent at central reserve city banks; from 17-1/2 to 17 per cent at reserve city banks; and from 11-1/2 to 11 per cent at country banks, thus freeing an additional $500 million of reserves.	
1958--Feb.-Mid-April	Purchased about $450 million of U. S. Government securities. Member bank borrowings declined further to an average of about $180 million.	To supplement reserve requirement actions in further increasing the availability of bank reserves.
1958--Apr.	Reduced reserve requirements on demand deposits from 19 to 18 per cent (in two stages) at central reserve city banks and from 17 to 16-1/2 per cent at reserve city banks, thus freeing a total of about $450 million of reserves.	To supplement previous actions to encourage monetary expansion and resumed growth in economic activity and to offset recent gold outflow.
1958--Apr.	Reduced discount rates from 2-1/4 to 1-3/4 per cent at seven Reserve Banks.	

April 22, 1958

The Current Economic Problem

Since the turning point early last autumn, downswing in the economy has now lasted seven months. Declines in broad measures of economic activity, such as gross national product, nonfarm employment and industrial production, have been rapid. Unemployment has shown a disturbingly large increase, especially among younger men formerly employed in producer and consumer durable goods industries. Nondurable goods industries, although less affected, have not been immune from downward readjustment.

This downturn has been sharper and deeper than either of the two preceding postwar recessions. It may be that recession was accentuated in midwinter months by unusually adverse weather conditions. The most recent information suggests some slowing of decline, but these signs relate to quite a brief period.

These are sober facts. We cannot be complacent about them, particularly when the downward phase of this cycle may not yet have run its course. At the same time, however, it is the task of those responsible for decisions in private and public policy to search beyond these facts and explore developments underlying them.

Problem of counter-recession policy

Fluctuation seems to be an inescapable feature of a growing economy in which imbalances and the need for adjustment are continually arising. These cyclical fluctuations can be and have been very severe.

However, they are not usually severe; the two preceding recessions were moderate and short-lived. History does not repeat itself; no one cycle is a close replica of any other. But our history does show that periods of contraction tend to be shorter and less pronounced than periods of expansion. This is another way of saying, of course, that our economy is a growing one.

In view of the unstable aspects of a growing economy, economic policy must have its long-run and short-run aspects. From a longer run standpoint, the major task of a competitive economy is to maintain a climate favorable to sustainable high-level growth without inflation.

In the short-run, major tasks for economic policy, both public and private, are to encourage flexible adjustments to changing conditions, to minimize the development of imbalances in market supply and demand, to correct them as they occur, and in general to avert excesses, which are always a danger and give rise to later problems.

Economic policy directed to shorter run objectives can have effects that go beyond those intended and interfere with attainment of longer run objectives. I continue to believe that we will have success in attaining orderly economic growth and in avoiding the hardships of periodic recessions to the extent that we can minimize excesses during recurrent booms. The excesses of booms are our greatest economic hazard because they later lead to unemployment.

In this modern age of the large corporation and the large labor union with their professional managements, private policy has great responsibility in these matters of general economic progress and stability. Responsibility for far-sighted appraisal and policy is in proportion to size and market power. And when excess resources come within the purview of management and labor decision makers, their first responsibility is to do whatever they can to see that these resources are put to productive work.

It is small comfort to the unemployed wage earner that his union leadership has won another wage increase for workers who remain employed. It is small comfort to consumers to find many products continuing in price beyond their willingness or ability to pay--or even rising further. And it is small comfort to investors to see profits and dividends dwindling as plants and manpower become idle. Too often, we seem only to give lip service to a market--supply and demand--economy, and are really afraid to make it work.

Features of current recession

This recession has been accompanied by numerous adjustments. Some of these have been in the nature of corrections of earlier imbalances. Others are responses to new imbalances developing out of recession itself. Many further adjustments may take place before a conjuncture of expansive forces predominates in a way as to set in motion, first, recovery and, subsequently, resumed economic growth. A solidly based recovery, that is, one which will ripen into healthy expansion, will not come by postponing essential adjustments; but neither will the beginning of recovery have to await the completion of all of them.

Business inventories. Business inventories, after many years of accumulation, became vulnerable to easier supply positions and declining final demands. Reacting last fall to the emergence of these conditions, businessmen cut their orders drastically and began to run off their inventory holdings. This run-off represented two-thirds of the decline in gross national product from the third quarter of 1957 through the first quarter of this year, and contributed to sharp reductions in output, particularly of durable goods industries.

The process of general inventory reduction may persist for a time. Total stocks, particularly of finished goods, remain large; in absolute amount, the running down of stocks has been moderate. The possibility exists, however, that the rate of inventory liquidation is already close to its maximum and that it has already had much, if not all, of its impact as a contractive influence on output and employment.

Steel industry operations, for example, have recently fallen to less than 50 per cent of capacity. Use of steel by steel consuming industries has not declined nearly as much, so that much excess steel inventory has been worked off. Even with no increase in consumption and with a further moderate decline in steel inventory, production might need to be increased to meet current demands.

Business spending for plant and equipment. While inventory liquidation has played an important role in this recession, it is misleading to characterize the present downturn as only "inventory recession." Another factor in reduced demand, and possibly a more fundamental one, has been cutback in business spending for fixed investment. In the third quarter of last year, business expenditures for new plant and equipment were at an annual rate of nearly $38 billion, or a fourth higher than two years earlier; plans for the current quarter suggest outlays are down to a rate of about $32.5 billion. Recent surveys suggest a continued decline in business investment spending throughout this year.

The preceding boom was very much a business investment boom, and a margin of excess capacity in many lines became a feature of the economic situation by last autumn. A major problem confronting business as a result of this development and its further aggravation by recession itself is to find the products and prices that will keep this plant and equipment employed. Given an opportunity for market demands to set recovery in motion and given the strong growth forces of our economy, we shall surely later discover inadequacies in our industrial plant that will warrant renewed expansion in business investment.

Industrial capacity, it needs to be remembered, is not only a matter of the stock of fixed capital; it is also a matter of its quality in relation to the state of technology and of the skill and ingenuity of management and workers. The flow of technological advances has been dramatically enlarged in postwar years by rapid expansion in research and development activities, many of which are directed toward the production of new or improved products, as well as towards reducing costs of production. This is the way in which advances in management and worker productivity are developed.

Consumer income and spending. Contraction in consumer money income has been smaller than the decline in the value of total output. Unemployment compensation payments have offset part--about one-fifth--of the sizable decline in wages and salaries. Also, payments under the old-age and survivors insurance program have continued to grow, as have other Government payments. And, recently, farm income has risen. Most consumers still have strong financial positions; in fact, many have reduced their debts and added further to their financial savings.

The purchasing power of consumers has been reduced since autumn not only by declining money income but also by rising prices. Consumer expenditures for goods and services, nevertheless, have been relatively well maintained. Declines in consumer spending have been concentrated in durable goods, particularly for new autos. Along with reducing their purchases of durable goods, consumers have cut back on their use of instalment credit. Meanwhile, repayments on instalment contracts have continued to rise and recently have exceeded the volume of new credit extended. Instalment credit outstanding is now being reduced and has become a contractive factor in the economy.

In the housing area, consumers have been increasing their home mortgage debts more slowly than earlier and have been less active in purchasing houses. With vacancy rates in the residential field continuing relatively low, easier credit conditions have been looked upon as stimulants to residential construction. In recent months, however, the volume of housing starts has been relatively low. In view of the significant decline in the marriage rate since last autumn, it remains to be seen whether easier credit conditions will meet with strong response in the housing field. The economy is indeed fortunate, however, that the inventory of unsold houses was small when recession set in.

Foreign markets. Added to declines in business and consumer investment spending since the fall has been a sharp reduction in U. S. exports of merchandise, particularly to industrial countries of Western Europe, to Canada, and to Japan. Meanwhile, over-all imports have been maintained despite the downturn in domestic activity.

The decline in U. S. exports has reflected mainly reduction abroad in demands for steel, fuels, raw cotton and other materials, as well as a leveling out in demand for machinery and equipment. The investment boom of 1954-1956 tapered off in all industrial countries in 1957.

Thus far economic activity in Western Europe has continued to hold up and prospects there now depend in part on developments in world markets for European exports. In Canada, recession, which started somewhat earlier than in this country, now appears to have moderated. A number of nonindustrial countries have been adversely affected by reduced export earnings. The longer recession goes on in this country, the more likely it is that activity in other countries will show contractive tendencies.

The current economic position

Although many adjustments have already been made in business and consumer demands, no one knows how long it will take for recession to be succeeded by recovery. For the longer run, the economy has many elements of strength and the problems of surmounting the imbalances of the short-run can surely be solved.

Fiscal and monetary policies have both been operating to cushion declines and to set the stage for a regathering of expansion forces.

For instance, monetary action has progressively made credit more readily available and has contributed to a marked lowering of its cost. Fiscal action has included an expansion of Federal spending programs and an easing of Federal underwriting programs in the mortgage field. At State and local government levels, public spending has continued to rise without letup in recent months in response to continued needs for expansion and improvement in community facilities and services.

Thus far, the emergence of recovery forces has been hampered by the tendency of declines in demands to impinge mainly on output, with costs and prices holding at advanced levels or even continuing to rise in some lines. Failure to adjust prices in periods of recession delays recovery and means a loss in the purchasing power of the dollar over the long run. It furthers acceptance of creeping inflation psychology and certainly weakens the adaptive abilities of our economy. In part, recent price behavior has reflected cost rigidities and in part it has reflected unwillingness on the part of producers to explore markets for their products at lower price levels.

Let me clarify my views on this topic. No one, so far as I know, advocates a policy of imposed deflation or desires a downward price spiral which would accentuate the business contraction. But there are areas in which competition to expand markets, including price competition, would stimulate demand and contribute to an early recovery. Competition, not fear of it, has always been a source of strength of the American economic system.

Summary

The current status of the economy is one of adjustment, a process which is continuing. Many of the adjustments result from earlier excesses; in short, are consequences of preceding inflation. Recent indications of slow-down in recession are encouraging, but must be appraised with caution. The Federal Reserve System by its actions has indicated its belief that the immediate problem is to halt recession and pave the way for recovery. There can be no doubt about the long-run growth prospects of the United States as well as of the free world economy.