William McChesney Martin, Jr., Papers

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Hearings, Aug. 1957-April 1958(cont.)

Mrs. Muehlhaus.

ANSWERS TO QUESTIONS

SUBMITTED BY THE

COMMITTEE OF FINANCE OF THE UNITED STATES SENATE

TO CHAIRMAN MARTIN ON

AUGUST 13, 1957

ANSWERS
Committee Questions

1. What, in your own words, is the best simple layman's definition of inflation?

Inflation can, of course, be defined in various ways. The most important thing, it seems to me, is to focus on its causes, its course, its effects, and the means of overcoming and preventing it. My opening statement, as a whole, is devoted to that purpose. See in particular these sections: "The Current Problem of Inflation," pages 8-9; "Conflicting Views on Causes," pages 9-10; "The Inflationary Spiral," pages 10-12; "Expectations of Continuing Inflation," pages 13-14; "Creeping Inflation," pages 14-16; "Effects on Productive Enterprise," page 16; "Effects of Inflation," pages 17-18; "Basic Factors in Recent Inflationary Pressures," pages 20-21; "What More Can Be Done" (to restrain inflation), pages 23-24; and "Action Required," pages 24-26.

In my opening statement, on page 10, appears one definition of inflation: "Aggregate demand . . . in excess of aggregate availabilities of . . . resources at existing prices." Mr. Wayne's presentation included another definition: "Inflation is a flow of spendings in excess of the flow of goods and services." The effect of inflation is, of course, manifest in rising prices. Thus, on page 8 of my statement, I noted that "inflation, . . . in terms of the man on the street, . . . is the rising cost of living."

2. Are we in a period of inflation now and when did it start?

Inflationary pressures still exist in the economy and are being reflected in further advances in prices.

The current period of inflation started during the third quarter of 1955. At that time recovery from the moderate recession of 1953-54 had evidently turned into boom. Gross national product, personal incomes, employment, and industrial production had increased to new highs. More important from the point of view of inflationary pressures, however, was the overriding strength of demands relative to capacity to produce. Output in key industries was at or near capacity and the backlog of manufacturers' orders for durable goods was rising rapidly. Not only were business expenditures for plant and equipment increasing, but, as became abundantly clear subsequently, business concerns were in the process of reappraising upward their fixed capital needs. Demands for manpower as well as for industrial resources were heavy. In response to these strong demands, the increase in the labor force was exceptionally large between mid-1954 and mid-1955 and unemployment declined to low levels. In manufacturing industries, the length of the workweek was still increasing in the second half of 1955 and overtime was widespread. In financial markets, too, demands were heavy.

The strength of demands relative to available resources put intense pressure on the price and cost structure. Industrial prices, which on the average had shown little change earlier in the recovery period, rose considerably after mid-1955, the rise amounting to 3.5 per cent from June to December of that year. The wholesale price index for all commodities, however, increased by less than 1 per cent; prices of farm products declined substantially further and food prices also came down as industrial prices rose. The wage structure was subject to upward pressures, with average hourly earnings in manufacturing up 6 cents, or 3.2 per cent, in this period. Consumer prices, however, changed little in 1955.

The sharp increase in consumer spending in 1955 was reflected both in that year and in 1956 by expansion of business expenditures for fixed capital--currently in record volume. In the second half of 1955 and in the course of 1956, aggregate demands appeared sufficiently strong to permit increases in wage and other costs to be recovered through price advances. With the demand-cost-price spiral well under way, expectations of continued inflation became widespread. These expectations, as well as the advanced level of prices, are major influences on continued strong demands for funds. Lenders today have no difficulty whatever in finding favorable outlets for their funds. Industrial prices are now 8 per cent and consumer prices 5 per cent higher than two years ago. Average hourly earnings in manufacturing industries have increased almost 9 per cent.

The following table indicates the extent to which increases in the dollar totals of gross national product over the past two years have reflected rising prices and increases in the physical volume of goods and services.

Increase in Gross National Product, 1954-57

Period	Percentage increase: Current dollars	Prices	Physical output
Second quarter 1954 to second quarter 1955	8.1	1.1	7.0
Second quarter 1955 to second quarter 1956	6.0	2.6	3.3
Second quarter 1956 to second quarter 1957	5.7	3.5	2.2
	Distribution of increase (per cent): Current dollars	Prices	Physical output
Second quarter 1954 to second quarter 1955	100	14	86
Second quarter 1955 to second quarter 1956	100	45	55
Second quarter 1956 to second quarter 1957	100	62	38

Increases in physical volume of product were more difficult to achieve after mid-1955 than earlier, since manpower and industrial resources were by then intensively utilized. Moderate increases in output have been achieved over the past two years, but inflationary pressures have been so strong that half or more of the dollar increase in product has represented rising prices. The wide disparity between the two over the past year largely represents the steady rise in consumer prices.

3. Do you regard inflation as our greatest domestic problem at this time?

In my opening statement, on page 8, I stated: ". . . Clearly the most critical economic problem now facing this country is that of inflation . . ."

4. What are the factors which ordinarily cause and contribute to inflation?

The factors which contribute to inflation are those which lead to a rate of spending in the economy greater than the rate at which goods and services are being made available on the market at existing prices. When the economy is already operating at a high rate--as it was by mid-1955, after recovery from the 1954 recession--further marked increases in spending bring about further increases in supplies only gradually and lead very soon to increases in prices, for both goods and services. Once prices start up, as they did in wholesale markets for industrial commodities in this country after mid-1955, many forces operate to keep them going--including the expectation of further price increases. The factors in the current situation and different views concerning them are discussed in my statement, especially on pages 9-11:

<u>Conflicting Views on Causes</u>

> 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 agreement that violate the limits of tolerance set by advances in productivity.
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> 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, businesses, and individuals to borrow in order to spend.

5. What caused the value of the dollar to decline between 1940 and 1952?

During the period 1941-45, the enormous volume of Federal Government war expenditures, matched only in part by taxation, increased incomes greatly while available supplies of goods were limited by the need to devote resources to the war. Rationing and price and wage controls, as well as patriotic motives, held down expenditures and restrained but did not prevent price advances.

With outlets for spending limited, involuntary savings of consumers and businesses were large and took the form of substantial accumulations of cash and Government securities. A considerable growth of the money supply was to be expected in view of the greater needs for currency and deposits accompanying higher levels of economic activity and greater mobility of the military and civilian population. The supply of money, however, increased more than was required for these needs, as indicated by the decline in velocity of money during the war years. The record expansion in the money supply--from $42 billion at the end of 1940 to $102 billion at the end of 1945--reflected large-scale purchases of Government securities by banks. The expansion of bank credit was based on reserves supplied by the Federal Reserve System, in accordance with policy of financing the wartime deficits at stable and low interest rates.

At the end of the war Federal Government expenditures declined, but private outlays rose sharply as consumers, including returning servicemen, spent accumulated savings in order to replenish wardrobes, acquire and furnish homes, and purchase automobiles; at the same time, businesses were motivated to undertake investment outlays that had been deferred and to increase their inventories. Also, State and local governments increased their outlays to provide war-deferred community facilities. Foreign countries, many of them suffering from war damage, also added significantly to demands for goods in the United States.

These heavy demands for goods and services, backed by large accumulations of cash and of Government securities in the hands of consumers, business, banks, and other financial institutions, imposed strong pressures on the administrative effectiveness of existing price and rationing controls. As these were relaxed and finally eliminated, prices rose rapidly. Moderate cash surpluses in the Federal budget in 1947 and 1948 helped to restrain inflationary pressures.in these years, as did regulation of the use of instalment credit. On the other hand, the Federal Reserve was inhibited from exercising flexible market restraints by the continued policy of supporting market prices of Government securities. Thus member bank reserves were provided virtually on the demand of holders of such securities. Between 1945 and 1948 the consumer price index rose one-third; this three-year period accounts for about one-half the absolute increase in the consumer price index from 1940 to 1952.

Prices reacted in the latter part of 1948 as the economy underwent a moderate inventory recession. A vigorous recovery began in the autumn of 1949 and prices started upward again in the first half of 1950, before the outbreak of the Korean War.

This upward price movement was sharply accelerated during the Korean War as consumers and businesses stepped up their purchases of goods acting upon expectations of inflation and shortages that might result from the Korean hostilities and the defense program then being formulated. This expansion of private buying was financed in part by a large and rapid expansion in bank loans. Until March 1951, when the Federal Reserve policy of supporting Government securities was ended, there was little deterrent to sales of Government securities by banks and other holders for the purpose of expanding private expenditures. Moreover, enlarged Government expenditures in connection with the Korean hostilities as well as the defense build-up here and abroad soon added to the over-all demand for goods and services. Price and wage controls, materials allocations, and instalment credit regulations were reimposed. Wholesale prices turned down in early 1951, but consumer prices continued to creep upward during the rest of that year and in 1952, as rents, transportation and utility rates, and other lagging prices continued to rise slowly.

6. Why did it stabilize between 1952 and April 1956?

Relative stability in commodity prices was established in early 1951, about the time when the Treasury and the Federal Reserve reached an accord "with respect to debt management and monetary policies to assure successful financing of the Government and at the same time to minimize monetization of the public debt." This stability followed a period of sharp price rise in late 1950 that resulted from the wave of overbuying, overborrowing, and overpricing on the part of the private economy in what proved to be exaggerated anticipation of the effects of the huge defense program that was being inaugurated.

Actually, this wave was brought under control and price pressures subsided while defense spending was expanding, and the economy as a whole maintained a fairly well-balanced position during most of 1951 and 1952. The more flexible operating policies which the Federal Reserve was able to adopt as a result of the accord, together with various selective and direct controls--including regulation of consumer and real estate credit and the voluntary credit restraint program, as well as price ceilings and allocations of scarce goods--kept private demands within the limits of productive capacity. Also, increases in taxes offset some of the additional Government expenditures. By mid-1952, the pace of expansion of defense expenditures was beginning to slacken, and there was again leeway for growth in private expenditures for consumption and investment. The various selective and direct controls were relaxed and discontinued.

Wholesale prices in general declined somewhat in 1951 and 1952, reflecting principally decreases in prices of those commodities which had risen most sharply in 1950, particularly farm products and other basic raw materials. Prices of farm products continued to decline until the end of 1955, as the world-wide structure of agricultural output was adjusting from wartime distortions and also to rapid increases in the productivity of farms. Finished industrial products, on the other hand, were relatively stable or tended to rise moderately in price from 1951 through 1953, reflecting the generally strong demand for these products. Wage rates also rose. Consumer prices continued to rise moderately in 1951 and subsequent years, owing in part to relaxation of price controls, particularly those over rents, and to gradual absorption into prices of the increases in costs of various services whose prices had risen more slowly during the war and early postwar years than had other prices.

In late 1952 and early 1953, with defense expenditures still large, private spending for both consumption and investment expanded again. The economy generally was operating on an overtime basis, supported by substantial credit expansion on the part of both private borrowers and the Federal Government. Mortgage loans and consumer instalment credit showed the most pronounced increases, as they had in most of the postwar years. Business borrowing--both long-term and short-term--also expanded, as did borrowing by State and local governments. Although savings by the public increased in this period, they did not suffice to meet the growth in demand for loans, and the Federal Reserve System applied restraints to prevent undue substitution of bank credit for savings. These measures were reversed rapidly in the late spring as strains developed in the money market.

Sharp curtailment of defense expenditures beginning in mid-1953, some slackening in consumer durable goods buying on credit, and a related inventory adjustment brought a moderate recession in economic activity until mid-1954. Prices remained relatively stable during this period. Consumer spending for nondurable goods and services, residential building, and State and local government expenditures continued to increase. A general recovery began in the latter part of 1954 and by the latter part of 1955 economic activity was at new highs.

During this period of changing economic climates, Federal Reserve policy was aimed at supplying adequate credit for growth but at the same time avoiding credit excesses. Restraint on bank credit expansion was strengthened in 1952 and early 1953. During the slackening in activity from mid-1953 until the last half of 1954, the major contribution of credit policy was to facilitate bank lending and to avoid a decrease in the money supply. The easier credit availability provided support for mortgage lending and for financing by utilities and by State and local governments. In addition to easier credit, large tax reductions in 1954 helped to stimulate both consumer buying and business investment. After mid-1955, resumed economic expansion and accelerated credit demands again pressed upon the limits of productive capacity and the supply of savings available for investment. Credit restraints were exerted to help keep monetary growth within reasonable bounds.

In summary, the relative stability in the value of the dollar that prevailed from the Treasury-Federal Reserve Accord in March 1951 until mid-1953 may be attributed largely to the restrictive monetary policy which limited credit expansion and permitted flexibility in interest rates in the face of huge and expanding defense expenditures and vigorous demands from the private economy. Other factors which had a moderating influence in the early part of this period were direct and selective controls of various sorts and reaction to the excesses that followed the Korean outbreak, as well as the basic adjustment in agriculture.

When the defense program was sharply curtailed after mid-1953, a relaxation of credit restraints stimulated demands, particularly for residential building, utility expansion, and State and local government borrowing for community facilities. A tax reduction early in 1954 provided another stimulus. By the end of 1954 general expansion in economic activity had been resumed and credit restraints were again imposed to keep expenditures within the limits of sustainable growth and of productive capacity and thus to maintain stability in the value of the dollar.

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?

The basic cause of renewed decline in the value of the dollar, to quote from my opening statement (page 10), is that "aggregate demand is in excess of aggregate availabilities of these resources at existing prices." It is true that expenditures for some important products--notably automobiles and houses--declined considerably in the course of 1956 and currently are smaller than in the third quarter of 1955. Business inventory accumulation this year has also been smaller than in 1955 and 1956. On the other hand, other demands have increased. Business outlays for plant and equipment are currently 28 per cent above the level of two years ago. Consumer outlays for nondurable goods and services and State and local government expenditures have risen without interruption. If demands for autos and housing had continued as strong as earlier, in addition to the demand pressure we have actually experienced, over-all inflationary pressures would have been even more intense than they have been.

So far as the Federal Government's fiscal position is concerned, its anti-inflationary influence declined in the fiscal year 1957. The pertinent figures follow:

	Federal surplus or deficit (-) (in billions of dollars)	
Fiscal year	Budget	Cash
1955	-4.2	-2.7
1956	1.6	4.5
1957	1.6	2.0 (est.)

The shift from deficit to surplus in fiscal year 1956 was a move in the right direction in restraining inflationary pressures, but clearly was not sufficient in the light of actual developments. In fiscal year 1957, the budget surplus was the same as in 1956, but the cash surplus was smaller so that total fiscal operations of the Federal Government, including trust funds transactions, had a smaller anti-inflationary influence than during the fiscal year 1956.

Fundamentally, the force of inflationary pressures has not been interrupted over the past two years, although its pattern of influence has changed. In the late winter and early spring of 1956, the opinion was expressed in some quarters that the boom was coming to an end and that inflationary pressures were virutally over. In retrospect, it is clear that this view was a misreading of the situation. The view relied heavily on the decline in consumer outlays for automobiles and housing. It did not adequately appraise the formidable strength of business demand for fixed capital. When the McGraw-Hill and Commerce-S.E.C. surveys of business intentions to spend on plant and equipment, available in the spring of 1956, revealed intentions of further large expansions, from already record levels, and as business concerns began to borrow in enormous volume both in the long-term capital market and from banks (particularly at the March and June tax dates), views about the future again became generally bullish. Moreover, throughout this period consumer demands for nondurable goods and services and State and local government demands related to capital programs and current operations continued very strong.

Industrial prices were strong on the upside from mid-1955 to the spring of 1956, and in the second half of 1956, following the steel wage settlement, they again advanced rapidly. This year, however, average industrial prices have increased little further. Consumer prices in April 1956 began the rapid and almost uninterrupted rise which has continued through June 1957, the latest available data. This sustained advance reflects the continued vigor of aggregate consumer demands. On the cost side, it represents in part the working out of previous price increases at the manufacturing level, rising costs incurred by retailers, and the sustained rise in the cost of services.

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?

The recent period is characterized by increases in spending in most sectors of the economy, and recent price advances stem from the combined impact of these demand pressures on available supplies of goods and services. Among these sectors, expenditures of the Federal Government, specifically those for national security programs, have increased substantially since the middle of 1956. These outlays have represented an additional demand for available goods and services and they may also have stimulated some related private expenditures. The effect of the increase in Federal outlays has been offset in part by some increase in Federal tax receipts as a result of expanding incomes--an expansion itself in part the result of inflation--but receipts have not increased as much as expenditures. The Federal cash surplus in fiscal 1957 amounted to only about $2 billion, compared with $4.5 billion in fiscal 1956. Thus, the anti-inflationary contribution of the Government's fiscal position decreased in fiscal 1957 from the preceding year. Under conditions of strong private credit demands, a substantial Federal Government surplus and retirement of Government debt help to provide additional funds for financing private and State-local government investment. In this way, Federal fiscal policies contribute to economic growth in a noninflationary manner.

In periods of active demand, as in recent months, any specific Federal programs which stimulate borrowing or improve the credit status of borrowers, must be considered in addition to the actual cash surplus or deficit in order to complete an appraisal of the role of various sectors of the economy in contributing to inflationary pressures. To the extent that such Federal programs actually have been effective in stimulating borrowing, they have added to pressures on capital markets.

In retrospect, considering the course of events over the last two years, it is clear that in an economy as large as ours and with the proportion of Government-stimulated activity as high as it is in our economy, the Federal Government should plan on larger budget surpluses in periods of high activity. As I commented in my statement (page 24), "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."

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?

In my opening statement I indicated that real wages in this country have risen to the highest levels in the world because of the increasing productivity of our national economy. While there have been many instances of pause or even temporary decline in productivity, over the long pull productive efficiency has increased fairly steadily.

Changes in the relationships of wages, prices, and productivity are uneven from year to year; it is, therefore, extremely difficult to determine for any given short-run period the precise influence of wage-productivity developments on prices and profits.

The facts for the postwar period indicate fairly clearly that real weekly earnings have increased significantly only in those periods in which prices were stable. (See table at end of answer.) Over the past year rising consumer prices have offset wage increases with little or no real gains in earnings for the average worker. Workers have been attemping increasingly, through cost-of-living escalator clauses or current wage negotiations, to obtain wage increases which will both meet the rise in prices and also provide for increases in standard of living. If past experience is any guide, however, further increases in money wages are not likely to result in gains in average real earnings as long as prices rise. This is one manifestation of the process of inflation in which rising costs and prices mutually interact upon each other over time with a spiral effect.

Unfortunately, the available data on output per manhour do not allow us to say with any degree of precision what the short-run changes in productivity or in unit labor costs have been from month to month, quarter to quarter, or even year to year. There is first the problem of accuracy of the measurement of output per manhour which requires relating output and manhour series to each other, each with different weighting factors, seasonal movements, and many possible, but unknown errors. Then there are problems of concept, including questions relating to the inclusion of various categories of workers, the measuring of changes in quality of product, the use of physical output versus deflated dollar output, the weighting of respective series, etc. While these problems are difficult and controversial, progress is being made in measurement. At present, however, there is no one official series pertaining to productivity.

The preliminary data for manufacturing, based on production workers only, suggests that in the last half of 1955 and the first half of 1956 output per manhour was relatively stable rather than increasing. Wage rates continued to rise during this period. After mid-1956, however, it appears that output per manhour again began to increase with the rise in output per manhour between mid-1956 and mid-1957 probably more in line with historical trends. These data, it should be noted, do not include nonproduction workers. The number of professional, managerial, and clerical workers in manufacturing has been growing rapidly in recent years, while the number of production workers has declined. Thus, basing productivity measurements on total manufacturing employment rather than production worker employment, would tend to lower the rate of growth in productivity. There are further technical problems involved in going a step further and attempting to measure unit labor costs. Private security and welfare programs, such as pension and health, have been extended rapidly and changes in hourly or weekly earnings do not fully represent growth in worker's compensation or employer's labor costs. Expansion in such non-wage benefits increases the difficulties of measuring statistically changes in unit labor costs in manufacturing.

In the nonmanufacturing sector, measurement of output per manhour is subject to even greater qualification than in the manufacturing industries, because it is so difficult to measure output in physical terms. In any event, the very expansive demands in all nonindustrial activities in the past three years--especially in the trades, services, and State and local governments--have been a significant factor in bidding up wages and prices in these activities.

This year the steep rise in the cost of living, rather than productivity, has become the major factor in collective bargaining and wage determination. For instance, the auto workers between mid-1956 and mid-1957 received approximately 15 cents, or 7 per cent, in additional wages, but 9 cents of that wage increase came as result of an escalator clause and merely offset the higher cost of living. The size of the total wage increase thus had less relation to changes in productivity in the industry or in the economy than earlier. As a result of recent price rises, there has been a resurgence in labor management contracts containing such cost-of-living escalator clauses. This year roughly 4 million workers have or will get cost-of-living adjustments. In addition, most of the major agreements, such as those in rubber, petroleum, and construction industries, which were reopened or renegotiated in recent months also provide for substantial increases in pay. The amount of these increases would seem to indicate that employee demands for higher wages to match higher living costs have been taken into account by employers in final settlements. Wages have also advanced to record levels in sectors of the economy usually considered as outside the sphere of direct union bargaining, with higher living costs also an important influence on the size of the recent adjustments made. The continuing strong demand for additional labor in these sectors has also contributed to wage pressures.

Rises in "real weekly earnings" in manufacturing industries in the postwar period have varied from year to year and have not always paralleled yearly changes in productivity. In the long run, real wages have increased in line with rising productivity, but in the postwar era money wage rates have risen fairly steadily from year to year, while real gains in earnings occurred when consumer prices were relatively stable. Average wage increases were only about sufficient to offset higher prices when prices were rising rapidly, but they were accompanied by real advances in worker's earnings when prices were stable. From mid-1946 to mid-1948, a period of sharply rising prices following the conclusion of World War II, both consumer prices and average weekly earnings in manufacturing rose by almost 25 per cent. This was followed by a period of little change in prices between mid-1948 and mid-1950, prior to the outbreak of Korean hostilities. In this period "real" weekly earnings increased about 10 per cent. In the following two years, mid-1950 to the spring of 1952, sharply rising prices again offset rising weekly wages, each rising about 10 per cent in the period. With prices again relatively stable between the spring of 1952 and early 1956, weekly wages continued to rise and significant gains in "real earnings" were achieved. In contrast, since early 1956 consumer prices have advanced by 5 per cent, about the same as the rise in weekly earnings in manufacturing industries.

In nonmanufacturing industries also, money earnings have risen fairly steadily but gains in real earnings appear to depend on stable consumer prices. This conclusion perhaps applies even more in these industries since in periods of rising consumer prices, wages in most of these sectors have often not been able to adjust to rising prices so quickly as those in the manufacturing lines.

Changes in Consumer Prices and in Average Weekly Earnings in Manufacturing
July 1946 - June 1957

Period	Percentage changes: Consumer price index	Percentage changes: Average weekly earnings in manufacturing
July 1946 - July 1948	23.3	24.4
July 1948 - July 1950	- 1.3	9.7
July 1950 - July 1952	10.9	11.2
July 1952 - July 1954	1.0	7.7
July 1954 - July 1956	1.6	10.8
March 1956 - June 1957	4.8	5.1

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?

In my opening statement, I discussed the question "Do rising interest rates add to inflation?" as follows (pages 19-20):

> 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.

I went on to say (pages 20-21):

> 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.

With regard to the specific question, these earlier remarks may be supplemented as follows:

1. Borrowers encompass every sector of the economy--business, consumers, government. The bulk of borrowing is done for purposes for which the concept of "productivity" is most elusive. This is the case especially for consumer borrowing which, as the table on page 5 shows, accounted for about one-half of the total increase in public and private debt from the end of 1954 to mid-1957. In a general way, we might say that better housing, more consumer durable goods, more adequate schools and roads, etc., increase the ability of individuals to make a more productive society, as well as improve their immediate well being. There is no way statistically to distinguish between the contribution of these influences to productivity and to higher standards of current living. For consumer and government borrowing, higher interest costs are small in comparison with the sort of widespread price increases that develop in an inflationary situation.

For individual consumers, the amount of interest payments may at times be considerable. For consumers as a group, however, total interest outlays are relatively small portions of total outlays, and total interest receipts are relatively small portions of total receipts. Thus, the Federal Reserve Board flow-of-funds accounts show that the consumer sector paid out \$6.9 billion of interest in 1955, only 2.1 per cent of their nonfinancial use of funds. This compares with interest outlays of \$3.5 billion in 1950, or 1.45 per cent of total uses in 1950. Meanwhile, the consumer sector received \$8.5 billion of interest in 1955, 2.5 per cent of aggregate funds from nonfinancial sources, and \$6.2 billion in 1950, or 2.6 per cent of funds. It may also be noted that as of December 1956, mortgage interest paid accounted for only 1.7 per cent of the weight of all items in the BLS consumer price index (interest on instalment debt is not included in this index).

2. The question appears more relevant for business borrowing, and in particular for business borrowing to finance investment in fixed capital. In this connection, it may be noted that a large proportion of such investment - varying, however, from industry to industry and concern to concern - is financed out of internal resources, i.e., depreciation allowances and undistributed profits.

3. If the question is interpreted as relating to productivity of fixed capital, it should be emphasized that the measurement of such productivity is extremely difficult for both conceptual and statistical reasons. The study "Productivity, Prices, and Incomes" recently published by the Committee Staff of the Joint Economic Committee states (page 23): "The ratio of capital to output fluctuates widely according to how capital and output are defined or measured and according to changing economic relationships, including relative costs of labor, capital, materials, etc."

Data are not available to indicate how output per unit of new capital has behaved. It is evident, however, that new fixed capital is considered by management to be generally more productive than existing fixed capital and, indeed, much investment is made primarily because products cost less when made with new plant and equipment.than when made with existing equipment.

Changes in labor productivity are generally measured by dividing changes in total output of goods by changes in the total input of manhours expended in producing the goods. Actually, of course, increased output results largely from providing workers with more and improved machinery and equipment, so that in a sense changes in output per manhour measure changes in the productivity of capital as well as labor.

While efforts may be made to pass higher interest costs on new capital on in the form of higher prices, for most industries the additional costs would be relatively small.

4. Despite higher interest rates, business outlays per fixed capital are at record levels. With the fixed-capital producing industries operating at or close to capacity, these business demands have added to inflationary pressures. They have also, however, expanded our productive base and also our ability to turn out a larger volume of goods for a given labor input.

Rising interest rates, reflecting demands for funds inexcess of the available supply, do perform a rationing function, i.e., on the whole, the free play of market forces tends to allocate available funds to those sectors where demands are most urgent. This function is not performed perfectly by any means, but it is performed better through market competitive forces than by any alternative open to us. The presumption is strong that, so far as business is concerned, funds have, on the whole, been allocated by this process to the most productive uses.

Increase in Public and Private Debt,
December 31, 1954 to June 30, 1957
(Billions of dollars)

Item	Increase, or decrease (-)
Net public and private, total	73.2
Net public, total	-0.1
Federal government and agencies	-11.9
State and local	11.8
Net private, total	73.3
Business, total	37.1
Nonfarm	34.3
Farm	2.8
Consumer, total	36.2
Mortgage	24.9
Instalment	8.7
Other	2.6

Source: Survey of Current Business, May 1957, and preliminary estimates for June 30, 1957 by Division of Research and Statistics of the Federal Reserve Board.

Net debt for the public sectors of the economy represents total outstanding indebtedness minus intra-sector holdings of such debt, e.g., total Federal debt minus such portions of that debt as are held by Federal Government corporations and agencies. Net corporate debt represents total corporate debt minus intercompany debts of affiliated companies. Debt figures for the noncorporate private area are gross, with no adjustment for intra-sector holdings. Excluded from gross and net debt of all sectors are (1) deposit liability of banks and amount of bank notes in circulation, (2) value of outstanding policies and annuities of life insurance carriers, (3) short-term debt of individuals and unincorporated nonfinancial business concerns held by other individuals and unincorporated businesses, and (4) nominal corporate debt, such as bonds authorized but not issued, and issued but reacquired. Data as classified in the Survey of Current Business, have been modified by the exclusion from loans to nonfarm business (and from the change in total debt, as well) of: (1) credit extended by commercial banks to real estate mortgage lenders, secured or unsecured by mortgages; (data used for this purpose relate to mid-August 1954 and mid-May 1957, the available dates closest to December 31, 1954 and June 30, 1957); (2) borrowing by finance companies through security issues, open market paper, and bank loans.

11. Is inflation being accelerated now? If so, what is the cause. If not, what is the stabilizing influence?

In recent months inflationary forces have continued dominant in the economy. Consumer prices reached a new high in June and apparently rose further in July, to a level about 5 per cent above that prevailing from mid-1952 to the spring of 1956. In wholesale markets, commodity prices increased in June and early July, to a level about 7 per cent above that in mid-1955, when the present broad advance began. Aggregate spending has continued excessive in relation to supplies of goods and services available at existing prices.

Spending this year for new residential building and automobiles, and also for business inventories, has been below earlier highs, but spending of most other types either has been maintained at an advanced level or has risen further. Producers' expenditures for new construction and equipment have risen somewhat further, beyond the high level reached toward the end of last year after a rapid uninterrupted advance of a year and a half. Government outlays have increased further at both the Federal and the State and local level. Consumer outlays, particularly for services, have continued to expand. The aggregate of spending--private and governmental--in the second quarter this year was higher than ever before.

While inflationary forces have continued dominant in the economy, with some important influences operating in the direction of speeding up the current price advance, other influences have been tending to slow down price increases. Saving in financial form has increased. Industrial capacity has grown to a level where it is capable of meeting current and immediately prospective demands. Business demands for goods to increase inventories have been cut back for a variety of reasons: (a) holdings are larger now, following further build-up last year; (b) costs of carrying inventories have been rising; and (c) businesses have become more concerned about their liquidity positions. Reflecting diverse influences, industrial price changes have become more selective, with some declines in evidence as well as increases.

In general, however, the upward price movement has continued and in some sectors recent price advances have been substantial, as illustrated by the latest increase authorized for freight rates. Thus, the broad upward price movement has become more selective but has not yet stopped.

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 how can the value of the dollar ever by regained?

In the past, an inflation, once started, has continued until it was stopped, usually either by appropriate monetary and fiscal policy or, failing the adoption of such policies, until it collapsed from imbalances it had generated. In extreme cases inflations have come to an end because people refused to accept what was in effect worthless money. As I said in my statement (pages 13-14):

> 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.

History tells us, however, that inflations have stopped. Sometimes they stopped because the currency became worthless and people refused to accept it in payment. The Continental currency issued in this country during and after the Revolutionary War is an illustration. Sometimes inflations have stopped before this stage was reached because of industrial and financial breakdown. As I pointed out on page 14 of my statement, ". . . if further inflation is expected, speculative commitments are encouraged and the pattern of investment and other spending--the decisions of what kinds of things to buy--will change in a way that threatens balanced growth." In other words, various types of imbalances tend to develop in the structure of industry. These may take the form of overinvestment in specific types of facilities based on the miscalculation that temporary inflation-induced consumer buying reflected a real growth trend. Or imbalances may take the form of speculative accumulation of inventories which promise to profit from rising prices. Or overextended financial commitments may be made which dangerously reduce the liquidity of borrowers. Once these imbalances are recognized, market forces tend to move to correct them and, if the imbalances have become at all general, to bring on readjustments that sometimes become serious. Prices as well as employment are likely to react when an inflation stops as the result of major imbalances.

The most constructive results ensue when inflation is stopped because appropriate fiscal and monetary policies are applied in time. As I said in my statement (page 13): "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." This type of constructive result takes place recurrently in the course of the business cycle when the forces generated during the upswing do not culminate in an inflationary spiral but rather diminish in potential as full capacity is reached. Adjustment of this type takes place without severe price repercussions. The higher price level prevailing at the time of the adjustment tends to be maintained except as it may subsequently reflect increases in productivity.

An inflation will stop when a condition is achieved where current investment can be financed out of savings without undue reliance on newly created money and where prospective savings and investment are not motivated by the expectation of further or continued inflation. As I said in my statement (page 13), "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."

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?

An article "Federal Financial Measures for Economic Stability," published in the Federal Reserve Bulletin for May 1953 (reprint attached), answers this question as well as the first part of question 16.

FEDERAL FINANCIAL MEASURES FOR ECONOMIC STABILITY[1]

Government financial measures are especially appropriate for promoting stable developments in private enterprise economies. For the most part they are impersonal and operate indirectly through markets by their effects on incentives to spend. To the extent that sources of instability are financial, moreover, they deal with basic causes.

The preceding article in this series explored in some detail the relation of credit and monetary action to economic stability. Before considering the functioning of the several instruments by which such action is effected, it is desirable to discuss, briefly and broadly, credit and monetary measures in relation to fiscal measures and debt management, the other financial methods available to the Federal Government for influencing the flow of the economy's expenditures. Each of these methods has a special and complementary role to play in sustaining orderly and stable progress.

Credit and Monetary Measures

Credit and monetary actions affect expenditures particularly of the private sector of the economy. As explained in earlier articles, they exert an influence on the availability and amount of credit, on the cost of lending and borrowing (both public and private), on the volume of saving, on capital values, on the volume of money, and on the value of the dollar at home and abroad.

There are three main methods of executing credit and monetary action—discount operations, open market operations, and changes in reserve requirements. Though they operate somewhat differently, each influences bank reserve positions and hence affects the ability and willingness of commercial banks to lend. Since the banks are a major factor in the credit market, changes in their ability and willingness to lend affect the whole credit market, that is, the general availability, cost, and volume of credit.

Bringing about credit restraint or ease through these measures has widespread effects on the economy. Their most direct impact is on the amount of spending done with borrowed funds. There is almost always a fringe of borrowers or potential borrowers whose decisions about investments with marginal profitability or about consumption of marginal usefulness are influenced by changes in the availability or cost of credit. As lenders become less able and less willing to lend, they both increase the rates of interest at which they lend, thus cutting back some of the demand for funds, and raise their standards of creditworthiness applicable to new borrowing. As lenders become more able to lend, they will lend at lower rates of interest and accept higher-risk borrowers. These credit developments have secondary effects that are reflected in spending and savings activities of all sectors of the economy.

A supplementary method of exerting an

[1] This is the third of a series of articles considering the operation of credit and monetary policy in the United States. These articles are based on selected replies submitted early in 1952 by the Board of Governors of the Federal Reserve System to a questionnaire from the Subcommittee on General Credit Control and Debt Management of the Congressional Joint Committee on the Economic Report. The material selected has been modified and expanded in order to bring it up to date and to fill gaps in content resulting from the fact that the original material was organized in reply to definite questions.

Preparation of the articles is under the direction of Ralph A. Young, Director of the Division of Research and Statistics.

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influence over credit conditions is the use of selective instruments which directly affect the equity or maturity terms of specific types of loans extended by banks and other lenders. At present only stock market credit may be regulated in this way.

In some periods of expansion, certain credit sectors may not be readily responsive to general measures of credit and monetary restraint. Examples of such developments are the growth of stock market credit in the late 1920's and expansion of consumer instalment credit and mortgage credit after the outbreak of fighting in Korea. Regulation of stock market credit was authorized in the mid-1930's to enable the reserve banking authorities to prevent a recurrence of excessive stock speculation financed through credit. Regulation of consumer credit and real estate construction credit was authorized on a temporary basis after Korea in order to effect restraint in these credit areas during an abnormal period. Regulation of consumer credit had earlier been used to curb personal spending financed by credit during the war period and in immediate postwar years.

Credit and monetary measures are indispensable to stable progress, but alone they cannot assure that progress. Their effectiveness will be conditioned by Federal fiscal action and debt management and by various specific Government programs. Their effectiveness may also be conditioned by unpredictable and sudden developments and changes in moods and impulses that affect activity in the economy.

Credit and monetary action, while powerful in combating an inflationary upswing, is sometimes viewed as being less effective in counteracting a deflationary downswing. This view is largely based on experience in a few depressions which followed major booms in which economic activity was seriously distorted. In these instances, shaken confidence of both lenders and borrowers militated against active response to an increased availability and supply of credit and money and a reduced interest cost of borrowing. While expansionary credit and monetary policy was essential to economic recovery under such circumstances, it was not sufficient by itself to achieve it.

The administration of credit and monetary measures is a task involving discretion, patience, and judgment. Action must be guided not by a single indicator or simple combination of indicators but by a balanced assessment of the entire credit and economic situation in the light of the fullest information available. Action, moreover, must be adapted promptly to changing conditions, because its full effectiveness on the economy will not be felt until after some time-lag. To the extent that promptness is not achieved, credit and monetary policy falls short of its potential and may even itself be a source of instability.

Fiscal Measures

Fiscal measures work mainly through the money collecting and money spending activities of the Federal Government. The amount, type, and timing of tax collections and of Government outlays affect expenditures directly and indirectly throughout the economy, and these effects will vary with the size of the Federal budget. Through the level of taxes, Government revenues influence directly the amount of private income available for spending, and because the Government buys large amounts of goods and employs large numbers of workers, its outlays affect directly demand and supply in specific markets. Federal fiscal activities also have indirect effects in stimulating private expenditures and in influencing the general economic outlook in a fashion similar to the action of credit and monetary policy. In addition, fiscal action may shift the distribution of income, alter the uses made of the nation's resources, and have repressive or incentive effects on economic productivity and output.

The influence of fiscal action on economic stability arises chiefly out of a difference between the Government's cash receipts and cash expenditures. The difference causes a cash flow of payments between the private sectors of the economy and the Government. In general, a cash flow from the Government has expansive effects on the economy's overall expenditures, while a cash inflow has contractive effects. These effects induce further spending or restriction of spending in the private sector.

Various combinations of taxation and Government expenditure programs will have different effects on total expenditures in the economy. For example, increased taxation combined with reduced Government spending will have contractive effects on the nation's spending activities, and hence be appropriate to a period of inflationary pressures. On the other hand, reduced taxation combined with increased Government expenditures will expand the total volume of expenditures during a period of recession. This assumes, of course, that specific Government expenditure programs are not of the kind that displace or compete with private economic activity, thereby discouraging rather than stimulating business confidence, private investment, and private consumption.

To some extent, changes in tax and Government expenditure programs come about automatically over the course of business fluctuations. This built-in flexibility of the budget tends to counteract swings in private spending without deliberate action on the part of the public authorities. For instance, with graduated income taxes the Government takes a larger part of national income at higher than at lower levels, and a change in national income will be quickly reflected in the tax take under existing pay-as-you-go tax arrangements. At the same time, Government expenditures as a result of the social security and agricultural support programs will tend to be greater in depressed periods than in prosperity.

Reliance upon built-in budget flexibility to adapt fiscal policy to severe economic fluctuations is unfeasible so that some discretionary action through legislative processes must be counted on for this purpose. By their very nature, however, the fiscal tools of tax and expenditure programs are complex, and they involve controversial aspects such as their effects on the distribution of income, on incentives to produce and to save, and on industrial and regional development. Speedy action, consequently, is difficult. Much time is necessarily absorbed in the legislative process—in the initial formulation of programs and in their consideration and final enactment. Execution of both tax and expenditure programs requires additional time, although to the extent that taxes are paid on a current basis the effect of tax changes is fairly immediate. In a downturn, expenditure programs may be hard to get into operation as promptly as needed; in a boom, it may prove to be impractical or wasteful to bring long-range programs to a halt.

Even if it were possible to get sufficient variation in fiscal action, it might be impracticable and possibly inadvisable to vary the whole program of Government expenditures and taxation primarily in accordance with the evident needs of economic stability. In some situations, other policies are so important as to outweigh considerations of economic stability in governmental decisions: the conduct of war or the undertaking of a major defense program are striking examples of such situations. Many large items in the budget are directed toward noneconomic objectives and do not lend themselves to the flexible treatment required in countercyclical fiscal policy. Furthermore, anticyclical actions may be in conflict with measures based on other important criteria. The tax structure needs to take account long-term investment growth and taxpayer equity. Remedial action based on these criteria is a desirable goal at all times but may not always be consistent with immediate programs aimed at stability.

Because discretionary fiscal action involves many special problems and cannot always be taken speedily, decisions as to its timing usually involve the difficult art of long-term forecasting. On the one hand, any action will affect economic activity only after some time lag, and anticipatory action runs the risk of accentuating rather than ameliorating cyclical fluctuations. On the other hand, the countercyclical potential of fiscal action is severely diminished if steps are delayed until the economy finds itself in recession or boom.

Different combinations of taxation and Government expenditures result in deficits or surpluses and accordingly involve Treasury borrowing or permit repayment of borrowing. The amount of the borrowing or repayment is determined by fiscal action; the manner and kind of borrowing or repayment are in the realm of debt management. The extent of the expansive or restrictive impact of fiscal measures depends not only on the relation between taxation and expenditures but in part on debt management operations. The effects of fiscal action in attaining economic stability are thus related also to debt management, and the effectiveness of this relationship in turn depends on the financial climate created by credit and monetary measures.

Debt Management

As a complementary tool of countercyclical financial policy, debt management now has great importance because of the present size of the Federal debt and because of the special role such debt plays in the asset structure of financial institutions. The Federal debt now amounts to about two-fifths of the economy's total debt. It is the only debt that is entirely free from credit risk. Short-term Federal debt serves as a principal liquid or operating reserve asset of banks, other financial institutions, and business corporations. Longer-term Federal debt functions as a major investment asset of individuals and savings institutions and competes with other investment media in absorbing the economy's money savings. The types of Government securities issued thus have a significant effect on the liquidity of the entire economy and on the market for other securities.

Debt management has two major aspects. It involves refunding operations affecting the maturity arrangement of outstanding debt. It also involves the expansion or retirement of debt in response to the current cash deficit or surplus of the Government. The maturity composition of the debt has its most direct tie with credit and monetary policy while the changes in the amount of debt are most immediately related to fiscal policy. Both aspects combine to determine the composition of the total Government debt at any given time and in this process exert an influence on the attainment of economic balance.

Management of the Federal debt makes a primary contribution to economic stability by arranging a maturity composition of that debt that will support and not impede development of appropriate credit and monetary policy. In general, such a debt distribution would be one with maturities well spaced over a period of years. This kind of maturity distribution is also important for administrative reasons in debt management.

There is, of course, constant need for a large volume of short-term issues to meet the basic liquidity requirements of banks, financial institutions, business corporations, and others. In a period of economic slack or depression this liquidity may be expanded by issuing additional short-term obligations. In the subsequent period of expansion the volume of these issues may be reduced somewhat by refunding operations or by retirements out of surplus.

To change the existing debt structure, however, takes time. Financing decisions of the past necessarily impinge heavily on the present and the future, and debt management actions must continually be a compromise between what may be most appropriate for the current economic situation and what may be appropriate in terms of a longer-run view of economic stability. This balance in judgment relates primarily to the volume of very short-term securities which may be outstanding at any time. Because the liquidity of such securities is not readily influenced by credit and monetary measures, the greater the proportion of the debt in these issues the less responsive the economy will tend to be to restrictive credit and monetary action when such measures may be appropriate.

From the point of view of economic stability, the maturity distribution of outstanding debt should always be such that moderate changes in the level of interest rates will have an important effect on the liquidity positions of holders, thereby influencing spending and lending decisions. To attain this, a sizable portion of the debt should be spread out over intermediate and long-term maturities so that when interest rates decline, and the market prices of these securities therefore rise, liquidity positions of holders will come to be regarded as more adequate than formerly. Conversely, when interest rates rise and security prices decline, holders will tend to view these positions as less adequate. Such a spread maturity distribution would limit the dependency of debt management on current interest rates and security market conditions and, on the other hand, would increase the sensitivity of the entire economy to interest rate changes.

Within the standards set for debt balance, current debt management can operate to reinforce or offset in part the impact of a Federal deficit or surplus. For example, a deficit in a recession period may be made somewhat more effective if in its financing the emphasis is placed on the use of shorter-term obligations. The expansive effects will tend to be greater and will support an expansionary credit and monetary policy to the extent that such issues are absorbed by the banking system and foster expansion in the money supply. Conversely, a surplus in a boom period will be more effective as a restraint on expenditures if it is used to retire short-term debt rather than to purchase long-term securities in the market. The restraining effects will tend to be increased and will reinforce restrictive credit and monetary policy if the repayment of debt reaches the holdings of short-term issues by the banking system, thus affecting bank liquidity positions.

Debt management actions to promote economic stability through shifts in terms and maturities of security offerings are limited by the necessity of meeting existing market conditions. Public debt must be handled so that the investing community will be receptive to new issues from refunding operations and will take additional debt into its portfolio. While public debt differs from private debt instruments in quality, public debt instruments compete with similar securities of private origin in the market. In short, the debt must be in such form that it is readily assimilated in the market.

There are other practical problems of debt management to be resolved. Recently, acceleration of corporate tax payments has resulted in a concentration of Treasury receipts in the first half of the year while Government outlays are more evenly distributed. This necessitates a seasonal pattern of short-term borrowing and repayment of borrowing even if the cash budget is in balance.

Debt management must develop its policies and feel its way not only in response to immediate Treasury needs, to security market developments, and to investor preferences, but also with regard to the cost of servicing the debt. From both the standpoint of interest cost and economic stability there are many alternative arrangements of a given debt. Problems of current interest cost must be weighed against the costs to the Federal budget and the economy in general if debt management decisions are excessively inflationary or deflationary. They must also be weighed against possible future interest costs under different economic circumstances. Debt management decisions thus must consider both the present and future, as well as the implications of action on the effectiveness of other instruments for achieving economic stability.

Interaction of Financial Measures

The combination of credit and monetary measures, fiscal measures, and debt management that will be most appropriate at any particular time will depend on the circumstances prevailing and on the feasibility of action in one field or the other. How they are interrelated in Government policy can be shown by a brief description of their use in periods of contraction and inflation.

Periods of contraction. In combating recession and deflation, fiscal measures can make a broad, direct attack by lowering taxes, increasing Government expenditures, or both, in an effort to cushion or offset the decline in the total volume of private income and expenditures. These fiscal actions will make for an excess of expenditures over receipts and an expansion of public debt.

Debt management as well as credit and monetary measures will condition the impact of fiscal action. The expansionary potential will be affected by the manner in which the deficits are financed. The effect will be greatest if the deficit is financed with funds that would otherwise have been idle or with new deposits generated by bank investment. The effects of a Federal deficit may be partly neutralized if it is financed with funds that might otherwise have found outlet in private consumption or investment. In summary, fiscal measures by themselves can produce an increase in total expenditure by an excess of expenditures over tax receipts, and perhaps to some extent by changes in tax and expenditure patterns which take advantage of differential tendencies of various sectors of the economy to spend for investment and consumption. The rise in expenditures promoted by fiscal measures will be far greater, however, if debt management and credit and monetary actions are also operating in a way that stimulates total demand.

In depressed periods, credit and monetary measures should ease bank reserve positions, making bank credit and other credit cheaper and more readily available. Such action will encourage the use of credit and prompt a rise in Government security and other capital values, thus increasing the economy's liquidity. This kind of policy will also facilitate financing of any Federal deficit. If some substantial portion of the new securities offered are shorter-term obligations, debt management will be functioning at the same time to increase the liquidity of the economy. To the extent that such securities are purchased by banks there will be an offset to contraction of private bank credit and a consequent stabilizing effect on the volume of money. Along with an expansionary credit and monetary policy, this will help to develop a condition of banking liquidity favorable to private bank credit expansion and resumed growth in the money supply. Increased liquidity of lenders generally will also help to swell the flow of credit.

Expansion periods when inflationary pressures are strong. When inflationary pressures are strong, it is of paramount importance that fiscal, credit and monetary, and debt management policies supplement one another in limiting expansion of both public and private demand. At such times, fiscal policy should avoid deficits and aim for surpluses in order to restrain expansion of expenditures. Credit and monetary policy should restrict bank reserve positions, making bank and other credit less readily available and more costly. This will dampen the expansion of bank credit and the money supply and lower capital values, thus reducing generally the liquidity of the economy. This kind of action will put a brake on expansion of spending financed by credit and at the same time operate to increase saving. Debt management policy should be directed at reducing the liquidity of the existing debt by refunding some maturing issues into longer-term obligations and by applying surpluses, when available, to reduce the volume of short-term debt. Reduction in liquidity so effected will exert a retarding influence on the momentum of spending. Thus these three methods of Federal financial policy can work consistently in an inflationary period toward the primary goal of economic stability.

To the extent that any of these instruments does not work toward combating inflationary trends, the burden is made heavier on the others. Total spending will not decline as a result of fiscal action if the dollars taxed away are replaced by dollars created by bank credit expansion; nor will restrictive credit and monetary policy be fully effective if fiscal or debt management policies are expansive. At times in expansion periods it may be difficult to avoid stimulative fiscal policies, and credit and monetary policy together with debt management must then carry an extra load.

* * *

The combination of credit and monetary measures, fiscal measures, and debt management that will be desirable at any particular time will depend in some degree on the special circumstances prevailing and on the feasibility of action in one field or another. These instruments of Federal financial policy are complementary, but to an extent use of one may be substituted for use of another. Inappropriate action in one area of policy, however, may overburden the task of the others and reduce their effectiveness. The greatest contribution to economic stability from Federal financial measures may thus be achieved when these are used as mutually reinforcing instruments of public policy.

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?

An article "Influence of Credit and Monetary Measures on Economic Stability" published in the Federal Reserve Bulletin for March 1953 (reprint attached) answers the first part of this question.

Attached is a list of principal policy actions of the Federal Reserve System during the period February 1945-August 1957, in chronological order.

INFLUENCE OF CREDIT AND MONETARY MEASURES ON ECONOMIC STABILITY[1]

Credit and monetary measures influence economic activity and prices initially through effects on the availability, cost, and volume of credit. Their force, however, extends beyond lenders and borrowers. It is reflected in the quantity of money, in the market value and liquidity of assets, and in the over-all liquidity of the economy. Ultimately, it is reflected in the spending and saving decisions of income receivers and of holders of cash balances and other assets.

The first article in this series provided a brief description of the nature of money, of the processes by which changes occur in the quantity of money, and of the reserve banking measures that influence expansion of the money supply. In the present article, the discussion is pursued further to consider the ways by which reserve banking action affects the lending and investment decisions of commercial banks and other lenders, alters the decisions of borrowers, and influences the lending, spending, and saving of all sectors of the economy. The discussion deals only with the mechanism by which credit and monetary measures affect the tempo of economic activity and thus contribute to stable economic progress.

[1] This is the second of a series of articles considering the operation of credit and monetary policy in the United States. These articles are based on selected replies submitted early in 1952 by the Board of Governors of the Federal Reserve System to a questionnaire from the Subcommittee on General Credit Control and Debt Management of the Congressional Joint Committee on the Economic Report. The material selected has been modified and expanded in order to bring it up to date and to fill gaps in content resulting from the fact that the original material was organized in reply to definite questions.

Preparation of the articles is under the direction of Ralph A. Young, Director of the Division of Research and Statistics.

Some General Observations

Credit and monetary measures have widespread effects in encouraging or discouraging expenditures. A general tightening of credit has its most direct effect in restricting the amount of spending with borrowed funds. Credit restraint also curbs the expansion of money, and so limits increases in the amount of cash balances held by individuals, businesses, and other spending groups.

Credit restraint, moreover, has important deterrent effects on spending out of existing cash balances and from funds obtained by the sale of assets, where no credit granting and no money creation are involved. These are indirect effects which come about in a number of ways. There may be a dampening of too optimistic expectations of businesses and consumers. A rise in interest rates produced by credit tightening will tend to reduce the value of capital assets, a development that will discourage some new investment in construction and in producers' equipment. Consumers and businesses may decide to save more, either because they are less sure that credit will be available for possible emergencies or to ensure fulfillment of future plans, or because the interest return on savings has become more attractive.

Easing of credit, on the other hand, tends to have opposite effects. It encourages spending with borrowed money. It also stimulates greater spending out of current income and past savings. Credit easing does this by promoting the belief that prices of goods will rise, by reducing interest rates and thereby both lowering the cost of borrowing and stimulating a rise in capital values, and by

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making it less necessary and less profitable for businesses and consumers to save.

Whether a tightening or an easing of credit will find a response in the demand for credit depends on the existence of a fringe of borrowing or potential borrowing. That is, greater difficulty in obtaining credit or increased cost of credit influences decisions of borrowers by deterring them from using credit for investments with marginal profitability or for consumption of marginal usefulness. It may also deter borrowers from using as much credit for other purposes as might have seemed profitable or useful had credit conditions remained unchanged. In a boom period, when credit is in great demand, there is always fringe borrowing which can be cut out either by greater selectivity in lending or by higher interest costs. If an easing of credit is to stimulate borrowing in a period of business recession, there must be a similar fringe of potential borrowing which will become effective when credit is more readily available and cheaper. Under most conditions such a fringe exists, and an easing of credit will stimulate borrowing in amounts or for purposes that were previously not regarded as profitable or useful, and for purposes for which credit could not previously be obtained.

This fringe of potential borrowing, however, may be very limited under special circumstances. In a period of inflationary boom, investment in plant and equipment (productive capacity) and in housing and purchases of durable goods may proceed so rapidly, unless checked somewhat, that future needs will be too far anticipated. Then, in case of a serious business downturn, many activities involving credit that would ordinarily have been greatly stimulated by an easing of credit may not respond, because for the time being the demand for them has already been filled in the previous boom. Other potential borrowers may feel so discouraged about profit possibilities as a result of the downturn that they too will not borrow, however cheaply and readily credit may be available. Once such conditions and attitudes have developed, the immediate effect of an easing of credit will be limited, although such an easing is still an essential measure in setting the stage for ultimate recovery. The ability to combat a recession with credit and monetary action, therefore, depends in large part on the extent to which restrictive credit action has been taken in the preceding boom, as well as on how early and aggressively easing action occurs after a downturn.

A general tightening of credit results from a reduction in the availability of credit relative to the demand for it. Such tightening may develop because the supply of credit has contracted without a corresponding reduction in demand, because the demand for credit has increased without a corresponding increase in supply, or from some combination of these. In a boom period, demand for credit typically increases and credit conditions tend to tighten even though there is an actual increase in the volume of credit granted. In order to keep credit from tightening under such conditions, reserve banking policy would need to permit the total credit and monetary base to expand at the pace set by the progress of the boom, regardless of the inflationary or other unsound developments that might be occurring.

A general easing of credit results from an increase in the supply of credit relative to the demand for it. Easier credit conditions may generally be expected to develop in a period of economic recession, except when there are banking difficulties or extreme pressures for liquidity on the part of consumers and businesses. Credit and monetary policy in such a period should encourage the development of easier credit conditions.

Effect on Lenders

A general tightening or easing of credit affects lenders in all sectors of the credit market, from short- to long-term. In the short- and intermediate-term sectors of the market, the major suppliers of funds are the commercial banks. Expansion or contraction of their loans and investments tends to expand or contract the volume of money. There are, however, many other lenders that supply a substantial volume of short- and intermediate-term credit through the investment in prime-grade marketable paper of cash balances not needed for current expenditures and of secondary reserve funds. The volume of such investment varies with the attractiveness of the interest return. The supply of bank credit is dependent on bank reserve positions, which in turn may be tightened or eased by reserve banking actions, as was explained in the first article of this series. The total supply of short-term credit is thus highly flexible.

In the market for long-term credit, the supply of funds is related to the volume of saving. Major lenders in this market, in addition to individuals, are insurance companies, savings banks, savings and loan associations, public and private pension funds, and nonprofit institutions. Commercial banks, although primarily short-term and intermediate-term lenders, also invest their time deposits in real estate loans and in long-term corporate, Federal, and State and local government securities. The supply of investment funds is relatively fixed at any time and does not adjust quickly to changes in demand. In a period of boom, however, increased demand for long-term credit tends to spill over into the short-term credit market, and in a period of recession lack of long-term credit demand may induce investment funds to seek short-term outlets. Conditions of availability and cost of short-term and long-term credit thus are constantly interacting. Moreover, the lending and investing activities of commercial banks bridge the markets and help to link them together.

Commercial banks. Individual commercial banks obtain funds primarily from the deposits of working balances and savings of individuals and businesses. For the banking system as a whole, however, most of the deposits result from credits extended by banks. Commercial banks as a group can expand their credits only to the extent that they have or can obtain the reserves needed to support the resulting growth in deposits.

The availability of reserves is directly subject to Federal Reserve influence. Aside from a gold inflow or a return of currency from circulation, which can usually be counteracted by reserve banking action, and except for certain temporary technical factors, the volume of bank reserves can be increased only by bank borrowing at the Reserve Banks or through open market purchases of securities by the Federal Reserve.

Commercial banks consider borrowing a temporary expedient. They do not like to be long in debt. Individual banks can get additional funds to lend by selling Government or other securities or by permitting maturing issues to run off. As a group, however, banks cannot expand their total supply of loanable funds in this way except when such paper is being bought by the Federal Reserve System. Unless the Federal Reserve is buying securities and thereby supplying reserves, reduction in security holdings by one or more banks will normally draw reserves from other banks and no net addition to reserves will occur. An attempt by banks as a group to obtain additional reserves by selling securities, or by allowing maturing issues to run off, will increase the supply of short-term paper for sale in the market, thus lowering prices and raising yields on such paper. Similar market pressure may result if banks draw upon balances with correspondents or call loans made in central credit markets in order to build up reserves.

At the lower prices and higher yields, Government and other short-term securities will be more attractive. Nonbank investors may be induced to buy more of them, using temporarily idle deposit balances. Sales of short-term paper by banks to nonbank investors and the use by banks of the proceeds to make loans will shift the ownership of deposits and may increase the activity of existing deposits, but such sales will not increase total bank reserves so as to permit an increase in total bank credit and deposits.

With prices lower and yields higher on short-term paper, banks are less likely to reduce their holdings of secondary reserve assets, notably short-term Government issues. Some banks may continue to do so, but others will stop selling or may buy. In the aggregate, the secondary reserve position of banks will tend to stabilize. This development is brought about in several ways. Many banks and other potential lenders are reluctant to sell securities at a loss. As the potential loss becomes greater, this reluctance deepens. Rising yields on short-term paper, moreover, make the credit outlook uncertain, and this uncertainty, together with the fact of potential losses on the sale of paper held, makes the secondary reserve positions of banks less satisfactory to bank managements. Hence, holdings of liquid assets that were previously viewed as adequate or even more than adequate come to be viewed with concern. The result is a greater unwillingness on the part of bank managers to reduce holdings of liquid securities in order to make more loans.

The key fact is that with a tightening in the credit situation banks cannot count with as much certainty on the ready availability of additional reserve funds and will therefore tend to be more restrictive in their lending practices and standards. This restraint both reflects and is a part of the process of credit tightening. As the credit and monetary climate thus changes, bankers will modify their expectations about the general outlook for business and commodity prices. Applications for loans, particularly inventory loans, will be more carefully screened. Businesses which obtain credit to accumulate inventories will be under pressure from their bankers to keep inventories more closely in line with actual requirements. Bankers will also bring pressure for repayment on many borrowers with outstanding obligations. In general, they will be alert to find reasons for refusing credit requests or not meeting them fully and for accelerating repayment of outstanding loans, rather than eager to extend credit.

When credit conditions ease, more and more banks will free themselves from borrowing and, as reserves accumulate in excess of working requirements, they will become more aggressive in competing for loans and marketable paper. Other lenders and investors will also be under pressure to keep their funds employed. This change in the credit situation will find prompt response in declining yields in all sectors of the market. Uses of credit that under conditions of credit tightness were postponed or not cultivated by lenders will be promoted by them under conditions of credit ease.

Lenders and investors in long-term market. A tightening in credit and the accompanying increase in interest rates will significantly affect lenders and investors who operate primarily in the long-term credit market, including life insurance companies, mutual savings banks, savings and loan associations, and pension funds. They will become less willing to make any but the best grade loans and investments. They will generally exercise greater caution in accept-ing marginal applications for credit.

In part this change in attitude reflects the declining value of assets associated with rising interest rates. All income-producing assets yielding a fixed rate of return tend to decline in price when market rates of interest rise. This is true because they are valued in the market on the basis of expected returns, capitalized at the appropriate current rate of interest including allowance for risk. It is easy to see this relationship in the case of prime-risk securities, since their market value changes only with changes in interest rates; when interest rates rise, the value of such securities correspondingly declines. Actually the decline can be even more marked in the case of securities or other income-yielding assets of lesser grade. As interest rates increase, investors become less optimistic about the business outlook and therefore change their appraisals of risk positions. Such changes in appraisals of risk, combined with the general increase in interest rates, will result in an even greater decline in value for lesser grade securities than for prime assets.

Thus in a period of tightening credit, long-term lenders and investors, while at first attracted by the higher yields available on assets of less than top grade, gradually become more restrictive and selective. They become less willing to sell prime securities to acquire higher-yielding but more risky assets, partly because they can sell the prime securities only at a loss, which they hesitate to accept. They also become more interested in retaining in or adding to their portfolios the more liquid types of assets, because of concern about the decline in the market value of their entire investment portfolio and the general uncertainty about future developments. In addition, the higher interest rates on these more liquid assets in a period of tightening credit come closer to providing the average interest rate which institutional lenders must obtain on their earning assets in order to meet contracts with their own creditors.

In recent decades the flow of savings to nonbank institutional lenders, particularly insurance companies, has been increasing rapidly and the size of the investment problem of these lenders has grown accordingly. In order to ensure the ready placement of funds regularly becoming available for investment from new savings and from repayment of old loans, the major savings institutions have developed techniques for committing their funds in advance to corporate, mortgage, and other borrowers. Such commitments make it possible for potential borrowers to proceed with projects which they might not undertake without assurance of financing on satisfactory terms. But nonbank lenders will hesitate to commit themselves beyond the funds they expect to have coming in if they fear that interest rates may rise in the near future and that they may therefore have to sell securities at a loss to meet future commitments. As a result, when credit is tightening, some proposed projects requiring long-term credit may be deferred because a financing commitment cannot be arranged.

When interest rates decline, investors in the long-term market will find their positions more liquid. The yields available on high-grade securities will fall and the prices of such securities will rise. This development in itself will encourage long-term lenders to extend investment into areas with more attractive rates of return. Moreover, if institutional lenders are quite certain that interest rates will fall and that prices of high-grade securities will rise, they will be willing to commit themselves to future lending that will require the sale of high-grade securities in order to make loans with a more attractive interest return.

Underwriters and security dealers are important in the money and capital market, and their responses to credit tightness in turn affect the availability of credit. They are particularly sensitive to changes in interest rates because they customarily carry a large inventory of securities in the process of distribution. They risk large losses if they are holding large amounts of securities in a period of rising interest rates, since they may not be able to sell them except below cost or may have to carry the securities for some time on borrowed money. Thus underwriters and dealers may be expected to carry securities less readily and hence to discourage security flotations while interest rates are adjusting to higher levels. When yields are stable or are expected to fall, they will be more likely to encourage such flotations.

Effect on Borrowers

Restraint on borrowing exerted by tightening credit results in part, as already explained, from the increased difficulty of finding lenders and obtaining loans. It also results in part from the influence on the borrower of higher interest costs and from his greater uncertainty about future credit and business developments.

Borrowers for business investment. Much business is done on the basis of being able to borrow capital at rates of interest lower than the return that is expected to be obtained on the use of that capital. These margins will be affected by changes in interest rates and by changes in the profitability of the businesses concerned. Each change, though small, may influence borrowing for which the profit margin is narrow, while not affecting the bulk of economic enterprise. Such small effects, however, help to maintain economic balance.

The sensitivity of business borrowers to changes in interest rates varies widely, however. In certain fields of long-term investment, such as industrial and commercial construction, public utilities, and railroads (which are large and important fields), interest costs are particularly significant. In such fields comparatively small increases in interest rates can have a substantial effect in postponing the demand for capital. Even in other fields where interest costs are less important, fringe borrowers may be deterred from borrowing when interest rates rise, while other borrowers may decide to get along with less credit. The higher that long-term rates become, and the more likely that this condition is temporary, the greater will be the tendency for long-term borrowers to postpone investment expenditures because they expect to be able to borrow later at considerably lower interest costs.

An increase in interest rates does more than just affect the cost of credit to borrowers. It also reduces the market value of existing assets unless the actual or expected earnings on these assets rise, since earnings are capitalized at a higher rate of interest.[2] The liquidity position of all asset holders is adversely affected by this development, and their willingness to undertake new long-term commitments may be influenced.

A rise in interest rates also influences the utilization of productive resources, di-

[2] In a highly developed economy such as the United States, the volume of accumulated capital assets is very great in relation to current income. Small percentage changes in the value of such assets involve large dollar amounts. In a recent study by Raymond W. Goldsmith, which is in process of publication, it is estimated that for the 145-year period 1805-1950 the average yearly rate of growth of reproducible tangible wealth in the United States was about 4¼ per cent, or about 2 per cent on a per capita basis. At the end of 1948 reproducible tangible wealth owned by individuals, businesses, and farmers was valued at approximately 600 billion dollars. Although not all of this represents assets whose value is directly affected by changes in interest rates, the figure serves to give some idea of the magnitude of reproducible assets involved. In addition, values of income-producing lands are affected, as are values of negotiable claims not represented by real assets. The study referred to is part of a comprehensive inquiry into savings and investment in the American economy, financed by a grant of funds from the Insurance Companies Investment Research Committee, with the joint participation of the two associations of life insurance companies.

recting some activity away from production of long-lived, slowly depreciating capital goods and thereby freeing resources for an immediate increase in output of consumption goods and of producers' equipment to make consumption goods.[3] An interest rate increase has this effect both by increasing the cost of long-term borrowing and by changing the relationship between prices of existing capital assets and the cost of producing new assets. In the fixed capital area these changes, together with changes in the outlook for profits and risks due to the altered credit and monetary situation, shift the balance of business decisions toward holding or buying old assets, and adapting old assets to new uses, rather than buying new ones.

How the changed relationship between prices of existing capital assets and costs of producing new ones occurs is illustrated below. The illustration pertains to hypothetical office buildings with a net income from rent of $100,000 a year.

Estimated cost of constructing new building	$1,500,000
Capitalized market value of existing building with earnings from rent (net of all current costs and depreciation) of $100,000:	
If the current interest rate, with allowance for risk, is 6 per cent	1,666,667
If the current interest rate, with allowance for risk, is 7 per cent	1,428,571

[3] Accelerated tax amortization for a capital good shortens the book life of the capital asset and reduces the period of borrowing that may be involved in its purchase. Long-lived capital goods may thus be made, in effect, more equivalent to shorter-lived producers' equipment, both from the standpoint of the effects of credit tightness on their purchase and from the standpoint of the obsolescence risk involved.

If the current interest rate for such investment, with allowance for risk, were 6 per cent, the capitalized value of the existing property would be more than the cost of constructing a new building with the same earning prospects. An investor in this type of real estate, instead of buying an existing building, would build a new structure, other things being equal. If, on the other hand, the relevant interest rate were 7 per cent, the decision would go the other way.

Business borrowers in the short-term market may also be greatly influenced by changes in credit conditions. Inventory accumulation is normally financed in substantial part by short-term credit. When businesses have been building up inventory positions, a tightening in the credit and monetary situation removes some of the incentives for inventory accumulation. Uncertainty with respect to the possibility of renewing the credit, moreover, increases the possibility that inventory holdings may have to be sold under unfavorable market circumstances. This deters particularly inventory accumulations of a purely speculative variety.

Lower interest rates, through their effects on costs, capital values, and business anticipations, will encourage borrowers to make additions to physical property and also to accumulate inventory.

Consumer borrowers. Use of credit by consumers is not subject to direct restriction by higher interest rates in the credit market. Consumer credits are generally extended on fairly standardized terms and at relatively high and inflexible credit charges. The rates paid for money at wholesale by the institutions that lend to consumers is only one of a number of important costs elements in the credit charge to consumers at retail. Thus changes in interest rates in the credit market have a less than corresponding effect on the charge for credit to consumers. Nevertheless, the interest cost is one important element in lenders' cost, and general credit tightness or ease tends to be transmitted to consumer credit through its influence on the strictness or leniency of credit standards applied by consumer-credit-granting institutions. Alteration of credit standards is a method by which lenders in this area control other important elements of their costs, namely, collection costs and losses by default. Because of the nature of the consumer credit market, selective credit regulation has been used in this field during emergency periods.

Residential mortgage credit. Mortgage borrowing for house purchases is considerably affected by increases in interest rates. Borrowing to buy houses is typically long-term and on an instalment-repayment basis. An increase in the interest rate, which adds to the monthly mortgage payment, raises the attractiveness of rental housing compared with ownership. Total spending for houses may thus be reduced, as some buyers are discouraged altogether and others are induced to buy cheaper houses. The effect of this on economic activity is felt most directly through the market for new houses. The size of the monthly payment on a mortgage, however, reflects the length of the borrowing term as well as the interest rate. By lengthening the period of mortgage repayment the restrictive effect in the housing sector of an increase in interest rates may be largely offset. It is, consequently, highly important to avoid encouragement of longer mortgage maturities during a period of boom when credit tightness is being relied on to maintain economic stability and hold down inflationary pressures. The tendencies described, of course, work in reverse to stimulate house purchases during a period of recession.

Investors and traders in corporate stock. The direct effect of changes in interest rates on demand for credit to finance purchases of corporate stocks depends largely on what is happening in the stock market. When stock prices are stable, credit tends to be used by regular investors and professional traders who deal in lots of substantial size and expect only small unit profits. Credit demand for such transactions may be sensitive to interest rates, since the increased cost of higher rates may wipe out profits, while lower rates will tend to add to profits. On the other hand, when stock prices are rising or declining under the impact of speculative pressures, the expectation of quick capital gains may be so strong as to make borrowing costs a matter of distinctly secondary importance. In such circumstances, selective credit regulation of margin requirements on loans to purchase or carry stocks can aid in restraining credit expansion in this area.

Tighter or easier credit conditions may indirectly affect borrowing on stocks through their influence on the pace of economic activity. The willingness of individuals to buy and hold stocks, both outright and on credit, is necessarily related to their judgments of business developments and prospects.

Effect on Saving

Changes in credit conditions and concomitant changes in interest rates will affect the volume of savings. If some groups in the economy increase their savings, an increase can take place in investment expenditures, or in consumption expenditures financed by borrowing or by drawing down asset holdings, without resulting in an increase in the total demand in the economy.

To trace the effects on saving of a tightening or easing of credit and the accompanying changes in interest rates requires a many-sided approach. To begin with, one needs to have in mind some facts about the term "saving" as it is generally used. First of all, saving may be done not only by individuals (including unincorporated businesses) but also by corporations and certain other institutional forms in the economy. Second, and more important, the aggregate volume of individual or other saving in any period is a total of the experiences of all who saved in the period, minus the total of all who consumed, or distributed as dividends, more than their incomes—that is, dissaved—by borrowing or by drawing on accumulated assets. Third, there are many forms of saving, or rather many uses of saving, and they vary in their response to credit tightening or ease and in their economic effects. In a discussion of how saving is affected by changes in credit conditions, each of these points must be considered.

For saving by individuals, credit tightness and a rise in interest rates, for example, may set up several cross currents of response. Some individuals save for the purpose of building up assets that will provide a retirement income of a certain size. As long-term interest rates rise, the amount of saving required for such an income declines. Such savers can reduce their saving and still meet their needs, if they choose to do so. On the other hand, some individuals are concerned about the current return and will save more when a more attractive return is available. It is not easy to establish where the balance of these motivations may be.

It is not necessary, however, that those who save increase their total saving in order to have an increase in the aggregate of personal saving. An increase in the aggregate of saving may be achieved by a reduction in the volume of dissaving—that is, a reduction in the extent to which consumption is financed by using past savings or by borrowing.

Here the effect of a tightening credit policy is clearer. First, since credit is less readily available, the amount of dissaving with borrowed funds will be reduced from what it would otherwise have been. Second, dissaving through the use of previous savings will also be discouraged, depending on the form in which such savings are held. For savings held in marketable bonds and many other noncash assets, a decline in market values will accompany the general rise in interest rates. The sacrifice of principal involved in liquidation of these savings will deter dissaving of this kind. Dissaving through the use of past savings held in savings accounts or in other liquid forms will be less penalized. For some types, however, the current interest return will rise with the general advance in interest rates and thus the accumulated savings will be more attractive to keep.

Another important consideration when credit conditions are tightening is that dissaving of any kind will be discouraged, and saving encouraged, by the fact that action to restrict the availability of credit is being taken for the purpose of restraining speculative and inflationary trends. There will be less incentive to hedge against advancing prices by buying in anticipation of such advances. The fact that measures are being taken to tighten credit and to curb monetary expansion will in itself reduce the likelihood of rising prices and lessen the incentive of individuals to buy goods ahead of needs. Also, overly optimistic expectations as to future income, other than from interest, will be tempered, and saving will be encouraged as a matter of prudent management of personal finances.

A business corporation saves when it pays out less in dividends in any period than it makes in profits. Dissaving occurs when losses are sustained or when more is distributed in dividends than is made in profits. Total corporate saving over any period is equal to the sum of all such saving minus all such dissaving. Again taking the situation of credit tightening, corporations that plan to expand plant and equipment are likely to be more cautious in their dividend policies (save more) in order to ensure that funds will be available for such outlays. Because availability of credit is uncertain, other corporations will be inclined to hold larger cash balances rather than to increase dividends—on the chance that an emergency or a profit possibility requiring cash might develop.

Savings may be held or used in many different ways. Personal savings, for example, may be invested in capital assets, either directly, such as in houses or individual business enterprises, or indirectly, such as in corporate stocks or bonds. Savings may be held as accumulated cash balances in demand deposit accounts or as currency holdings. They may be channeled into savings institutions through increased ownership of savings deposits or shares, or through the building up of claims in pension funds, annuities, or life insurance. Savings may also be kept in savings bonds or other Government securities.

The form in which savers wish to hold savings, current or past, is of great importance for economic stability. A policy of credit and monetary restraint, for instance, can influence the decisions of many savers, both individuals and corporations, to invest new savings in such dollar claims as savings deposits or Government securities and to keep old savings in that form. Yields on these investments tend to become more attractive. At the same time the desire to invest in goods in order to beat price increases is reduced because the expectation of price increases, particularly of capital goods, is lessened. Holders of certain liquid savings, such as bonds, are discouraged from liquidating them to invest elsewhere by the fact that the selling prices of the bonds decline with increasing interest rates.

In a period of recession, increased credit availability and declining interest rates, together with the expectation of continuing monetary ease, will tend to make employed individuals more willing to spend and go in debt for consumption and business purposes and corporations more willing to maintain dividend payments even though borrowing is required to provide for plant and equipment outlays. Both individuals and corporations will be encouraged by the greater certainty of credit availability and capital gains on assets held to rely on sales of such assets if necessary to meet future needs. Added to all this will be a growing confidence that declines in incomes and prices will be checked. Relatively low levels of interest rates on prime assets under such circumstances may encourage savers to invest in lower grade, higher yielding securities.

Effects Traced by Categories of Economic Activity

Gross national product of an economy may be divided for analytical purposes into categories of investment and consumption. Credit and monetary policy actions influence activity in these areas in varying degrees. For illustrative purposes it may be helpful to outline the effects of credit tightening on spending for broad categories of goods and services. The effects of credit easing would be generally the opposite of those for credit tightening. The discussion will be limited primarily to the initial and direct effects of credit and monetary action. No attempt will be made to relate to special economic sectors the pervasive indirect effects of such action.

Gross private domestic investment. New construction is ordinarily financed to a considerable extent through long-term credit. The volume of expenditures for this purpose is thus subject to substantial direct influence through credit measures. This is true of outlays for housing and for business construction, but perhaps most particularly for housing. In addition to the direct restraint through reduced credit availability, the effect of rising interest rates on capital values and on profit expectations is a restrictive factor in the construction area.

Since producers' durable equipment is frequently bought on credit, reduced availability of credit curtails such purchases. For some producers' goods the credit period is typically long and the interest rate is an important cost consideration. Interest cost is particularly relevant in connection with investment in heavy, long-lived equipment. The effect of rising interest rates on capital values and in changing the relationship between prices of existing capital assets and the cost of producing new assets is also of considerable significance here. In the purchase of some other types of equipment, credit is usually shorter term, and here the factor of interest cost may be less important, although less ready availability of credit is a deterrent to borrowing.

Changes in business inventories are influenced to an important extent by reduced availability of credit, for inventory investment is heavily dependent on short-term credit. There is usually a close business relationship between bankers and inventory borrowers, and changes in the credit climate will be quickly reflected in bankers' advice to borrowers to proceed cautiously. In addition, the mere existence of a policy of credit restraint will help to reduce the expectation of rapid price advances that encourage inventory speculation.

Personal consumption expenditures. Automobiles, household appliances, furniture, and other durable goods are frequently bought on credit, and limitation on the availability of credit will reduce such outlays. Interest rates in the credit market, however, have relatively little bearing on credit charges to consumers where credit is available. Because of general credit tightness, nevertheless, credit grantors will need to place greater emphasis on the creditworthiness of borrowers and on the terms on which the credit is extended. This change in lenders' attitudes will exclude some borrowers from the market, and the existence of some credit tightness will encourage others to postpone durable goods purchases if they expect lower prices later.

Credit is not a key factor in purchases of nondurable goods, although credit restraint may indirectly curb such expenditures by making it necessary for consumers to use more of their available cash and less credit for housing and for durable goods purchases, thus curtailing the money available for spending for other purposes. Also, merchants, because of reduced access to credit and higher interest costs on carrying charge account receivables, may screen applicants for such accommodation more carefully and pay more attention to prompt collection of outstanding accounts. Credit tightening will further have some influence on nondurable goods purchases through its encouragement of saving, which will presumably reduce buying of these as well as other goods, and through its effect in reducing the expectation of price increases, which will lessen advance buying of goods.

Since services are usually not bought on credit, credit tightness will have relatively little direct effect on such spending. Expenditures in this area will be affected indirectly in ways similar to the effect on spending for nondurable goods.

Net foreign purchases. A restrictive credit policy will tend to reduce the dollar volume of United States imports. Effects upon exports will be mixed. To the extent that restraint of domestic demands reduces prices, some United States materials and products may become more attractive to foreign buyers, and exports may be stimulated. On the other hand, foreign purchases in this country may be reduced if short- or long-term credit in this country is restricted and if no alternative means of financing such payments are available. On balance, the over-all short-run effect on United States export-import trade is difficult to predict.

International movements of liquid funds to this country in response to interest rate increases or to changes in the outlook for stability in the United States economy might be substantial. If so, they would tend to be reflected in a flow of gold to this country, which would ease the credit situation somewhat unless offset by reserve banking action or other factors. Such movements of funds would tend, however, to tighten reserve positions abroad and might lead to restrictive credit developments there, assuming that inflationary pressures were world-wide. This would curb foreign demand for goods and reduce foreign purchases of goods in this country.

Government purchases of goods and services. The general availability and cost of credit, particularly in the long-term capital market, has an influence on the timing of State and local government outlays which require credit. The outlays of the Federal Government are influenced considerably less by the availability and cost of credit.

Secondary Effects

The effects of changes in credit conditions on lending, spending, and saving discussed in this article are their initial and more direct results in combating excess or deficient demand and resultant inflationary or deflationary pressures. These initial effects are succeeded by secondary effects which may be of great importance. If credit becomes tighter, for example, initially less money is paid out to consumers at a time when additional money income would merely increase prices without expanding the supply of goods available. As a result, there will be less to spend for goods and services in later periods, and accordingly an abatement in further pressure of demand against the supply of goods. Curtailed spending for consumer goods and other finished products in turn will have a dampening effect on the demand for machines and other producers' equipment to make them. Consumers and investors may anticipate these secondary effects and, through their attitudes and actions, may bring them about more promptly and in greater amount.

Magnitude of Interest Rate Changes

Interest rates, as the prices paid for credit, perform the important function of influencing the flow of funds into various channels. They also serve as a basis for establishing the present value of any assets which are expected to provide income over a succession of years. Changes in interest rates constitute signals and incentives by means of which demand for funds is kept in balance with supply.

Thus far the discussion has been carried on without specific reference to the magnitude of interest rate changes. As has been explained, a tightening of credit involves an increase in interest rates; an easing of credit, a decline in interest rates. Higher interest rates tend to eliminate some marginal demand for loans. At the same time the increased interest rates, combined with capital losses on assets and a change in business expectations, make lenders more selective in their lending activities and spenders in general less willing to spend. Conversely, lower interest rates tend to increase marginal borrowing, to encourage lenders to expand into lower grade securities, and to make spenders generally more willing to spend.

The magnitude of interest rate changes

necessary to bring supply and demand for funds into equilibrium and to retard the development of inflation or deflation depends on many factors. This section will give some examples of these factors, with specific reference to their operation in periods of tightening credit conditions.

Kinds of interest rates. There are many interest rates because there are many kinds and grades of loans and investments. They are all related to one another in some degree and reflect in varying measure the relationship in the market between the demand for credit and the supply of funds available for lending and investing.

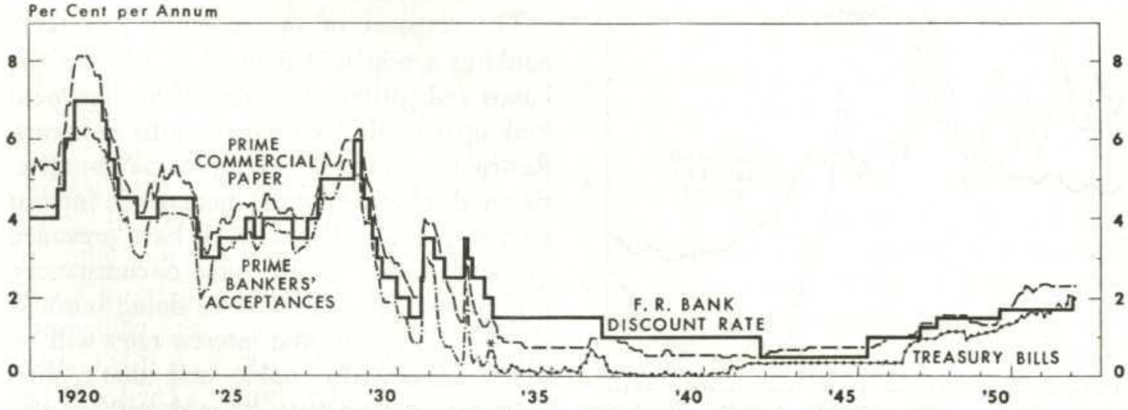
In a free enterprise system, interest rates are established by the interplay of market forces. Traditionally, reserve banking influence is directed to expanding or contracting the supply, availability, and cost of Reserve Bank credit as needed to maintain general economic and financial stability. This activity necessarily affects the supply, availability, and cost of other credit. The Reserve Bank discount rate has a relationship to the cost of credit generally. Since Reserve Bank advances are extended on short-term paper of prime quality, the relationship between the discount rate and other market rates is closest in the short-term prime credit area.

Under present conditions in the United States, Government securities play a key role in the credit market. The market rate on Treasury bills is the most sensitive index of changes in credit market forces, including particularly changes in commercial bank reserve positions. Other short-term interest rates usually have generally similar movements. When credit and monetary demands expand and member bank borrowing at the Reserve Banks increases, rates on short-term Government securities tend to rise, and this tendency toward higher rates is in turn transmitted to other credit markets. The discount rate is adjusted or not in accordance with the judgment of the Federal Reserve as to the general economic situation and the strength and soundness of credit developments. The relation of the discount rate to other short-term interest rates since the First World War is shown in the chart.

Long-term rates generally rise when short-term rates rise and decline when short-term rates decline. The tighter or easier credit conditions which accompany changes in business activity are generally felt directly in both

SHORT-TERM INTEREST RATES

Per Cent per Annum



* Rate on bankers' acceptances not shown after 1933; Treasury bill rate shown beginning in 1934.

NOTE.—Federal Reserve discount rate is rate at Federal Reserve Bank of New York; from October 30, 1942, to April 24, 1946, preferential rate on advances secured by short-term Government securities is shown. Monthly averages of prevailing weekly rates are shown for prime 4- to 6-month commercial paper and prime 90-day bankers' acceptances. Treasury bill rate is average rate on new issues during month. Latest figures are for February 1953.

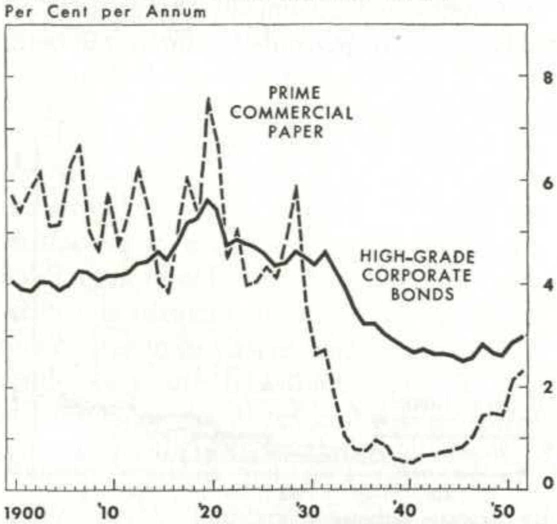
long- and short-term fields. Moreover, for some lenders the long-term markets for credit are competitive with the short-term markets.

While short- and long-term rates generally move together, the change in long-term rates is ordinarily smaller in magnitude than that in short-term rates. Lenders generally expect extreme levels of short-term rates to prevail for only a short period of time. Since the current yield on long-term securities will be received until the maturity of the security, a relatively small change in long-term rates will restore the competitive relationship. Moreover, as already noted, when yields rise the capital loss incurred on long-term securities may serve to check sales and thus moderate the rise in long-term yields. Short-term paper, on the other hand, is generally held by both banks and nonbank investors for the express purpose of adjusting to changed requirements for funds and hence tends to be sold or bought as cash assets temporarily fall below or rise above desired levels.

In recent years, long-term rates have been constantly above short-term rates, but this has not always been the case. The chart shows the relationship since 1900 between the commercial paper rate and the yield on long-term corporate bonds.

LONG-AND SHORT-TERM INTEREST RATES

Per Cent per Annum



NOTE.—Annual averages of monthly figures. High grade corporate bond yield series comprises Standard and Poor's Corporation series on high-grade railroad bonds through 1919, Moody Investors' Service series on Aaa railroad bonds for period 1920-29, and Moody series on Aaa public utility bonds beginning in 1930.

Influence of general economic and financial factors. The extent of interest rate increases under conditions of credit tightness will depend on the entire economic background at the time. To understand that background calls for careful consideration of many questions. For example, how strong are the credit demand pressures? By what forces are they being generated? How extended or overextended is the underlying economy itself? How optimistic is the climate of business expectations? And always, in appraising the possible response of interest rates to a general tightening of credit, it is necessary to take into account the established organization of the credit market and the investment and operating experience of the institutions which make up this market.

Under some circumstances, reserve banking measures involving only minor increases in interest rates would be adequate to restrain undue credit and monetary expansion; with another background, effective credit and monetary policy would require pronounced increases in rates.

The response of the economy to reserve banking action will depend in part on the habits and patterns of financial management built up over the preceding months and years. Restrictive action, for example, may be effective with relatively small increases in interest rates if existing interest levels have prevailed for some time. Under these circumstances, institutional investors will be doing business on the assumption that interest rates will remain substantially stable and that consequently securities may be sold without significant loss. To these investors and to a great many others, a tightening of credit will introduce new problems of liquidity and bring about a retrenchment in their activities, including their commitments to grant credit at some future time. In the light of extensive past experience, uncertainty regarding future interest-rate increases will promote caution among lenders as long as demand for credit continues strong.

The absolute level of interest rates prevailing at a given time and the range of variation in interest rates for various kinds and grades of credit are other factors influencing the extent to which a given credit action may cause interest rates to change. A given absolute increase in rates, for example, has a more depressing effect on the capital values of prime long-term investments if they are capitalized on the basis of a 2½ per cent rate rather than at 4 per cent. More significantly, if the spread between the rate on prime paper and the rates on secondary grade credits has been small, the impact on capital values of a given increase in prime rates will tend to be carried more quickly throughout the entire credit market than if a wider spread in rates has prevailed.

The effect of a change in interest rates depends also on the total volume of those types of assets having market prices that will respond quickly to such a change. The larger this volume is, the greater and more immediate will be the impact on the entire economy of a given interest rate movement. On balance, developments in the American credit market in the past 25 years, including particularly the large expansion in marketable public debt, have increased the importance of assets having prices that move promptly with interest rate changes.

Influence of special credit conditions. Institutional and other factors that exist in the credit market at a particular time can have a big influence on the responsiveness of the economy to credit tightness and on the size of interest rate increases that credit tightness will bring about. In 1928 and 1929, for example, speculation in the stock market had raised stock prices so high that equity capital was available to corporations on more attractive terms than debt capital. The cost of debt financing (the long-term interest rate) was increasing, but a corporation could sell stock on such favorable terms that this became the favored method of financing. In this period corporations relied heavily on the equity market for capital. Investors on their part were attracted into equities by prospects for future gains, even though yields on high-grade bonds were higher than those currently obtainable on stocks. The stock market boom in those years was based largely on margin trading financed heavily in the brokers' loan market, mostly by *nonbank* credit (loans to brokers and dealers for the account of others). Interest rates of 9 per cent or more in this market did not prevent a large volume of borrowing for speculation in stocks.

Under such circumstances, credit actions taken to restrict the general availability of credit could not easily be made effective in curbing an unsustainable speculative boom in the stock market except by affecting economic activity in general and in that way making investment in equities unprofitable. Despite the decline in long-term interest rates in the downturn that followed the eventual stock-market crash, long-term borrowing was still considerably less attractive than the equity financing that had been available to many prime borrowers in 1929. Legislation designed to prevent a repetition of this situation authorized the Federal Reserve through margin requirements to regulate the use of credit in the stock market.

Under other and quite different circumstances, restraint on credit may have a sharply restrictive influence before the interest rate rise has been large. For example, when a large amount of business financing is being done in the bond market, investment underwriters and security dealers need to carry a substantial inventory of bonds. For these institutions the ratio of capital to this inventory is typically small, and their operations are heavily dependent on the use of short-term bank credit. Moderate increases in interest rates cause the value of their inventory of bonds to decline, put their capital positions in jeopardy, threaten their creditworthiness, and cause them to reduce the volume of new flotations of securities that they are willing to undertake.

To give another example, in the spring of 1951 the mortgage market was particularly sensitive to a moderate increase in long-term rates. This was because major lenders were overextended in their lending commitments. In response to the change in the credit situation at that time, and the uncertainty as to future interest rate and security price levels, these lenders reduced sharply their commitment activities in mortgage financing and to some extent in other financing also. This brought about some limitation on the volume of their lending, which up to that time had been running substantially in excess of the funds they had from repayments of old loans and new savings, with the difference made up by sales of Government securities which in turn had been purchased by the Federal Reserve at supported prices.

Concluding Comment

This article has described the way in which a general tightening or easing of credit, with accompanying changes in interest rates, may function to help maintain economic stability. It has not dealt with the many forces, other than credit and monetary forces, that cause instability. It has taken for granted that credit and monetary measures are not the only reliance of public policy in sustaining economic balance.

The discussion has largely focused on the broader effects of credit tightness and rising interest rates on lending, spending, and saving. The mechanism of credit ease is in general the opposite of credit tightness. The response to credit easing, however, is greatly influenced by cyclical or other prevailing circumstances, and the effectiveness of credit easing in checking monetary contraction and in bringing about resumed growth in economic activity depends greatly on earlier effective reliance on credit tightness to limit excessive credit and monetary expansion.

In considering the mechanism of credit tightness and related interest rate increases in counteracting unsound business booms, it is important to bear in mind the alternative to such developments. To avoid credit tightness it would be necessary to supply additional funds to meet all demands, even though they might be excessive from the standpoint of the maintenance of stable economic progress. In a free enterprise economy, decisions regarding the use of purchasing power are made by the individuals who receive incomes and have savings, rather than dictated by government. The extent to which it is possible to devote resources to expansion of productive capacity and the stock of housing and commercial construction without generating excessive, inflationary bank credit and monetary expansion depends largely on the combination of individual decisions to save and to dissave—on the aggregate volume of saving. When savings are very large, as they ordinarily are in this country, sustained expansion is possible in substantial volume without an excessive and unstabilizing growth of credit and money.

Question 15 (continued)

PRINCIPAL POLICY ACTIONS OF FEDERAL RESERVE SYSTEM,
FEBRUARY 1945 - AUGUST 1957

Date	Action	Purpose of Action
1945 - Feb. to 1946 - Jan.	Margin requirements raised from 40 to 50% of market value in February; to 75% in July; and to 100% in January 1946.	Continued upward trend of stock prices, volume of trading, and stock market credit.
1946 - Apr. to 1946 - May	Removal of preferential discount rate of 1/2 per cent on advances secured by short-term Government securities.	Required borrowing banks to pay regular discount rate of 1 per cent and thereby made it less easy for member banks to obtain Federal Reserve credit on the basis of which to expand loans. Indicated that the Federal Reserve System did not favor a further decline in interest rates in the circumstances then prevailing.
1946 - Jan. to 1947 - Oct.	Reduced total holdings of Government securities by more than \$2 billion. Retirements of about \$7 billion of maturing securities offset in part by \$5 billion net purchases of other short-term securities. Buying rate on bankers' acceptances raised (July-August 1946).	Restrained growth in member bank reserves (due chiefly to gold inflow) by redeeming maturing U. S. securities as Treasury retired securities using accumulated balances in war loan accounts and budget surplus. Business active; inflationary pressures were strong.
1946 - Dec.	Removed noninstalment credit from regulation; list of articles under credit control curtailed.	For purpose of simplifying the regulation, making it administratively more workable, and narrowing its scope to a minimum consistent with the exercising of a stabilizing influence on the economy. Amended regulation covered approximately 70 per cent of instalment credit.
1947 - Feb.	Margin requirements reduced from 100 to 75 per cent of market value.	Stock prices and the volume of credit in the stock market had been reduced to levels at or below those prevailing at the time of the previous increase in requirements.

Date	Action	Purpose of Action
1947 - July to 1947 - Oct.	Discontinued buying rate of 3/8 percent on Treasury bills and support of certificates at 7/8 per cent.	Relieved Federal Reserve System of necessity of continuing to buy short-term securities at the extremely low wartime rates and thereby providing the basis for further monetary expansion. Business activity at very high levels; inflationary pressures strong. Coupon rates on new issues of certificates raised by Treasury to 1 percent.
1947 - Nov. to 1948 - Mar.	Bought $5 billion Treasury bonds.	Bought large amounts of Treasury bonds in November and December to stem decline in bond prices. Dropped buying prices in late December to levels slightly above par. Bought bonds thereafter to maintain these price levels.
	Sold or redeemed over $6 billion of short-term Government securities. Buying rate on bankers' acceptances raised (Dec. 1947 - January 1948).	Sold or redeemed short-term Treasury securities, partly to offset effect on bank reserves of bond purchases and continued gold inflow, in the effort to restrain the growth in bank credit. Inflationary pressures continued strong. Short-term rates rose further.
1947 - Nov.	Joint statement by bank supervisory authorities.	Urged banks to avoid making nonessential loans in view of inflationary conditions. Statement was followed by action by American Bankers Association to arrange bankers' meetings in various parts of the country early in 1948 to urge avoidance of unnecessary or undesirable extensions of credit.
1948 - Jan. to 1948 - Aug.	Buying rate on bankers' acceptances raised (Aug.) Raised discount rate from 1 to 1-1/2 percent at all Banks.	Part of an anti-inflationary program designed to keep pressure on member bank reserves and thereby to restrain expansion of bank credit and at the same time continue the policy of stabilizing the long-term rate on Government bonds.

Date	Action	Purpose of Action
1948 - Feb. to 1948 - Sept.	Bought $2 billion Government securities in Sept. including $1.5 billion bonds and $500 million bills; certificates, and notes. Raised reserve requirements on demand deposits from 20 to 26 percent at central reserve city banks; 20 to 22 percent at reserve city; and 14 to 16 percent at country banks; on time deposits from 6 to 7-1/2 percent at all banks.	Reserve requirement action to help absorb additional reserves made available by gold inflow and by Federal Reserve purchases in support of the market for Government securities. Congress provided authority (until June 30, 1949) for increases in reserve requirements above those otherwise authorized. Securities purchased in open market to maintain the stability of the market and to assist temporarily in the adjustment of member banks to increased reserve requirements.
1948 - Sept.	On installment credit for a list of consumer durable goods reimposed down payment of 20 - 33-1/3 percent; maximum maturity 15-18 months; same maturity on installment loans.	Congress restored (until June 30, 1949) Board's authority to regulate consumer credit, which it had terminated in November 1947. Consumer installment credit was expanding at a rate of $2 billion a year; this growth was contributing to inflationary pressures. Regulation as reestablished affected about 70 percent of consumer installment credit.
1949 - Mar.	Margin requirements reduced from 75 to 50 percent of market value.	Stock market credit outstanding was close to the lowest level on record. Stock prices declining and volume of trading low. Equity financing of business small.
1949 - Mar. to 1949 - Apr.	On consumer installment credit reduced down payment to 10 percent (except on autos); increased maturity to 24 months on all listed articles.	Consumer buying pressures had moderated significantly; many commodities covered by regulation in larger supply; consumer installment credit expanding less rapidly than formerly; general inflationary pressures had abated somewhat.
1949 - May to 1949 - Sept.	Reduced reserve requirements on demand deposits by 4 percentage points; on time deposits by 2-1/2 percentage points. Changes in several steps.	Recession in business and prices. Credit policy aimed at encouraging a high level of business activity, but avoiding conditions of such ease as would prevent needed adjustments or encourage undue expansion.

Date	Action	Purpose of Action
1949 - Jan. to 1949 - Sept.	Reduced holdings of Government securities by more than $5 billion. Sold over $3 billion of bonds from January through June; sold or redeemed $2 billion of bills, certificates, and notes.	To prevent prices of long-term bonds from rising sharply and to meet heavy demands for short-term U. S. securities arising out of reduced member bank reserve requirements, net Government disbursements, reduced currency circulation, gold inflow, and other factors. More flexible credit policy announced June 28 determining operations on basis of the needs of general business and credit situation and of maintaining orderly conditions in the Government security market, rather than a fixed pattern of rates on United States Government securities. Open market operations throughout the period consistent with easier credit conditions, while recession lasted.
1949 - Nov. to 1950 - June	Sold $1.5 billion of long-term Treasury bonds.	Sales of bonds to meet market demand for long-term securities and discourage overextension of private long-term financing.
	Bought a net of $1.6 billion of short-term Government securities. Little change in total portfolio.	Operations designed to allow money market to firm moderately in response to increased demand for funds, as business recovery gained momentum and signs of inflationary pressures reappeared, and at same time to aid Treasury refunding. Slight rise in yields on both short-term and long-term securities.
1950 - Aug.	Buying rate on bankers' acceptances raised. Raised discount rate from 1-1/2 to 1-3/4 percent at all Banks. Request by bank supervisory agencies for voluntary cooperation of lenders in restraining credit.	Output and employment close to peacetime record levels; accelerated expansion of credit; prices rising; prospective increases in Government expenditures for military purposes. System announced it was prepared to use all means at its command to restrain further bank credit expansion consistent with policy of maintaining orderly conditions in Government securities market.

Date	Action	Purpose of Action
1950 - Aug. to 1950 - Dec.	Bought $8 billion of maturing Government securities (Aug.), $1 billion of restricted bonds (Sept. - Dec.), and $1.4 billion of short-term securities (Dec.)	Purchases to aid Treasury refundings and prevent decline in long-term bonds below par.
	Sold $7 billion of short-term Government securities (Aug.).	Sales of short-term securities at lower prices (higher yields) to offset effect of purchases. Note--The above mentioned sales did not completely offset purchases so that the actual net effect of operations for this period was expansionary.
1950 - Sept. to 1950 - Oct.	On instalment credit for list of consumer durable goods down payment 10-33-1/3 percent; maximum maturity 15 months, except home improvements 30 months; maximum maturity of 15 months on installment loans. On real estate credit down payments 10-50 percent of value of residential property; maximum maturity 20 years with certain exceptions.	Unprecedented rate of expansion of consumer installment and real estate credit. Regulations are parts of fiscal, monetary, and credit measures to restrain inflationary pressures and facilitate diversion of critical material and manpower to production of defense needs, under authority of Defense Production Act of 1950. For reasons of administrative and regulative efficiency consumer credit regulation confined to installment credit and scope set to affect about 75 percent of such business.
1950 - Nov.	Banks again requested to restrain unnecessary credit expansion.	Unprecedented expansion in bank loans from midyear to mid-November. Continued expansion in credit put upward pressure on prices, impairing purchasing power of dollar and adding to cost of defense program.

Date	Action	Purpose of Action
1951 - Jan. to 1951 - Feb.	Bought $800 million of long-term Treasury bonds.	To maintain prices of long-term Government securities.
	Raised reserve requirements by 2 percent on demand deposits; 1 percent on time deposits; maximum limits except at central reserve city banks.	Continued expansion of bank credit. Action taken to absorb about $2 billion of funds, largely from seasonal return of currency and System purchase of bonds, and generally to reduce the ability of banks to expand credit that would add to inflationary pressures. At central reserve city banks requirements were raised to a level considerably above those that prevailed during most of the war period.
	Bought a net of $300 million of short-term Government securities.	To facilitate adjustment to reserve requirement increase.
1951 - Jan.	Margin requirements raised from 50 to 75 percent of market value.	Continued upward trend of stock prices volume of trading, and stock market credit.
1951 - Jan. to 1951 - Feb.	Real estate credit control extended to cover multi-family and certain nonresidential properties.	To add further restraints on inflation by limiting the credit available for the financing of nonresidential construction and to bring about a decrease in building to provide materials and labor for the defense program.
1951 - Feb. to 1951 - May	All financing institutions requested to participate in program of voluntary credit restraint.	Program formulated by representatives of banks, investment bankers, and life insurance companies, in consultation with Federal Reserve representatives, for organized effort by all types of financing institutions to restrain unnecessary credit expansion in accordance with the Defense Production Act of 1950.
1951 - Mar. to 1951 - mid-Apr.	Lowered buying prices on Government securities.	Action taken, under Treasury-Federal Reserve accord, to terminate support of Government securities market at fixed prices, with a view to promoting a selfsustaining market and discouraging sales of Government securities to Federal Reserve System to obtain funds with which to extend credit to private borrowers.

Date	Action	Purpose of Action
1951 - Mar. to 1951 - mid-Apr. (continued)	Bought $1.1 billion of Treasury bonds and $100 million of bills.	Interim purchases taken to maintain orderly market conditions in transition to self-sustaining market and to facilitate exchange of long-term marketable bonds into nonmarketable bonds with longer term and higher interest coupon.
1951 - Apr.	Ceased purchases of Government securities except primarily to maintain orderly market conditions.	To minimize monetization of public debt without jeopardizing necessary Government financing; to enable the Federal Reserve System to regain greater control over its extensions of Federal Reserve credit through security operations, and thereby more effectively to restrain inflationary expansion of credit.
1951 - mid-Apr. to 1951 - Nov.	Bought $300 million of long-term bonds through June, and $1.5 billion of short-term securities during refunding periods.	Purchased restricted bonds to aid in readjustment of bond market; purchased short-term securities to aid in Treasury refundings.
	Sold or redeemed $1.7 billion of short-term Government securities at other times.	Sales to absorb reserves created by above purchases.
1951 - July	On installment credit for list of consumer durable goods and for installment loans increased maximum maturity to 18 months (home improvements, 36 months); down payment on appliances reduced to 15 percent cash or cash and trade-in.	Action taken to bring Regulation W into conformity with the provisions of the Defense Production Act Amendments of 1951.
1951 - Sept.	Increased maximum maturity to 25 years for houses up to $12,000; raised maximum value per family unit for specified down payment requirements; suspended credit restrictions for programmed housing in critical defense housing areas.	Action taken to bring Regulation X into conformity with the provisions of the Defense Housing and Community Facilities and Services Act of 1951.

Date	Action	Purpose of Action
1951 - Dec.	Increased holdings of securities in late Dec. by about $600 million net.	To meet seasonal reserve needs.
1952 - Jan.	Reduced holdings of securities by $1.1 billion, net.	To offset currency inflow and the effects of other seasonal factors on bank reserves.
1952 - Feb. to 1952 - June	Increased holdings by about $200 million, net.	Large purchases of securities made in February and June to facilitate market adjustments to Treasury financings. Most of those purchases were offset by sales of other securities.
1952 - Sept.	Suspension of regulation of real estate credit.	To conform with the terms of the Defense Production Act, as amended, requiring suspension of regulation if housing starts in each of three consecutive months fell short of an annual rate of 1,200,000 units, seasonally adjusted.
1952 - July to 1952 - Dec.	Limited net purchases of United States Government securities in open market to 1.8 billion dollars.	To meet seasonal and other reserve drains only in part, requiring banks to borrow some of the reserves needed so as to restrain bank credit and deposit expansion at a time when credit demand was very large and the economy was fully employed. Purchases in August and September were made primarily at times of Treasury refunding operations and were offset in part by subsequent sales.
1953 - Jan. to 1953 - Apr.	Sold in open market or redeemed 800 million dollars net of United States Government securities.	To offset seasonal changes in factors affecting reserves and thus to maintain pressure on member bank reserve positions.
1953 - Jan.	Raised discount rates from 1-3/4 to 2 per cent and buying rates on 90-day bankers' acceptances from 1-7/8 to 2-1/8 per cent.	To bring discount rates as well as buying rates on acceptances into closer alinement with open market money rates and to provide an additional deterrent to member bank borrowing from the Reserve Banks.

Date	Action	Purpose of Action
1953 - Feb.	Reduced margin requirements on loans for purchasing or carrying listed securities from 75 to 50 per cent of market value of securities.	To reduce margin requirements from the high level imposed early in 1951, in the judgment that the lower requirement would be adequate to prevent excessive use of credit for purchasing and carrying stocks.
1953 - May-June	Purchased in open market about $900 million of U.S. Government securities.	To provide banks with reserves and to permit a reduction of member bank borrowing from the Reserve Banks at a time when such borrowing was high, credit and capital markets were showing strain, and seasonal needs for funds were imminent.
1953 - July	Reduced reserve requirements on net demand deposits by 2 percentage points at central Reserve city banks and by 1 percentage point at Reserve city and country banks, thus freeing an estimated $1.2 billion of reserves.	To free additional bank reserves for meeting expected seasonal and growth credit demands, including Treasury financing needs, and to further reduce the pressure on member bank reserve positions.
1953 - July-Dec.	Made net purchases in open market of U. S. Government securities totaling $1.7 billion.	To provide banks with reserves to meet seasonal and growth needs and to offset continuing gold outflow with little or no additional recourse to borrowing. This action and the one below were taken in pursuance of a policy of active ease adopted in view of the business downturn.
1954 - Jan.-June	Limited net sales to about $900 million of U. S. Government securities in open market.	To absorb only part of the reserves made available by seasonal deposit contraction and return flow of currency thereby further easing bank reserve positions.

Date	Action	Purpose of Action
1954 - Feb.	Reduced discount rates from 2 to 1-3/4 per cent and buying rates on 90-day bankers' acceptances from 2-1/8 to 1-3/4 per cent.	To bring discount rates as well as buying rates on bankers' acceptances into closer alinement with market rates of interest and to eliminate any undue deterrent to bank borrowing from the Reserve Banks for making temporary reserve adjustments.
1954 - Apr.-May	Reduced discount rates from 1-3/4 to 1-1/2 per cent and buying rates on 90-day bankers' acceptances from 1-3/4 to 1-1/2 per cent.	
1954 - June-Aug.	Reduced reserve requirements on net demand deposits by 2 percentage points at central reserve city banks and by 1 percentage point at reserve city and country banks, and requirements on time deposits by 1 percentage point at all member banks, thus freeing about $1.5 billion of reserves in the period June 16-August 1.	To supply the banking system with reserves to meet expected growth and seasonal demands for credit and money, including Treasury financing needs.
	Sold in open market or redeemed U. S. Government securities totaling about $1 billion in July and August.	Reductions in reserve requirements were offset in part by temporary sales of securities in order to prevent excess reserves from increasing unduly at the time, but security purchases were resumed as need for funds developed.
1954 - Sept.-Nov.	Made net purchases in open market of approximately $850 million.	To supply the banking system with reserves to meet expected growth and seasonal demands for credit and money.
1954 - Dec.	Made net purchases of U. S. Government securities in open market of less than $50 million, all under repurchase agreements with dealers and brokers. Member bank borrowing increased to an average of $250 million in December.	To meet part of the temporary end-of-year needs of banks for reserve funds, but in view of rising credit demands, to permit these needs to be reflected in part in slightly less easy reserve positions.

Date	Action	Purpose of Action
1955 - Jan.-June	Sold in the open market or redeemed U. S. Government securities totaling $1.3 billion. Member bank borrowing increased to an average of more than $400 million in the second quarter.	To offset effects of seasonal factors affecting bank reserve positions and, in view of strong credit demands, to bring about somewhat greater member bank borrowing from Federal Reserve Banks.
1955 - Jan.	Raised margin requirements on loans for purchasing or carrying listed securities from 50 to 60 percent of market value of securities.	To help prevent an excessive use of credit for purchasing or carrying securities in a period of increasing use of credit for carrying securities.
1955 - Apr.	Raised margin requirements on loans for purchasing or carrying listed securities from 60 to 70 percent of market value of securities.	To help prevent an excessive use of credit for purchasing or carrying securities in a period of increasing use of credit for carrying securities.
1955 - Apr.	Raised discount rates from 1-1/2 to 1-3/4 percent.	To bring discount rates into closer alinement with open market money rates and make borrowing by individual banks more expensive.
1955 - Mar.-Dec.	Made net purchaase of bankers' acceptances in open market totaling $28 million.	To recognize increased use of bankers' acceptances by business as a means of financing international trade.
1955 - July-Dec.	Made outright purchases of Treasury bills in the open market totaling $700 million net and increased repurchase agreements with dealers and brokers by 300 million. Member bank borrowing increased to an average of about $850 million in September and more than $1.0 billion in November but declined to about $850 million in Dec.	To meet part of reserve needs associated with seasonal factors, thus requiring banking system to meet needs in part by further increasing indebtedness. This action was taken with a view to providing for seasonal needs while limiting undue expansion of bank credit.

Date	Action	Purpose of Action
1955 - Nov.-Dec.	Purchased when-issued Treasury certificates of indebtedness totaling $167 million.	To facilitate Treasury refunding in period of money market stringency. Supply of reserve was consistent with overall open market policy at time.
1955 - Aug.Sept.	Increased discount rates from 1-3/4 to 2-1/4 per cent. This increase was made in two steps at all Reserve Banks except Cleveland.	To keep discount rates in an appropriate relationship with market rates of interest and thus maintain a deterrent on excessive borrowing by individual banks at the Reserve Banks.
1955 - Nov.	Increased discount rates from 2-1/4 to 2-1/2 per cent.	
1956 - Jan.	Reduced System holdings of U. S. Government securities by over $1.4 billion through sales in the market, redemption of maturing bills, and termination of repurchase agreements. Member bank borrowings increased to weekly averages of $900 million in late January.	To offset seasonal return flow of currency and reduction in reserve needs and restore degree of restraint prevailing before December action to moderate restraint temporarily.
1956 - Feb.-Mar.	Bought small amounts of Govt. securities at times. Member bank borrowings declined somewhat in February but increased substantially in March as result of sharp increase in required reserves.	To meet changing reserve needs and avoid an increasing degree of credit restraint in view of growing tone of uncertainty as to economic prospects.
1956 - Apr.-May	Discount rates raised from 2-1/2 per cent to 2-3/4 per cent at 10 Reserve Banks and to 3 per cent at 2 Banks around middle of April; System holdings of U. S. Gov't securities reduced by $350 million. Member bank borrowings at Reserve Banks rose to over $1 billion.	To increase restraint on credit expansion, in view of sharp increase in bank credit in March and indications of broad increase in spending, growing demands for credit, and upward pressures on prices and costs.

Date	Action	Purpose of Action
1956 - Late May to early Aug.	Increased System holdings of U. S. Gov't. securities around end of May and end of June and maintained holdings at higher level than in previous period.	To meet currency needs around holidays, to cover added demands for reserves around tax payment and midyear settlement periods, and to avoid increasing the degree of restraint in view of uncertainties in economic situation.
1956 - Aug.-Nov.	Discount rates raised late in August to 3 per cent at the 10 Reserve Banks with rates of 2-3/4 per cent. System holdings of U. S. Gov't. securities increased by nearly $1 billion; member bank borrowings at Reserve Banks rose to average of $900 million in August and averaged between $700 and $800 million in other months.	Discount rates increased in conformity with rise in market rates resulting from vigorous credit demands. Policies designed to increase and maintain restraint on undue credit expansion while covering seasonal and other temporary variations in reserve needs, including effects of frequent Treasury financing operations.
1956 - Dec.	System holdings of U. S. Gov't. securities and bankers' acceptances increased by over $550 million, including substantial repurchase agreements with dealers. Member bank borrowings declined to weekly averages of around $600 million, except in last week of year, and at times were less than excess reserves.	To supply reserve funds in recognition of additional pressures in money, credit, and capital markets resulting from seasonal factors and international conditions, at a time when lower liquidity ratios of banks were themselves exerting restraint on bank lending.
1957 - Jan. to 1957 - June	Reduced holdings of Government securities by about $1.8 billion. Member bank borrowings increased from an average of $400 million in January to $1 billion in June.	To offset the effect on reserves of seasonal factors and the sale of $600 million of gold to the United States Treasury by the International Monetary Fund, and to exert pressure on bank reserve positions by bringing about a higher level of member bank borrowings.
1957 - Aug.	Discount rates raised from 3 to 3-1/2 percent a 8 Reserve Banks (through August 16).	To bring discount rates into closer alinement with open market money rates.

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?

The Federal Reserve Bulletin article "Federal Financial Measures for Economic Stability" (reprint of which is submitted in answer to Question 14) indicates that fiscal policy and debt management have special and complementary roles to play in relation to credit and monetary policy.

Throughout the postwar period, fiscal policy and Federal Reserve policy generally have worked in the same direction. During a considerable part of the period, however, the ability of the Federal Reserve System to combat economic instability was seriously limited by its policy of supporting the United States Government securities market. Fiscal policy performed well in fiscal years 1947 and 1948 as Federal expenditures declined and tax rates were maintained, producing cash surpluses totaling $15.7 billion in the two years. In this period the Federal Reserve supported the Government securities market and consequently one of its most important policy tools--open market operations--could not function in a counter-inflationary manner. As long as the Federal Reserve acted as a residual buyer of securities offered in the market, the initiation in the creation of bank credit rested with the market, not the Federal Reserve authorities. Attempts were made to offset these effects by resort to other actions. For example, reserve requirements were increased on three occasions in 1948 and the discount rate twice; also selected regulations were applied to stock market credit and consumer credit.

Both fiscal and Federal Reserve policy shifted as the economy started to decline in the winter of 1948-49. During the fiscal years 1949 and 1950, Federal cash expenditures rose, the $5 billion tax cut that had been enacted earlier in 1948 took effect, and the cash surplus was replaced by a small cash deficit. The Federal Reserve eased credit conditions. It reduced reserve requirements by two percentage points in the summer of 1949, eased consumer credit regulation in two steps, before the temporary authority finally expired, and reduced margin requirements.

The Korean conflict brought about a sharp reversal of public policies. Tax legislation enacted in late 1950 and 1951 was designed to produce added revenues of nearly $15 billion in a full year and a large cash surplus resulted in fiscal 1951. The discount rate was increased in August 1950; margin requirements were increased in January 1950; regulations on consumer and real estate credit were imposed in the fall of 1950; and reserve requirements were increased in January 1951. Following the Treasury-Federal Reserve Accord of March 1951, the Federal Reserve System was able to use open market operations, and thus all its instruments, to promote economic stability. Actions over this period contributed substantially to the ending of the price rise by the spring of 1951.

During 1952 and early 1953, price rises were held in check despite vigorous growth in the private sector of the economy. Rising defense outlays produced a Federal cash deficit, but this was counterbalanced by a restrictive credit policy. Open market operations were conducted so as to limit credit expansion generally and the discount rate was raised in January 1953, but consumer and real estate credit regulations were suspended in 1952 to conform with the intent of the enabling legislation.

By mid-1953, the economy reached another turning point. During the fiscal years 1954 and 1955, when the economy was operating at below-capacity levels, a series of Federal Reserve actions eased credit conditions. Expansive open market operations took place from June 1953 through the end of 1954; reserve requirements were reduced in the summers of both 1953 and 1954; and discount rates were reduced twice in early 1954. Meanwhile, most of the tax reductions scheduled by law were permitted to take place at the end of 1953; most excise tax rates were reduced by 1954 legislation; and the 1954 Internal Revenue Code provided a variety of tax reliefs. Federal expenditures, however, declined rapidly from mid-1953 through mid-1955, so that the Government's deficit was smaller than in 1953, despite the tax reductions.

During the past two fiscal years of inflationary pressures, fiscal and monetary policy have operated in the same direction. Scheduled tax reductions were postponed and no new reductions were enacted. Although tax rates were not increased, receipts rose--mainly as a result of increases in incomes--and a substantial cash surplus of $4.5 billion was achieved in fiscal 1956. In fiscal 1957, the surplus declined despite further increases in Federal revenues from further expansion of incomes and profits, which in part reflected price increases, as Federal expenditures rose by a larger amount. The impact of monetary policy has been on the side of restraint; open market operations have been designed to restrain undue growth in the money supply, and as market rates rose discount rates have been increased several times in order to maintain a deterrent on excessive borrowing by member banks.

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?

I answered this question at some length in my response to Question 5 addressed to me by the Subcommittee on General Credit Control and Debt Management of the Joint Committee on the Economic Report in 1952. In sum, I said that it would be impossible "to foster and promote . . . the general welfare" and "to maintain maximum employment, production, and purchasing power" if prices were highly unstable and credit use were unrestricted. The achievement of these objectives requires the maintenance of reasonable stability in the value of the dollar as well as the avoidance of credit liquidation that would inevitably follow excessive credit expansion.

The objectives expressed in Section 2 of the Full Employment Act of 1946 have been, in fact, the aims and goals of the Federal Reserve System since early in its history. In the Annual Report of the Federal Reserve Board for 1923, for example, the broad purposes of System policy were described as follows on page 33:

> The problem in good administration under the Federal Reserve System is not only that of limiting the field of uses of Federal Reserve credit to productive purposes, but also of limiting the volume of credit within the field of its appropriate uses to such amount as may be economically justified--that is, justified by a commensurate increase in the Nation's aggregate productivity.

In order to dispel any possible doubt that the policy declaration of the Full Employment Act of 1956 has this meaning, I made the following suggestion on page 25 on my opening statement to this Committee:

> 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.

18. What are the Federal Reserve plans further to combat inflation and decline in the value of the dollar?

A direct answer is given on page 26 of my statement: "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 that effort, the Federal Reserve will continue to use the powers assigned it by the Congress, as enumerated in the opening part (pages 2-8) of my statement, in the manner most appropriate in the light of economic developments as they occur, to achieve the System's objective "to promote monetary and credit conditions that will foster sustained economic growth together with stability in the value of the dollar."

MARTIN-
Transcript

SENATE FINANCE COMMITTEE HEARINGS
ON FISCAL AND MONETARY POLICIES

August 13, 1957

Chairman Martin's first day before the committee was entirely taken up by his reading of his prepared statement, copy of which was sent to you yesterday, and by a flannel-board presentation by First Vice President Edward Wayne (D., Va.), of Richmond, on the structure and organization of the Federal Reserve System. There was no questioning. The session was adjourned to meet at 10 A.M. Wednesday, August 14, when a further flannel-board presentation was scheduled first, on how the money system functions.

SENATE FINANCE COMMITTEE HEARINGS
ON FISCAL AND MONETARY POLICIES

August 14, 1957

Eddie Wayne, aided by Assistant Vice President McKinney and Assistant Cashier Fentress of the Richmond Bank, opened the second day of Chairman Martin's appearance with the flannel board presentation of how the money system works. Besides Chairman Byrd, Senators Kerr, Long, Smathers, Anderson, Gore, Martin, Flanders, Carlson, Bennett and Jenner attended. Frear, Douglas (who has not attended any of the hearings), Williams and Malone were the only absentees on the committee.

After the economic presentation, Byrd said, "I want to thank the Richmond group for this splendid presentation. I am very proud of them." He then announced that he and Kerr would defer their questioning. He gave the floor to Senator Martin (R., Pa.):-

Q. * * * I want to congratulate you, Mr. Martin, on the splendid statement you made yesterday. It was most informative. I feel that it provides a solid foundation for further inquiry into the many phases of the inflationary problem.* * * What are the purposes of the Federal Reserve System as expressed in the Federal Reserve Act?

A. Well, the purpose, Senator, is to produce a monetary climate which will be conducive to growth in the economy, and to stable prices and to the well being of all of us. Those are the purposes and the objectives which the System is directing its effort to at all times. I stated it here in my prepared statement, to promote monetary and credit conditions which will foster sustained economic growth, together with stability in the value of the dollar. And I emphasized there that we have to translate those into human terms, which are job opportunities, employment, and at the same time recognize that the savings of people, the money that they have preserved out of their thrift and industry, has to be safeguarded, also, because that is their income. And that applies to older people, people who cannot any longer enter actively into any business activities, and we must recognize the two purposes are inseparable in that sense; and we have to recognize that, particularly now that we have Social Security and pension funds and others, there is a two-fold obligation here to both provide job opportunities and to preserve the purchasing power of the dollar.

Q. In the United States, we pass an Act of the Congress, and then as we go along we frequently interpret it. I would like to ask you, regarding the purposes of the Federal Reserve System as expressed or implied in other sources, what they are.

Questioning by
Senator Martin 8/14

A. Well, the most important additional piece of legislation, I would say, is the Employment Act of 1946, and I subscribe fully to the objectives of the Employment Act. * * * it seems to me that all the efforts of the Government should be directed toward achieving, as it says in the statement, maximum production, maximum employment, and maximum purchasing power.

Q. I think we all are in agreement with that. * * * What are the principal powers or functions of the Federal Reserve System as expressed in the statute? You have covered that to some extent, but I think that is worth repeating.

Chairman Martin reviewed the System's powers and functions.

* * * * *

Q. * * * How much money (have) our banks now borrowed from the Federal Reserve. Do you have those figures?

A. It is about a billion dollars, Senator.

Q. How does that compare with a year ago? Do you have that information?

A. It is about double, I would say, a year ago.

Q. What is the source of your responsibility to prevent inflation?

A. Well, I think it is our responsibility there, which is implicit in the Employment Act, to provide maximum purchasing power; and we have the responsibility, whenever imbalances are occurring in the economy, to do everything within our power to exercise these restraints which we have, in such a way as to permit the market forces to make the adjustments that are required to attune themselves to a stable dollar.

Q. Mr. Chairman, the next two questions are most debatable, and if you feel they are improper, I will not ask you to answer them. Do you consider your obligation to encourage price stability, prevent inflation, as imporrant as your obligation to foster economic growth, prevent unemployment?

A. I do not think there is anything improper in the question at all, Senator. I think that is the problem we are dealing with almost continuously. What I have come to believe in the last few years is that you cannot completely separate the two. I think that we have a responsibility for growth. We should increase the money supply to provide for that growth. But I like to put it in terms of a stream or a river: We should try to get the flow of money in such a way that the growth factors can be maintained by a growing roadbed for that stream, river bed for that stream, without overflowing the banks on either side and flooding the fields; that we should provide for growth and we should provide for maximum employment and maximum job opportunities.

But I believe that we undermine the stability of existing jobs and lay the groundwork for unemployment if we do not recognize the fact that if that money supply grows too rapidly for the river bed, and I am using my illustration on that, it will create imbalances which will undermine existing employment, and lead to further unemployment.

Now, in terms of the period that we have been struggling with in the last six years, the only possible means of attaining the objectives of the Employment Act, in my judgment, are to resist inflation.

What comes first is inflation, and then deflation. In other words, we are fighting deflation all the time. But under the growth potential of expanding population and expanding needs and the pent-up demand from the war, and the technology and improvements in services and needs of people, partly resulting from the war, and the world-wide grouping of needs and the development of raw materials, we have to recognize an entirely different situation than we had in the 30's; that the pressures here are for imbalance on the up side, for a swollen money supply, creating imbalances which will ultimately lead to serious deflation unless the adjustments which the market can make are made, and made at times when they can be made on a rolling adjustment basis, without coming to a cumulative head as they will come to a cumulative head if excesses just run rampant, and when we reach the precipice we suddenly find everybody having to make an adjustment at the same time.

Under those circumstances, the objectives of the Employment Act will be completely destroyed.

I happen to be one of those who believes that we can have full employment and price stability. I am not one of those who believes that the alternative to inflation is unemployment. I think that we will have.

If you are talking about temporary employment, if you are talking about having the expediency of employment created for a period of three or four months which will not be sustained, that is a different thing.

It is my conviction that we can do this; and it is also my conviction that as the future is developing today, the opportunities for development are still unlimited, and that we have within our grasp a substantially higher standard of living with stable prices, relatively stable prices--nothing is precise in this area--but relatively stable prices, for many years to come, if we just do not fritter it away by trying to do too much too fast, and believing that you can ignore excesses or can indulge in any amount of imprudence and improvidence and expect that the Government or someone else will pick up the check for you.

Q. It is going to take a lot of courage on the part of someone to do that controlling.

Now this question, if you do not want to get into it, it is entirely satisfactory to me, but I think it is one of the great things confronting our country right now.

If you were faced with the choice between price stability and temporary cessation of economic growth on the one hand, or creeping inflation and continuing economic growth on the other hand, which would you choose?

A. Again, Senator, I think it depends on the point you are at in the process of inflation. Inflation is a process. It is a spiral. It is excesses. It really does not make too much difference whether you are talking about wage inflation, price inflation, credit inflation, you are talking about excesses that have their origin in imprudence, improvidence, that take the form of a cancerous growth. It is not a narcotic that you can just take in small doses and control. It produces a spiral. I do not want a recession of any sort at any time. I do not want any man to be unemployed in this country if it is possible to avoid it. But I still think you have to come face to face with the realities that under conditions of excess, extravagance, waste, incompetence, inefficiency, under those conditions somebody has to take a loss. This is a loss economy as well as a profit economy, and we have no way of getting away from the fact that if a child puts his hand into the fire--I am not saying it is a good thing he gets burned--but he gets burned, and I think that we have got to weigh at all times, in answering the question you have propounded, that question of whether this economy can take adjustments and take them promptly and properly, without destroying themselves, or whether we think we are all-powerful, masterful controllers that can prevent any pain or suffering in life.

It is my conviction, Senator, that we can recognize the forces of the market, that it is not money and credit policy that controls this. I am constantly talked to by people who say, "You are balancing on the thin, razor edge of inflation and deflation, and what the Federal Reserve does will be terribly important. It will destroy this economy for years to come."

I hope you will not mind my saying if I really thought those people were accurate, I think I would give up the job. I would not sleep any more. I just do not believe it. I think the vitality and the strength and the capacity of this economy is so great that the Federal Reserve may make a few mistakes, and I think it has already made a number of mistakes, and I think the rest of us can make mistakes, but I have more confidence in the vitality and the adjustability of this economy than most people have, and less confidence in the money or credit policy or other Government policy.

But fundamentally, I think that these adjustments, Senator, you are talking about have to be related to our over-all objectives, and our over-all objectives are to have maximum production, maximum employment, and maximum purchasing power. And this is a continuous process.

When you get out of balance, as we are today, we have more difficult problems. This thing got away from us--I have said this publicly a number of times, and I reiterate it--I think that inflation got ahead of us a little over a year ago, and we now have to pick up some of the pieces.

I illustrate that by saying that the increase in the gross national product from 1955 to 1956, in those two years, over $10 billion of it--some people may say this is a small amount, but I do not think it is, even on a $400 billion gross national product--the increase, over $10 billion of that is a mark-up in prices with no additional goods and services.

Now, that is an imbalance for which some adjustment has to be made, and I do not believe that it is money and credit policy that makes that adjustment. I think the adjustment is made when the demand which is still there at a price, comes face-to-face with the fact that either prices have to be reduced in order to create the demand, or adjustments have to be made in the level of inventories; or some businesses have to recognize that perhaps they are expanding too fast, and that they are developing what I believe to be in this economy temporary overcapacity, not overcapacity permanently, but temporary overcapacity, which creates adjustments.

I do not think there is any industry you can think of which, in terms of capacity, has anywhere near enough capacity today for what I conceive to be the needs of 15 or 20 years from now.

Q. Thank you very much. All of us assembled here this morning, the Chairman of the Federal Reserve Board said they have made mistakes; in Congress we have made mistakes; as Americans we have made mistakes. But is it not marvelous to live in a country where there is no danger of being purged when an official makes a mistake? And if we all use a little common sense, we will come out of it.

* * * * *

Q. * * * Would you recommend that price stability be set forth as a specific goal in the Federal Reserve Act?

A. Well, I think it is implied in the Federal Reserve Act today, Senator.

I have in my prepared statement, and I have thought about this for a long time, I felt that it might be made explicit as well as implicit; although I think you have to recognize that this matter of price stability, as an over-all goal, is not our end.

I happen to believe firmly that money should be our servant, and not our master. I believe inflation makes money our master.

Q. Money is just a matter of convenience.

A. It is just a matter of convenience * * *

* * * * *

Q. I would now like to ask you some questions about the present, current inflation. When did this current inflation begin?

A. Well, I cannot state it precisely, Senator. It is pretty difficult to say that it began at any precise point. I think those of us in the System -- and mind you, the System is not a one-man operation. We have many varying views. But I think we began to get worried about the current aspect of inflation in the middle of 1955.

Q. And that is when you began to recognize it as a --

A. We began to recognize it. Let me go back just a little bit, if I may, and say in the inventory recession of 1953-54, we pursued a policy, and I think we were quite correct in our policy, in the early stages, of adjusting promptly, to make the inventory adjustment as orderly and as viable as possible, by easing money. By the end of 1953 and the early part of 1954, I personally think that we were overdoing it a bit. We were using the phrase "active ease." One thing you find out about this, which is that while it is easier, while your weapons may be more effective against restraint in terms of restraint than they are in terms of galvanizing the economy, nevertheless it is more difficult to get people to recognize them and take action when it comes to restraint.

And I think in retrospect that one of the errors we made was that in 1954, when the adjustments that were being made by the market were culminating and the base was being laid for the recovery that we have, we got a little bit enthusiastic about increasing the money supply, and we lowered our discount rate in February of 1954 from 2 per cent to 1-3/4 per cent; and then we lowered it again to 1-1/2 per cent in April of that year.

And we were now fomenting a psychology of expansion rather than letting the natural forces take their play, and I am inclined to think, in retrospect, that we were permitting a validation at that time of a price level which probably was not warranted, and that we therefore laid the seeds for some of our later difficulties. Now, that is a judgment in retrospect.

The trouble in 1955, the place where I began to get concerned was, it took us from April of 1954 until April of 1955 to move back from 1-1/2 to 1-3/4 per cent in the discount rate, a whole year, because the constant discussion in the System was, "Well, better not take a step, you had better not do anything to slow things down." You see, everybody likes expansion.

Then we went up to 1-3/4. We later moved up successively during 1955 in four notches. But it was from the middle of 1955 that we saw what was happening there was that a decline in farm prices was taking place on a supply and demand basis, but inflation in manufactured products, end products, some of which were affecting the farmer, was already beginning to take place.

So that our price stability in the last half of 1955 was, in my judgment, not the sort of price stability you would seek. It was one end going up and the other end going down.

I do not think we can make prices, ever. I think we can help influence them, but we do not control these prices. And I think the minute we in the Federal Reserve, or any of the rest of us, get the idea we can completely control this economy or make this economy, we are asking for trouble.

What we have to do is to make our adjustments within the framework of the flow of the economy.

Q. Do you feel you acted soon enough, and do you feel those actions were strong enough to stave off inflationary pressures then present?

A. No, I do not think we did. But there are differences of opinion on that within the System.

I would think we would have been more effective if we had acted a little bit quicker and a little bit sharper in our movements.

Q. What factors or developments preceded the outward evidence of price increases that you considered as inflationary? What brought it to your attention?

A. Well, in the last half of 1955, the price of manufactured products began to rise; and then we had, as we approached the problems in the guaranteed annual wage negotiations with the automobile companies, and then the steel contract later in the year, we approached this problem of the price level during that period tilting upward.

And at one point in 1956, in the summer of 1956, it was not very difficult to see that imbalances existed, and that the demand was so much greater then for certain items, certain types of steel, at that point, at the time of the steel strike, demand was so much greater than supply that additions to the money supply under those conditions could do nothing but run prices up.

It becomes more difficult later in the stage when the shortages are not there; the shortages had been filled, and the demand then changes. The demand is there, but at a price.

Q. What are you doing currently to curb inflation?

A. Currently, we are -- our most recent action was merely a recognition of the money rates that had developed in the market.

The rate on Treasury bills has been higher than the discount rate for roughly nine months, and we work very closely with the Treasury in this problem. Our purpose is always to assist the Treasury, but not to guarantee the Treasury a specific rate.

During this period, we have leaned over backwards, I think, not to lead the market, but to keep in tune with the market. And our most recent step here occurred recently when, starting in late May, there was a conjunction of forces in the money market which were gradually adjusting upward that culminated in the Treasury's offering of a one-year 4 per cent security, followed a little while ago by an increase in the prime rate by the banks.

And, merely as an adjustment to these pressures that we think were already here in the economy, we increased our discount rate at seven of the twelve Federal Reserve Banks.

We are not taking any overt actions at the moment. We are watching this situation very carefully, and I could not forecast what our policy would be for the future. But we still think, the great majority of us in the System, that inflation or, put in terms of the man on the street, the cost of living, is our major problem.

Q. Do you believe that the inflation will gradually wear itself out as our actions produce their intended effects? In other words, will added production coming from new investments create the supplies to meet existing demand at stable prices?

A. Well, I think in a country as strong and as vigorous as this, in an economy as strong and as vigorous as this economy, that savings accumulate surprisingly rapidly. It does not take too long for savings to accumulate.

Our problem at the moment is overspending, too much spending, in relation to the available savings.

I believe the trend is in the right direction at the present time. I believe that savings are going up, and the money supply is going up. But the demand has increased, has outpaced them.

I think that the factors are in the right direction. But let us not exaggerate the importance of money and credit policy, because we have to consider fiscal policy and we have to consider debt management policy as well as money policy in connection with this problem.

Q. Yesterday you mentioned velocity of circulation. To what extent has this factor nullified or diminished the effect of your actions in restricting the increase of the supply of money?

A. It is our judgment that we have been trying to look at the economy -- each time we have an Open Market meeting, I would like to list, if I may, the things that we are looking at.

We are looking at the requirements of the Treasury. We are looking at the seasonal requirements of business. We are looking at a growth factor in the economy, and we think that growth factor should normally be in the neighborhood of three or four per cent. In excess of that is, we think, too much.

We have let the money supply move down to, depending upon -- of course, these figures sometimes are changed, because you add time deposits to demand deposits, but we usually eliminate time deposits from these figures -- we have let the money supply, growth of it, slow down to about one per cent.

We have let the balance of the two per cent on our three per cent growth take place out of the velocity of money, the turnover of money, and we have felt that that was about right, though I think sometimes we felt that perhaps we have erred a bit on the side of letting the velocity accumulate faster -- it is very difficult to measure -- than the situation warranted.

But we do not think that the economy has been starved for money, and we have to starve it for money. We do not want a drought of money supply at all. We want the forces of the market to have play.

We consider ourselves as managers of the money supply. Congress has delegated to us the responsibility for managing this money supply. That means there should not be an oversupply or an undersupply. Now, within the limits of human fallibility, that is what we are trying to gauge.

Q. If you make some mistakes in this, it is really the Congress' responsibility. We have just simply delegated that power to you, and it is like a commander in the Army, if he selects the wrong man to command his left wing, it is his error. So really, after all, it is our mistake if you make one.

A. Well I do not know. We may make such mistakes that you should remove us, but we are trying to serve as trustees for you under the trust indenture which you have given us in the Federal Reserve Act, and within the latitude prescribed by that Act.

* * * * *

Q. You have referred to monetary and fiscal policies as the two important anti-inflationary tools of Government. You have also said that industry, labor, and individual citizens must contribute their part. Just what can anybody do about the income demand on the price, and spending by each of these? I would appreciate it if you would comment on the governmental side of it first.

A. Well, on the governmental side, I have already pointed out the necessity, under current situations, for a larger surplus, a larger budget surplus, than we have had. I am not critical of anyone on the budget problem. I do not know enough about it. But I think what you have got to recognize here is that this is a rich country. We can support the programs we have to support.

But we have to see our way clear to paying for them, and we have got to provide taxes to cover programs that we think are essential, or to find some means of diluting some other program and keeping within this spending-savings stream that is the heart of our problem and the heart of our debt.

It seems to me that it is absolutely essential that we recognize that, and that we try to get across to everybody that the inflation is not inevitable, that it can be halted, it can be minimized.

But if we let this psychology which is the factor that has come in the last year and a half that has caused us more concern than anything else, this psychology of the inevitability of inflation, carry us away so that you impair the saving-investment process, then we will not be able to finance the programs that are essential to the country, and we will find a steady erosion of our dollar and ultimately, I think, a change in all of our institutions and the nature of our society.

* * * * *

Q. * * * Are not wage increases continuing year by year, covering larger and larger segments of the labor force?

A. Well, I think the wage -- they are, but I think wage increases must be related to productivity. I think judging whether they are actually related to productivity or not is something that you cannot precisely come to an agreement on. That is one of the reasons you have collective bargaining in labor negotiations.

There are some people who say they can never pay higher wages. There are some labor people who say that there are no cost-price relationships to be considered, and I think that quite frequently it is in the middle ground.

But it is real wages that we are talking about, and real wages that we want to see increased. And we also want to have the productivity increases.

Q. If the productivity equals the increased cost in wages, there is no danger, so far as inflation is concerned?

A. That is right. And if we can spread that productivity. What we want to do is to spread that productivity through the entire economy as far as we can, and not get it imbalanced and in the hands of a relatively few people.

Q. Are not more and more contracts including escalator clauses?

A. They are; and cost-plus contracts have become quite common, also.

Q. Are not fringe benefits being extended by both Government and in industry?

A. They are.

Q. In all of this, has the supply of money and credit been fully adequate to support these increasing demands?

A. I do not know whether it has been fully adequate to support them, but it is our intention to keep a steady flow of money, as steady a flow of money as we can have. And if that flow of money does not cover the increases that are unwarranted, there should be no pressure on us to increase the money supply just to validate some imbalance which occurs in the economy which is not warranted by productivity. Again, I want to say I never want any recession. I do not want anybody to be unemployed. Certainly our job at the Federal Reserve would be much better and much easier if we never had to look at a decline of any sort. But, unfortunately, it is not made that way at the present time.

* * * * *

Q. * * * is it not true that most of the depressions followed too much borrowed money? * * * *

A. Borrowing is not the great blessing that some people like to make it out to be. Debt is not. We have tended to glorify debt in recent years, all out of proportion to the benefit that it produces.

That is not to say that I do not recognize that debt is important and, under certain circumstances, should be -- certainly borrowing people should have access to borrowing.

But let us not forget the fact that the greatest slavery in the world is to have people under borrowed money to the point that they are just breaking their backs. I have watched plenty of them just breaking their back to meet the payments. One of the interesting things is that people who are always advocating easier terms are the people who are the least forgiving when it comes to paying back a debt which has been contracted. That is one of the human facets that I have observed a good many times.

"Let me interrupt you to say that you made one of the wisest statements I have ever heard," Senator Byrd remarked. "You are right."

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Q. * * * debt is a dangerous thing. And of course we have got to have it. But I have been worried, and I wonder what your thought is, as to whether or not we do not now have in this expansion too much debt as compared with the equity capital.

A. Well, I would not want to make a categoric statement on it, but I think the trend has been in that direction.

* * * * *

Q. You referred yesterday to the dangers arising from expectations of inflation. * * * * I would appreciate a little further comment on that from you.

A. Well, I would only reiterate the closing part of my statement yesterday, Senator, and say that I think you can destroy the cynicism of people on a matter of this sort when they see actions being taken, and resolute determination.

And when they see, they get to a relationship between stocks and bonds, for example; that is where the process does begin to work. And people see that the yield on stocks is not as high as on bonds, and there is a closing of the gap.

Now, this takes time. This does not happen overnight. And I think one of the most unfortunate things, it is one of the things we have been dealing with, is this psychology that has come into the picture.

Q. Do you anticipate any lessening in the demand for wage increases, escalation provisions, and fringe benefits, in the foreseeable future?

A. I do not know as I do.

Q. How can prices be stabilized as long as labor leaders compete with one another over who can achieve the largest wage gains and fringe benefits, irrespective of productivity gains in their respective industries or in the economy as a whole?

A. I think there I can only say the problem is to reduce spending and increase saving, and get back to the fundamentals.

Q. That is what I am trying, through these questions, to do, and you are doing wonderfully well; what I want to do is to get these things before the American people.

* * * * *

Q. Do higher interest rates cause inflation, or do they check inflation?

A. Higher interest rates, in my judgment, are not a cause of inflation. I pointed out in my prepared statement the relative problem. Interest is a wage to the saver as well as a cost to the borrower. Now, no one deprecates more than I do the cost of carrying the national debt, and I do not favor high interest rates. I stated that yesterday, and I keep stating it. * * * * I favor as low interest rates as it is possible to have, without producing inflationary pressures.

Q. You are saying we want to be able to buy bread and meat as cheaply as we possibly can, as long as it does not disturb the economy. Of course, you cannot produce meat and bread and clothing without a profit, in our country.

A. The heart of the problem here is debt. And if interest is one of the balancing factors, it is one of the governors, and I think that the increase in interest rates in relation to encouraging saving will encourage saving at that time. I do not agree with people that interest rates make no difference. They take a long time to operate at times. But interest adjustments -- you have to pay more if you want to borrow more than is available out of savings, you have got to pay more. The way to reduce interest rates is to reduce spending, and to see the level of saving go up in relationship to it, and then you have a leveling-out process. And I know of no other device in a free economy than the governor on the flywheel of it, which I refer to from time to time as being interest.

Q. Mr. Chairman, I appreciate very much the answers to the questions made by Cousin Bill (sic), but I would like the opportunity of asking some further questions after he has made his answers to the questions which you propounded to him yesterday.

This referred to a prepared series of questions that Byrd handed to Chairman Martin on Tuesday.

The session was then adjourned until 10 a.m., Thursday, August 15.

SENATE FINANCE COMMITTEE HEARINGS
ON FISCAL AND MONETARY POLICIES

August 15, 1957

Senators Williams (R.,Del.) and Long (D.,La.) took up the questioning of Chairman Martin on his third day's appearance before the committee.

Senator Williams' interrogation was as follows:

Q. * * * Do you think that with today's controls and mechanisms of our Government, we can eliminate booms and busts phases of our economy?

A. I do not think we can eliminate them completely, Senator, but I think we have it within our power to keep them within manageable proportions. I do not think we can ever say we can precisely determine specific limits that will keep us on a straight line.

Q. But that is a part of the goal which you are trying --

A. That is definitely a part of the goal, and our most serious objective.

Q. Are the recent months' increase in the rediscount rate a part of that planned program of the Federal Reserve System to stabilize our economy and to eliminate these booms and busts?

A. They are.

Q. Do you think we have been successful in that field?

A. Not entirely. I think they have had some success. But I think, again, we must never exaggerate the influence of money and credit policy. It cannot do everything, and we have to recognize that fiscal policy and management of the debt also enter into it. They all have to work together. We have not been completely successful in halting the present inflation, but I think it would have been a whole lot worse if we had not taken the steps that we have taken.

Q. You think this was one of the essential steps?

A. One of the essential steps.

Q. Are the rediscount rates in general tending to lead or follow the market in interest rates?

Questioning by Senators
Long and Williams
8/15

A. I do not think you can state that, as each individual move has to be considered on its own. There may be circumstances where it would be desirable for the rediscount market, if we thought there was heavy pressure building up, to lead the market a little bit. But generally speaking, we recognize that the market forces are the ones that are controlling. That we can influence the market. We never want to take the position that we do not have any influence at all, the market forces just produce all these changes. Otherwise, there would not be any reason for our existence. We influence them. We lean against the wind when we can determine which way the wind is blowing. But we never try to usurp the function of making the wind. Whenever we think we can make the wind, we think we are in trouble. Generally, in recent years we have tended to follow the market rather than lead the market. The last increase in the rediscount rate definitely followed.

Q. Was that the same situation a couple of years ago when we first started on this?

A. It was a moot point of judgment at that time.

Q. It was a point of judgment. It was planned to increase the rates; is that correct?

A. That is right.

Q. That was part of the plan. Was one of the factors that was giving you concern the speculative activity in the stock market at that time?

A. Yes, that was one of the factors that concerned us, and that concerned us more in 1955 than in 1956. The stock market was in better control in 1956 than it was in 1955.

Q. Then has the leveling off of the market in the last couple of years and, we will say, the recent decline, been a part of your program?

A. We have not consciously attempted to influence --

Q. I understand that. But I mean, you were trying to put --

A. We wanted to minimize speculation.

Q. Minimize speculation. Do you feel, so far as the management of the credit is concerned, that you have the situation under control now?

A. No, I would not want to say that, Senator. I say we are working with it every day, and we are trying to keep a flexible policy. We want to see to it that the legitimate needs of credit are met at all times. I would not want to make the specific statement that we have the situation under control. I think that we are doing everything within our power to watch it and adjust to it as it develops, recognizing that it is a moving picture, it is a continuous operation. And I think that, by and large, we have not been entirely unsuccessful; let us put it that way.

Q. What, in your opinion, are the principal causes of the inflationary pressures which we have experienced since the spring of 1956?

A. Well, I would say that the primary force since the spring of 1956 has been the plant and equipment expansion. We have had a constant pressure on the capital markets for long-term financing, some of which had been postponed for some time in hopes that money would get easier or that they could use bank credit in place of long-term credit for financing. I just happen to have some figures here which I would like to put into the record:

Corporate financing for the first eight months of 1957 was $8.4 billion compared with $6.6 billion in 1956.

State and local financing, $4.3 billion in 1957 compared with $3.7 billion in 1956.

* * * * *

Q. You mentioned the fact that the control of interest rates was just one phase of the problem, and that budget was another factor, balanced budgets. Do you think it is more essential today than perhaps ever before that we do maintain a balanced budget at this time?

A. I think it is extremely essential that we have a larger surplus as long as we have the spending impetus that we have, than we have had or presently have in prospect, because that definitely lessens the inflationary pressures. I would like to comment there on the ebb and flow of this, as I see it. When I was in the House last week, I commented that the forces that we are dealing with here are very much like the tides. They are as large as the tides. We cannot stand, like King Canute, on the short and tell the tides to stand back. We have got to adjust to them. When the spending stream definitely exceeds the savings that are available for the economy, it is most unfortunate, in our judgment, to use bank credit to supply the deficiency.

Q. Do you feel that Government deficits are one of the major contributing factors toward inflation?

A. I think that -- I never favored deficit financing, although I recognize that it can sometimes have an impetus on our economy. But again, it is like debt, that I commented on yesterday: It is not a situation to be desired. Under certain circumstances it may be useful, but -- and I do not want to make a blanket statement on it, but I never favor deficit financing. I think it is wrong in principle; and I think it is not really the benefit, even when it is used, that those who claim it has the benefits think it has.

* * * * *

Q. I think you indicated that you feel your policies on interest rates are working. Do you think we have reached the point where you can say that you are satisfied with the leveling off process, or do you think further increases in these rates are going to be necessary?

A. I do not know, Senator. That is forecasting the future. And I fall back on the cliche that we are watching it on a day-to-day basis, and trying to adjust to the moves as we see them developing. I will not forecast the future.

Q. Of course, part of your work is to try to picture and forecast the future as far as you possibly can.

A. Well, it is, indeed. We have to gauge it in terms of trends. But whenever we get wedded to a theory, whenever we start riding a hobby, as I frequently call it, I think we are probably asking for trouble, because the nature of the problem we are dealing with requires us to be ready to admit mistakes, just as well as to accept its success in what we are trying to do.

* * * * *

Q. Do you anticipate that this management of the credit policy is going to necessitate a change in reserve requirements?

A. Well, I hope not. I have testified on a number of occasions that I think, for the growth that I foresee in the country, the reserve requirements -- I will probably be picked up by the newspapermen on this -- I think reserve requirements are too high. That does not mean we are going to change them tomorrow; but I think in terms of the long-term growth of the country, reserve requirements are on the high side at the present time.

* * * * *

Q. Would you say this inflation of today was merely a continuation of the war-born inflationary pressures of 1946 to 1950?

A. No. I think the inflation today is in a little different category than that. It is hard to put your finger on it, but as I said yesterday in answer to Senator Martin, we were worried about it, certainly I was worried about it, from mid-1955 on. I was not worried about it in the sense that I have been talking about it now. The spiral, the inflation spiral, it seems to me, seems to have begun about a year ago, in the summer of 1956. And there the important aspect of it was psychology, in the sense that there was general acceptance that gradually grew in the early stages of 1957, of the inevitability of inflation, and that is the most difficult thing to deal with, because now you are dealing with people's expectations and reconcilement of people. I think the inflation which we had had previously did not have quite that spiral effect of expectation. It had the other elements in it, but the portion that has concerned me the most has had to do with this psychological aspect of the expectation of the inevitability of inflation. It just seems to me we have got to stop that.

Q. Do you have any theory to account for that psychology on the part of the people?

A. Theories, I think, are very difficult. I think unquestionably it was connected, and I do not know what point in time to place this, but it was connected with a conviction that spending was going to continue on an increasing scale, and a recognition of the fact that savings were not available in amounts to handle that level of spending. Now, at what point that took hold, I do not know. I suspect it took hold in around the turn of the year, 1956-57.

Q. Do you think that was the result of a submission of an extraordinarily high budget?

A. I think that was one of the factors in it.

Q. Do you think that the inflation in the period between 1946 and 1950, or the recent inflation which we are just experiencing, was in any way connected with the premature release of controls?

A. I think that that was a factor in it, yes. I think that you cannot -- I think it is extremely difficult to analyze the transition from a controlled economy to a freer economy. It has to be taken in stages and in degrees. My own judgment was, and I expressed it at the time to the Congress, we would have been a little wiser, much as I disliked Regulation W, if we had not released Regulation W and Regulation X quite as quickly as we did, along with all the other physical controls that were being released at that time. It is very easy to make statements about things that might have been done differently, but we did have an enormous build-up and increase in consumer installment credit as soon as those regulations were taken off.

Q. What year was that?

A. That was 1952. It was in June of 1952.

Q. What was your rediscount rate at that period?

A. In 1952, it was 1-3/4 per cent.

Q. Do you think that your low money rates at that time were a contributing factor, in looking back retrospectively; that you perhaps made a mistake at the same time?

A. I think you have to put that in perspective. I want to comment here, Senator, that the Treasury-Federal Reserve accord, which was adopted on March 4, 1951, was a transition to a flexible money policy. One of the elements in that accord was an understanding that in view of the heavy Treasury requirements, the heavy financing needs of the Treasury for the balance of 1951, that except in a cataclysmic situation we would not change the rediscount rate. When you are unpegging the market, you do not unpeg it in one fell swoop, and that applies to controls and everything else. You have to watch it. We have the responsibility to see that markets do not go completely haywire. We do not want the law of the jungle prevailing in markets. And when we embarked upon the unpegging of the Government securities market, we faced for a couple of years the very difficult problem in which the ordinary criteria of money and credit policy that we are trying to apply today could not apply, because we had to take it by stages. We had Government securities pegged at par and 22/32 on the long end. They came down to about 99-1/2 and then stabilized there for a while. It was our hope that perhaps the demand would strengthen at that point, and they did strengthen for a little while, and then later they adjusted further, when the demand for credit constantly grew.

The point I am trying to make here is that in the perspective of this period, I think probably we did not make a mistake in our discount rate. I think our agreement with the Treasury there -- and we always have to have the requirements of the Treasury in mind -- were such that it would have been unfortunate for us to have adjusted the discount rate. And I think that, which was a part of the Treasury-Federal Reserve accord, was an important part of it. I do not think you can apply the ordinary criteria to that period.

Q. Speaking of that Treasury and Federal Reserve accord, the Federal Reserve has always been an independent agency, is that not correct?

A. That is correct, sir.

Q. And the Treasury acts in an advisory capacity. As I understand it, even in 1951, the final decision was with the Federal Reserve; is that correct?

A. That is correct, sir.

Q. At that time, you were with the Treasury or the Federal Reserve?

A. I was with the Treasury.

Q. When you speak of the accord you were able to reach, apparently referring to between Treasury and Federal Reserve, would you say that Treasury had more to say about determining the Federal Reserve policy then than they do today? In other words, was that change in policy on the part of the Federal Reserve to suspend the supporting of the Government bonds a decision of the Federal Reserve alone, or was that done upon the insistence of the Treasury, or what?

A. Well, I cannot comment about the period prior to the accord.

* * * * *

Q. * * * I would be interested in hearing about the part with which you are familiar, because as I understand it, you were in on the negotiations in 1951 * * * when they suspended the pegging of the Government market, and I was just wondering whether the influence of the Treasury was greater then than it is today.

A. No, I would not say that. What we worked out with the Treasury then was not something that was entirely satisfactory to the Treasury. I do not know that it was entirely satisfactory to the Federal. It was a compromise.

Q. You would say that the relationships between the two departments are still good?

A. They are still extremely good.

Q. In working out that agreement to suspend the Federal Reserve supporting of Treasury, as I understand it, a part of the agreement was, the Treasury Department was to call a previously floated bond issue of about $16 billion, 2-1/2's, they were 25-year bonds, in which they were called and refinanced at 2-3/4, with a proviso that each bondholder would have an option to convert those bonds into a five-year certificate.

I wondered what was the basis or reason behind that, of a premature calling of a long-term issue, and floating it at a higher interest rate and putting an option on it which would make it possible to convert the entire issue into what at that time was recognized would be a higher interest rate than the other. Because, as I understand it, that was the beginning of the higher interest rate policies.

A. Well, that was to face up to the fact that there was a persistent overhanging of Government securities that were pressing upon the market; although the sales during the period were not particularly large, $15 million, $20 million a day, they were growing in volume and intensity, and as the demand for credit grew it became apparent that the entire flood of these longer term securities was going to come into the market. So this convertible issue that you refer to was a device which we worked out in the Treasury-Federal Reserve accord, to remove that overhang from the market. In other words, to give an incentive to these holders of long-term bonds to stay in, give them a little better interest rate and stay in. If the market had firmed up, they would have a longer term piece of paper with 2-3/4 per cent instead of 2-1/2 per cent. If they wanted to get out at any time, they could convert into the five-year security, and they would have a 1-1/2 per cent marketable issue. It was a device to handle a specific situation that was overhanging the market.

Q. Well, what was there about that bond issue that made it any different from the other types of bonds which were outstanding? Because there were other 2-1/2's outstanding at the same time, and just what was there about this particular issue that made it --

A. Well, the fact that you gave them a 2-3/4 per cent interest rate and gave them the privilege of unlocking.

* * * * *

Q. Do you know any other instance in Government financing where they have called a long-term bond issue and voluntarily refinanced it at a higher interest rate?

A. I think there are some instances, but I will check it for you, Senator.

* * * * *

Q. As I understand it, at that time this was a program which was worked out as a part of a planned program at that time to promote higher interest rates, on the basis that it would be better to aid and assist in controlling inflation; is that correct?

A. No, I do not think so, Senator. This was used as a device to handle money market situation that was fast developing into one we could not handle. This was not a part of a plan to raise interest rates. It was a specific handling of a situation that, if the demand for credit had declined in the next five, six months, or so, why, this would have been just something standing out. It was merely an adjustment to a market situation at the time.

Q. When did your program become a part of a planned program to raise interest rates on the basis --

A. It never became part of a planned program to raise interest rates.

Q. I understood in the beginning that you were speaking about part of your plan which was that you were leading the market on the basis that you felt it needed some restrictive controls, credit controls, and that you were at that time promoting more expansive money in order to curtail some of this excessive expansion.

A. Well, the lead, whether we are leading or following the market, it was the market forces that were the determining factors. Now, it is my contention that if we lead the market and the demand for credit falls away, then we are out in front and we have to fall back after a time to adjust to the market. Now, that is the fine line of judgment that we were discussing earlier with respect to these trends in the economy. But so far as consciously trying to promote higher interest rates, that has not been our aim at all. And I keep stating this for the record because I happen to believe it, that I favor as low interest rates as it is possible to have without producing inflation. I am not in favor of high interest rates.

Q. I appreciate that. I did not mean to put the question in that manner. But you said that you promoted as high interest rates as necessary to combat inflation. And as I understood it, your program a few months back was that you felt the inflation threat was such that you had to combat it with, which you did, with raising the discount rates.

A. We have to permit -- yes, we raised the discount rate because the forces in the market were such that they would have been borrowing through the discount rate. And since we were keeping the money supply at about a 3 per cent growth factor in the economy, any additions to the money supply over and above that could have done nothing but add to higher prices and add to inflation.

* * * * *

Williams asked a series of questions on bank mergers and branch banking, then turned to steel prices.

Q. Do you think the escalator clauses in some of the wage contracts are good or bad for the economy?

A. There again, I do not know. I have no objection to escalator clauses, but I would say if the escalator clause in the long run contributes to inflation, it is bad for the worker, and it does not achieve its objective. Now, it is a device to recognize an increase in the cost of living; but if the overall cost of living gets away from us, I think that the person benefitted by the escalator clause suffers also.

* * * * *

Q. * * * Do you anticipate a climb in business activity in 1958 or 1959?

A. I do not at the moment. Well, 1958-59 is too far off for me to make any calculation; but I would say that the longer range outlook for business is still quite good. Now, there may be some dips from time to time, but I am quite confident on the longer range outlook for business.

Q. You feel if the Government can bring its budgetary policies under control, we would have a reasonably good chance of controlling this inflation which is with us?

A. I think it would be very helpful, yes, sir.

Q. Would you say that it would not only be helpful -- I mean necessary, but it would be practically essential that we do?

A. Yes, I think it is practically essential, yes.

* * * * *

Q. When inflation hits a country, who is it that is hurt the most?

A. I am convinced, Senator, that it is the little man that bears the brunt of inflation. The man who has small savings, small income, the white collar worker, and the man at the old ages, with the pension -- those are the people who are almost defenseless. Now, the bigger operators -- and in the long run, of course, as I have tried to outline in this paper, everybody suffers from inflation. But in terms of its immediate impact, I think the primary sufferer is the small man.

I think the best illustration of that is in the way that so many well-to-do individuals have been able to purchase securities and properties and one thing or another, and participate in the expansion, whereas the little man has been limited to a fixed income security largely, unless he has been willing to gamble pretty heavily with his small means, that he is not in a position to adjust to where the larger individual is.

Q. As a rule, the smaller individual has his investments either in a pension fund, life insurance policies, savings accounts, or government bonds; isn't that true?

A. That is correct.

Q. And the result of the American dollar losing one half of its purchasing power, is it not the net effect of that action, the destruction of one half the savings of the American people?

A. That is correct.

* * * * *

At this point Senator Long took up the questioning, which some observers felt was being prompted, at least in part, by Leon Keyserling who was in the hearing room, having just returned from an A.F. of L. and C.I.O. economic policy meeting. Long referred to 4 million unemployed during the first half of 1957. After a prolonged exchange, it appeared that he had confused numbers with percentages, in citing figures from a table of economic indicators, on which he was basing his questions. The result was a confusing transcript for many pages, which are omitted altogether for the purpose of this digest.

Long argued that with 4 million idle we could produce more houses, automobiles, etc., and that there is no pressure now on productive capacity. The questioning then ran on:

Q. Do you think it is desirable that we should try to set into action a round of declining prices?

A. I do not think we set it into action. I think that is determined by the market.

Q. Do you think it is desirable we should have a fiscal or monetary or tax policy that should contribute to that result?

A. We should have a fiscal, monetary and credit policy that contributes to stability.

Q. I mean either.

A. That permits the market to operate; otherwise we have a completely controlled economy.

Q. Wait a minute. I wanted to relate that to your previous answer about saying that goods are available but they are at a price that the consumer will not pay. Do you regard it as a desirable government policy, in any respect, whether fiscal, monetary, taxation, or any other way, that we should try to set into effect a round of declining prices?

A. I have never advocated recession at any time.

* * * * *

Q. Therefore, it would be desirable, and I want to know if you agree with this, that it would be desirable that we should at this time have higher consumer expenditures at the existing price levels?

A. No, I do not think so. I think what we need today for plant and equipment expansion is more savings.

* * * * *

Q. Now, insofar as, and separating this item of inflation for a moment and relating it to the consumer spending only, insofar as a tight money situation, and a high interest rate situation reduces consumer spending, is that a desirable thing at this time?

A. Well, I contend that there is no tight money situation that is reducing consumer spending at the present time. The problem is that the consumer is spending at a colossal rate, and I think the phrase "tight money" is a misnomer. I think it is really loose money we have been having for the last year or so.

* * * * *

Q. Let me go back to this question I tried to get answered sometime ago, and perhaps we are ready to get an answer to it now: On this showing -- and these are the only figures I have to show it, and I hope you can answer this question yes or no, but you do not have to -- do these figures show any pressure on our productive capabilities of a genuine inflationary nature?

A. Now, in terms of prices, I think it does.

Q. Let us not talk about it, let us talk about your ability to produce to meet demand.

A. Well, the demand at a price, though.

Q. In other words, I would like to separate these things, and that is the reason I started talking about labor force. I want to talk now about our capabilities to produce, and I do not want to talk about the price at this moment. We will get to that later, and if you want to make a statement about that now or any other time, I will be glad to hear it. But I want to know if the facts before us, the facts in the President's Economic Report, the facts in our Economic Indicator, show any pressure whatever upon our over-all productive capabilities to indicate that there is an inflationary strain on our productive capabilities?

A. Well, if you are talking about whether we can produce more than we are producing at the present time, without regard to whether we can sell it at current prices, I think there is very --

Q. That is all I am talking about at this moment.

A. All right. I think there are very few instances where you can show any strain on our capacity at the moment.

* * * * *

Q. Let me ask you this: do you think it is desirable to have less consumer spending if the result of it is less production?

A. Well, there again you are taking the wheel -- if you could take any isolated point and project --

Q. You are the man who told it to me first. You are the one who told me here that you have less production because of people not being willing to buy, you say, at these prices. I say, is it desirable to reduce prices, and you say, no. Is it desirable to increase prices, and you say, no, if I understand you correctly.

A. No. I think you are misquoting me a little.

Q. Let me ask a second question. Do you say it is desirable to increase prices?

A. To increase prices?

Q. Yes.

A. No, I have not said it is desirable. I say that the market forces are the ones that are going to control ultimately these price adjustments, and that neither you nor I can make them; that there you are up against the operation. Now, if we could plan the economy in its entirety and ignore this problem of saving and investment, we could unquestionably just try to produce more goods, but the people want them at lower prices all the time. I just do not think you can do that in this production, consumption and distribution scale.

Q. We will be through by 10:30 here if you will just give me the correct answer. All I am trying to get from you is just the answer as to whether or not it is desirable, one, to have a reduction in normal times of per capita disposable income where no tax increase has occurred from one year to the other; that means, after taxes.

* * * * *

At this point Chairman Martin turned to Win Riefler who sought to straighten out figures that Long cited which did not seem to accord with the known trends in the economy. Turning again to Martin, Long continued:

Q. You are familiar with Professor Sumner Slichter, are you not? You either know of him or you know him, one or the other?

A. Yes.

Q. He is well regarded by a great number of people in the field of economics. Here is a letter on August 8 of this year that he wrote to the New York Times. He says that:

"The figures" -- which I assume refer to these figures we are discussing here, "The new figures show that the weak spot in the economy is now consumption, especially consumption of durable consumer goods," and I assume that relates to automobiles, household appliances, and things of that sort, "and that this weakness exists in spite of a fairly good increase in personal incomes.

"For more than six months the American economy has been merely marking time. Physical production in the second quarter of 1957 was virtually the same as in the first quarter, and between the last quarter of 1956 and the first quarter of this year there was only a negligible rise in physical output.

"As a result, total physical production today is only about one half of one per cent greater than it was in the last quarter of last year. Industrial production is even less today than it was nine months ago and is not even one per cent greater than it was in the spring of 1956 -- in spite of large outlays by factories and mines on new plant and equipment."

He goes on down, and I will not read the whole letter, but it is all along that line, and he makes this statement:

"But the fact that the American economy has made virtually no progress in increasing production for over six months shows that the number one economic problem is not inflation -- it is the problem of restoring expansion to the economy by persuading individuals to increase their spending, thereby creating markets for a larger volume of production." Do you agree with that statement?

A. No, I do not agree with it. He has got a billion dollar error in there. That is not terribly important, but it is true, but I do not agree with the statement at all. There is an answer to it from a life insurance president today that I think is rather good. He says:

"In a time of relatively full employment as is the present, to state as does Professor Slichter in his letter of August 8 that the number one economic problem of the moment is 'to restore expansion to the economy by persuading individuals to increase their spending' is to argue for an increase in the forces making for inflation."

Q. Let me ask you this question: do you think a life insurance president can be an unbiased witness?

A. This is from an economist.

Q. I thought you said he was a life insurance president.

Mr. Riefler interjected: "He was a economist and a professor of economics a few years ago, and he has become the president of this life insurance company."

Q. He is president now. He is not their economist; he is their president. Well, I repeat the question, do you think that the president of a life insurance company can plead from a position of an unbiased witness in this situation?

A. I think so. I think he has got --

Q. Do high interest rates substantially increase the income of a life insurance company?

A. Yes. But the depreciation of the dollar destroys entirely his business, and no one has more concern about the depreciation of the dollar than a life insurance company.

Q. Nor has anybody more concern about the increase rates, do they?

A. No, I do not think that follows, Senator. I think the number one problem for a life insurance company is making good --

Q. You say the witness would not be biased, that the increase in his income would not relate to his judgment? Let us go ahead and hear the rest of it.

A. "With the level of expenditures for investment as high as they have been during the past year, where would industry have obtained the materials and labor to produce a higher volume of consumer goods?

"The really phenomenal thing is not that consumer expenditures have not expanded during this period, but rather that it has been possible to increase expenditures for investment so much without causing their decline.

"Perhaps later, when the current investment has resulted in an enlarged plant capacity, the need may then be to increase consumer expenditures in order to keep the enlarged plant running full capacity. But not now when our economy is practically bursting at the seams."

* * * * *

Q. I take it then you do not feel there is any desirability for increasing consumer spending? I take it that would be your view even if that should be increased -- if that should mean increased production?

A. I think the important thing at the moment is to increase savings. That has to come out of the consumers.

* * * * *

Q. * * * Here we are at a standstill, showing the actual reduction in per capita income in terms of real dollars, that is, in terms of constant dollars, and here you are saying that it would be good to further reduce it to meet growing consumer demand. I do not understand that. There is growing consumption demand, I believe is the term you used. Well, it is not growing, I mean, it is getting less rather than more, according to this.

A. No, it is growing, but the demand -- the problem that you have here is that the demand for these products is offset by an enormous requirement for plants and equipment expenditure for the production of these products in all lines, not just the lines that you mentioned, across the board, and that is in excess of our available savings, so that if you create bank credit to supply that, why, you are just endangering the deposits of everyone.

Q. Well now, let us just look at this for a moment. If you make additional funds available for the expansion of these plants and facilities, then you have more funds available to purchase the goods and commodities that are being produced today, do you not?

A. But the price factor comes into it. This money supply, then, if you are going to say that the way to increase production is to increase the supply of money, when there is an inadequacy of savings --

Q. Let us take it step by step.

A. There is no other way to do it.

Q. You are the one who told me the way to increase production is to increase consumer spending.

A. No.

Q. Didn't you?

A. No, I have never said that.

* * * * *

After a discussion with Riefler on productivity--on which there was no meeting of minds--the hearing recessed until 10:30 a.m. Friday, August 16.

SENATE FINANCE COMMITTEE HEARINGS
ON FISCAL AND MONETARY POLICIES

August 16, 1957

Senator Long continued his questioning throughout Chairman Martin's fourth straight day. After the session, Senator Byrd, as Chairman, announced that the hearings would be put off until fall, possibly mid-October, with the understanding, however, that Long and Senator Carlson would complete their interrogation at Monday's session.

Long began by asking about Federal Reserve "independence."

"Well," said Martin, "we feel ourselves bound by the Employment Act and by the Federal Reserve Act. And in the field of money and credit we consider ourselves to be, regardless what the decisions of the Administration may be -- we consult with them but we feel that we have the authority, if we think that in our field, money and credit policies, that we should act differently than they, we feel perfectly at liberty to do so."

Q. In other words, you feel that you have the freedom in promoting what you believe to be the full employment policy of the law?

A. That is right.

Q. To adopt policies that may not be the policy of the Administration itself?

A. That is right.

Q. And you feel that there is a possibility and the right within the Board to adopt a policy that may be completely at variance with the attitude and the direction of the policy of the Administration?

A. Well, I wouldn't say that -- we will discuss we will discuss it at considerable length.

Q. You have the right to disagree with them?

A. Exactly.

Q. And you believe the Federal Reserve Board if it does disagree has the right to pursue a policy that is completely contrary to the policy that

Questioning by Senator Long 8/16

the Administration proceeds to follow, not meaning that you are doing that or that you have, but that you feel that under the law you do have that right?

A. Under the law we feel it is our prerogative, yes, sir.

Q. At the same time you believe, if I understand it correctly, that you should in a sense persuade them that the policy that you are pursuing is the correct policy, and that their policy should be consistent to ours and that you should make yours available to the Executive, for the Executive to persuade you if possible that the policy that the Executive is pursuing is the policy to which you should -- the same end to which you should direct your activities?

A. That is right.

Q. At the present time, if I understand it, the testimony from the executive branch has been that their policy is consistent with the policy that you are pursuing?

A. Well, I think in a broad sense that is correct. We have differences of opinion -- differences of judgment with respect to our actions.

Q. Yes. Has the Administration of recent date, and the spokesman for the Treasury Department or the President in any other capacity been urging you to take the position or to have a policy contrary to the one that you have been pursuing?

A. Well, over the last year there has been no pressure, Senator, and saying, "If you do not follow this policy, we will drop you out of office." They have tried on a number of occasions to persuade us that we should not take action which we did take, but it was a perfectly friendly discussion and honest disagreement, not about broad policies so much as about timing and judgment with respect to whether it was a wise course for us to pursue under present conditions.

Q. Could you give us some indication of recent decisions and recent actions that the Board has taken which you feel were not the policy that was recommended or was, perhaps, contrary to the attitude that you believed that the Administration would have taken if they had been charged with the same responsibility that you have?

A. Well, I think the most glaring instance of that was in April of 1956, we, pursuing our method of cooperation, I began discussions with Secretary Humphrey. In February of that year Governor Balderston and I had a meeting with Secretary Humphrey in that year and there was a disagreement as to the nature that the economy was developing, and we were so convinced. We discussed it with various people, and in a series of meetings from about the middle of February until the last week in March. By the last week in March the position in the Federal Reserve which was not a one-man operation, you see, the twelve bank directors were considering all aspects of this -- it was that it would be wise for us to go up in the discount rate. I think at that time Secretary Humphrey subsequently testified that his judgment was that the timing was poor, that he was not opposed to the long run objective. We finally reached a point where there was no meeting of the minds that could be had, and there was nothing for the Federal Reserve to do except to go and act. And we acted.

Q. Since that time the discount rate has been advanced several additional steps, has it not?

A. It has. And it has been discussed persistently with the Treasury and with the Council of Economic Advisers and others in the Administration. And we benefit a great deal from these discussions with them, just as we benefit from the meeting here before this committee, getting the different points of view.

Q. Are you free to say whether there was a divergence of opinion on the subsequent increase in the rediscount rate?

A. In some degree I think there was. There was no pressure put on us not to do what we did. Everything was very friendly and amicable, but I am inclined to believe, I would have to be honest, I am inclined to believe that if it had been handled by the Administration it would have been handled differently.

Q. Are you inclined to believe that the Administration would have been more rapid in advancing the rediscount rate or less rapid?

A. They would have been less rapid, although I want to be very fair in this and say at one point, early 1955, I think, the Administration probably would have, if they had had the authority might have gone up and at that time we were opposed to going up. It has not been a one-way street.

* * * * *

Long then asked a series of questions on interest rates and on productivity. He said he could "not understand the confusion on the part of the Federal Reserve Board as to the distinction between productivity and production." He turned to Win Riefler to discuss current figures on production, disposable income, etc. Long quoted from Business Week and argued at length that the steel industry is producing way under its potential, indicating to his mind that inflationary pressures are off. He was critical of both Martin and Riefler because he could not get agreement on the kind of answers he sought.

Q. Here are the figures, and here are all the business writers explaining there is a vast amount of plant capacity idle, and you are still making a statement--you are making the affirmative statement on the one hand, and declining to acknowledge just the opposite conclusion, that we do not have any inflation because of inability of the American productive facilities to manufacture and produce goods sufficient to meet consumer demand.

A. Now, I have great respect for Business Week. I have read it for a long time. But if you will take Business Week over the last four or five years, and pinpoint the times they have stated that a given industry was in a state of oversupply or undersupply, and then see what happened in a period of six months, you will find that their errors of judgment have been pretty high, also, as all of us have been in this.

Now, this is a continuing cycle. I have never intended to imply in anything I have said that this boom in plant and equipment is unwarranted. What I have been trying to say is that this boom in expenditures for plant and equipment is moving too fast too rapidly for the resources that we have available.

* * * * *

Q. In your prepared statement, you would have appeared to be one of those who believes in a steady expanding economy, and one who would not be satisfied with a staggered economy. Now, I should not take it that you would be satisfied with a plateau of industrial activity in a nation where the population is expanding. Would that be correct?

A. You and I are in complete agreement on that, but we do not want to get that expansion by inflation; and it does not, expansion does not occur necessarily in a straight line. This year is not finished, and the levels of our production here are substantially higher than May, June, and July of a year ago; and yet our price, the cost of living has gone up for 10 successive months.

* * * * *

Q. * * * Now, if you are trying to provide a cure for inflation, can you suggest to me any better cure than to increase production to meet the demand? It is certainly a better cure than rationing, is it not? It is a better cure than credit controls, or is it?

A. Well, you cannot cure inflation by supplying more money.

Q. Well now, wait a minute, I am not talking about supplying more money here; that is not what I am talking about. I am talking about supplying goods.

A. I know. But in order to supply more goods at the present time--

Q. That is not the question I asked you, and I am just afraid we will go round in a circle for a while longer to get back to our starting point. What I am talking about here is the production of goods: food, fibers, housing, transportation, automobiles, anything, tangible goods. Question: Do you know of any better cure for inflation than the production of goods to meet demand?

A. You want these goods to be held when people acquire them, and we have an economy that is an earning economy. If people can not pay for the goods out of earnings, they can not retain them. You can give houses away, but the Government then will have to supply the funds.

* * * * *

Q. Well now, let us get to the next point. You are advocating, if I understand you correctly, an increase in consumer savings in order to finance the expansion of plants and equipment at this time; is that correct?

A. I am, and any other capital expenditures.

Q. Now, if this increase in consumer savings must result--in order to build additional plants--must result in a reduction of consumer expenditures, which is the only thing that could happen with it, a reduction in consumer expenditures and additional idleness in plants that are producing for consumer use, is that a desirable result at this time?

A. Well, that is the only way you are going to get the adjustment.

* * * * *

Q. * * * The question is: Why did the prices rise? They certainly did not rise because industry could not produce to meet the demand. Is that not correct?

A. They rose because the price spiral was in operation and the manufacturer wants to pass it on to the consumer, and how is the consumer ever going to get that back.

Q. That is just fine. I am glad you made that statement because I can ask the same question again. They did not rise because of the inability of the plants to produce. Here we have been two hours getting that answer, have we not?

A. No. Well, I just can not put it in simple terms as that.

Q. You are saying they rose, you are saying that there is plenty of production available at a price but that the consumers are not willing to pay the price?

A. Well, I assume at some point--we can not compel consumers to buy or to save.

* * * * *

Q. So here we are on a broad plateau, and not just on a pinnacle for one day. Now, that being the case, is not that statement tantamount to saying that industry can produce substantially more consumer goods than the public can buy at existing price levels?

A. Well, no, I do not think so, Senator.

Q. What is the difference?

A. Well--

Q. Why would not that follow? You are saying that prices are so high that the consumers will not buy that which industry will produce, and that there is plenty of production and plenty of productive facilities available, and that there is a shortage of consumer demand at existing prices. Does it not follow that at this existing price level industry can produce far more goods than the public is ready to buy?

A. Well, the cost goes up as they produce more, and as the cost goes up, why, then there is less buying power even than there is at the moment. And this is just a clear case of a cost-price operation that industry wants to pass on to the consumer and it is getting more and more difficult to do it.

Long then suggested a recess subject to the call of the chair.

"I would like to continue this examination," he said, "because there are quite a few additional things that I would like to cover. I regret, Mr. Martin, that I have such difficulty in getting the answers I want, or perhaps it is my fault that I do not put the questions so that--

"It may be my fault, Senator."

"You can convey the meaning that you would want to convey," Long added, "but in any event, I would like for us to attempt to get these matters for the record, and perhaps we can meet again before the Senate adjourns, at which time I could ask my questions, and if I can get my information for the record, I will be glad to yield to Senator Carlson."

The hearing then adjourned to Monday, August 19.

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SENATE FINANCE COMMITTEE HEARINGS
ON FISCAL AND MONETARY POLICIES

August 19, 1957

Chairman Martin, on his fifth and final--for the time being--appearance was questioned further by Senator Long, then by Senator Carlson and finally Senator Malone. The session was called to order at 10:30 a.m., recessed at 12:20 p.m., reconvened at 2 p.m.,--when Malone began--and ran until 8:35 p.m., one of the longest, if not the longest, marathon for one witness certainly in recent times.

Long again argued that "this tight money policy" has not stopped the "investment boom," and Martin contended the boom would have been bigger but for monetary policy.

Q. * * * Assuming that we get past this investment boom and that the inflationary pressures subside so that we do not have inflation to contend with, would you then propose to use the powers of the Federal Reserve Board to bring these interest rates down to a level where they were in 1953, or even lower than that?

A. I do not think we would have much trouble. Once the demand for funds disappears, declines substantially, you will find that the interest rate level begins to decline. We would not be the slightest bit averse to using our powers, once deflation is clear, to ease money. We have got to make a judgment of when the time comes and what the right time is. In 1953, we started easing money, and we got a little bit overenthusiastic about it, I think, toward the end of the year, but we actually pursued a policy of active ease during that period.

* * * * *

Long asked a series of questions on what higher interest rates add to the cost of housing, to rentals and to small business, and Senator Carlson then took over.

Q. * * * if it should develop that we had to make a choice between creeping inflation or some unemployment, which would you choose?

A. I think it depends on the point that you are in the cycle. I think that any employment which would develop as a result of a creeping inflation of the sort you are talking about would be very temporary indeed, and I think you cannot separate price stability and growth in the economy. I

Senators Long, Carlson and Malone

think that you have to recognize that they are very closely related. It is not possible to completely isolate one from the other.

Now, I would not make a conscious choice in favor of unemployment at any time. I would not make a conscious choice in favor of price stability. But I think on an ad hoc basis, you have to gauge the position in the cycle of the operations.

Q. If the Federal Reserve had pursued a much easier credit policy over the last 18 months, what would have been the result?

A. You would have had, in my judgment, more inflation than we have had. You would have had inflation feeding upon itself in a way that it has not fed upon itself, and I am confident that you would have had greater demands upon our resources than we could have met without rather sharp further increases in prices. The cost of living has gone up for ten successive months, as it is.

Q. Well, am I to understand if we would have had easier credit policies, there would not have been more people employed?

A. I do not think there could have been more people employed except temporarily here and there. I think you were pressing against capacity all through the period.

Q. Are the decisions the free market makes about the allocation of savings, in line with the economic welfare of our people? For instance, is it consistent with our economic welfare for wealthy corporations like the A.T.&T., General Motors, and many others, to be able to borrow money, while school districts, housing, and other worthy enterprises have unsatisfied demands for credit? That has been one of the problems, I know, which has been discussed for some time before this committee.

A. I say in a free economy, of course, if a corporation has retained earnings, just as if a wealthy man has wealth, it can be used. If we had had additional savings recently and less exuberance in our economy, there would have been more funds available for schools and highways and churches and playgrounds and the type of financing which ought to be done out of savings and not out of bank credit.

* * * * *

Q. Would you recommend Government measures to assure that a larger proportion of the savings go to States and cities, school districts, and to housing?

A. I think allocating the funds should be left primarily to the market. I do not think we can very readily maintain a free economy, take these funds and specifically allot them, except by Congressional action; and that, I think, is within the province of the Congress.

Q. Well, do you consider the current rise in prices is at least partially independent of monetary developments?

A. I think it is partially, yes, because I think that the spending, governmental and State and private spending, is a factor. I do not think that -- there are the three factors here, money and credit policy, budget policy, and management of the debt, all of them working together, and I think that money and credit policy is just one of those three factors.

* * * * *

Carlson cited the recent AFL-CIO Executive Council attack on Administration economic policy and "tight money", which said the Administration was "blundering dangerously".

Q. * * * Do you concede that you are blundering dangerously at the present time?

A. Well, obviously I do not think the Federal Reserve Board is blundering dangerously. I think that to take the position that the way to cure an inflation is by additions to the money supply is just asking for more inflation, and I am convinced that the number one economic problem today is to direct all of our energies to reducing spending and increasing savings.

We have within our grasp, as I stated earlier, I think, a higher standard of living on a sound basis, if we just do not try to do too many things too fast, and if we will give savings a chance to accumulate to be utilized in the way they should be, instead of depending upon the creation of bank credit to supply a deficiency in savings.

* * * * *

Q. * * * Am I to understand that the Federal Reserve has in mind to hasten a recession?

A. There is no intention on the part of the Federal Reserve to hasten a recession. I do not want recession at any time. I have pointed out that if there are excesses which develop, corrections are necessary from time to time. The actions, the overt actions, we have taken -- we influence the money supply, but we do not control it -- have been as a result of reflections of the demand, the terrific, overwhelming demand for credit that has occurred persistently in the economy for the last two years.

It seems to me that it is tantamount to a California gold rush in its intensity, and that the forces which we are dealing with cannot be equalized in any sense without the use of the price mechanism, and interest rates are merely a reflection of this operation.

Interest is a wage to the saver as well as a cost to the borrower, and it will over a period of time have an equalizing effect.

* * * * *

The questioning turned to unemployment figures, and Martin read the following statement:

"I had not prepared it for that purpose, Senator, but I have an analysis of current unemployment here which I would be glad to put in the record, made by our staff recently, which certainly, I think, would be at variance with those figures you read.

"I think you could analyze these figures a great many different ways, and I would not offhand want to -- I would be glad to put this in the record.

"Factors Accounting for Differences in Unemployment; 1951 - mid-1953 and 1957.

"Current unemployment:

"First, in terms of perspective, it is worth while 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 seasonal 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, under the 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 to the labor force, a much larger increase in the labor force than would have been expected on the basis of growth of the population of working age, reflecting the continuing strong demands for workers.

"This fact also indicates the frictional nature of current unemployment, in that it has been necessary to go outside of the labor force to meet demands for additional employees.

"Other indications of the current low level of unemployment are that about two-thirds of the unemployed have been looking for work less than 6 weeks, and that only 500,000, or less than one per cent of the labor force, were reported as having been unemployed for 15 weeks or more in July.

"Except for the very young age groups who are just starting their careers or looking for summer work, unemployment rates among adult workers are very low. In each age group 25 years and over, the unemployment rate was substantially below the average.

"For married males with wife present, the unemployment rate in July was only 2.3 per cent.

"While there are a number of areas which report substantial labor surpluses -- unemployment rates of 6 per cent or more -- they consist mainly of textile towns and mining areas, in which the age, sex, past work experience, and geographical location have in large part prevented the absorption of these persons into gainful employment in a period of expanding demands for workers.

"In contrast, there are still reported shortages for engineers, teachers, and other professionals along with some kinds of skilled workers."

Q. That was certainly a very interesting statement. If I understood it correctly, in July the unemployment had reached only 2 or 3 per cent, less than 3 per cent, of our national labor force.

A. I will continue this a little bit further, if I may:--

"I have here comparison of current unemployment with 1951 to mid-1953: In the first half of 1957, average unemployment was about 800,000 to one million more than in comparable months in 1952 and in 1953. The old definition was used in both instances for purposes of comparability.

"Since 1952, some 6 million people have been added to the labor force. If the data is standardized to take account of increases in the labor force and differences in age and sex distribution in the two periods, unemployment would have increased by 200,000.

"The major differences in unemployment in the two periods primarily result from the Korean hostilities. Between mid-1950 and the defense peak, the armed forces increased by 2.3 million. This resulted in a sharp reduction in the number of unemployed males under 25 years of age.

"Since mid-1953, however, the armed forces have been reduced by 800,000 men, from 3.6 million to 2.8 million, and this to some extent accounts for a slightly higher unemployment rate among younger men in 1957 than in the earlier period.

"During the period of the Korean conflict, there was a well-advertised manpower shortage. Public agencies and many employers conducted an active and extensive drive for workers. This apparently had a number of effects.

"It tended to reduce unemployment as well as the length of unemployment for those seeking work. On the other hand, it led to hoarding of workers and use of less efficient workers on the part of employers who feared that sufficient manpower might not be available in the future.

"On the whole, in this period it appears that there was a good deal of underutilization of manpower, and there was very little growth in productivity. It was not until after cessation of hostilities that output per man-hour started to rise again.

"It seems likely, although it is difficult to prove, that during periods of hostilities -- World War II and Korea -- people interviewed in the Census household sample surveys may have been reluctant to admit to being unemployed -- on the assumption that unemployed persons were not contributing to the defense effort in view of stories of worker shortages delaying war efforts and other patriotic appeals. During World War II, reported unemployment fell to the very low figure of 400,000.

"Since 1953, there has been a reduction in manpower requirements in the railroad, mining, and textile industries which has resulted in some increase in longtime unemployment and is reflected in somewhat higher rates of unemployment among older workers now than in the 1951-1953 period.

"As mentioned earlier in this memorandum, this has resulted in what might be called some chronic unemployment; but the number of such persons appears to be small.

"In 1956 and 1957, there have been a number of mixed trends in the employment situation resulting in some layoffs. In 1956, the reduction of automobile production was definitely reflected in the unemployment totals but was offset by other gains.

"In 1957, while unemployment among automobile workers declined, reductions in residential construction, lumber, electrical machinery and more recently aircraft employment, have tended to keep the unemployment totals fairly constant, but probably slightly higher than if all activities were currently rising.

"The unemployment series is based on a sample survey and has all the difficulties of such data including sampling error. A difficult factor to evaluate has been the improvement in unemployment data resulting from two changes in the Census sample since 1952-1953.

"In 1957, Census interviewed about 35,000 households in 330 areas each month. In 1952-1953, only 21,000 households were interviewed in 68 areas each month. Sampling error for unemployment in 1952 was calculated as 190,000. In 1957, the sampling error is 100,000 for unemployment.

"The Census sample was increased from a 68-area sample to a 230-area sample in January 1954. The results of the new sample showed that for January 1954, unemployment exceeded the old sample figure by some 700,000, or 31 per cent, a considerably larger difference than could reasonably be attributed to sampling variability.

"An examination of the evidence by the Census Bureau's staff and a special technical committee led to the conclusion that the old sample figure was understated, partly because of inadequacies in interviewing during the period of transition to the new sample.

"On the basis of comparing the total unemployment statistics with the number of persons receiving unemployment compensation, it was concluded that the understatement started in September 1953.

"On this basis, an adjustment was made by arbitrarily graduating downward the percentage difference between the old and new sample estimates of unemployment from January 1954 to September 1953, and no change was made for prior months.

"In April 1956, the sample was again expanded, this time to 330 areas, but the unemployment figure was reported as approximately the same for both samples."

Carlson cited an article by Leon Keyserling which contended that consumption and production were well under potentials.

Q. In view of your statement, it seems to me we have been producing pretty well at capacity, and any additional production to be purchased by the consumer would have been bought at greatly inflated prices; would that not be correct?

A. That is correct. I have a comment on production here I would like to read, if you would permit it, Senator:

"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, 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 avoid a crisis."

* * * * *

Q. Well now, if we should agree with Dr. Means' theory, and there are some who do, would it not mean that it would take a national buyers' strike to end or retard inflation, if we followed through in his theory?

A. I do not know about a national buyers' strike, but you cannot, in a free economy, you cannot make consumers either spend or save or increase their spending by fiat, by decree. It has to come about by their recognition of the business process, and their wants and desires, and the satisfaction of them.

I do not think that you will have a buyers' strike per se in this country, from business causes. It would be more likely a buyers' strike, if you want to put it in that sense, would come from somewhat psychological frustration.

And one of the psychological frustrations that could become overwhelming would be just general frustration about the course of our fiscal and monetary affairs.

* * * * *

Q. Can the aggregate of profits and wages rise more rapidly than productivity without causing a rise in prices?

A. I do not think so.

Q. Is it reasonable for the public to expect that with proper Federal Reserve policy and a balanced budget, wage increases will be compatible with a stable dollar?

A. I think so.

* * * * *

Q. It seems like when Congress starts tampering with the economy, and we have -- I have been here 22 years and I have observed some of these controls, not only wages, but allocations of materials -- that it may work temporarily, but over the long term we get into difficulty. Is that not about right?

A. That is right.

Q. If increased productivity is due primarily to increased investment, is there any reason why so much of such benefits as is in excess of that claimed by capital should go to labor in higher wages rather than to the entire public in lower prices?

A. Well, I think it should be shared by everybody, and I think the excess that you are talking about, I think, sometimes I think that the consumer is the forgotten man in most of our discussions, and I think he ought to be given a very prominent role. It seems to me we are all working in one sense for the consumer, and we ought to do what we can to see that he gets some of these benefits.

* * * * *

Q. How can continuous increases in the aggregate of profits and wages be prevented from exceeding increases in productivity?

A. Well, I think that is -- we have collective bargaining and I think that both management and labor have got to study that. It is not a one-sided operation. I think that as you approach most of the labor negotiations, management is inclined to claim they can not do anything and labor is inclined to ask for the moon, and I think the answer is probably in the middle ground.

Q. You have been much concerned for some years about the need for maintaining a stable dollar. In your testimony the other day you said that monetary and budgetary policies are only part of the answer. As you see it, what part of this problem is not susceptible to monetary and budgetary policy, and along what lines are solutions to be found?

A. Well, I think that the management of the debt is something that should be borne in mind at all times, and I think that it is very difficult for money and credit policy to operate against a debt, for example, such as we had at the time of the pegged market, when the government securities virtually were interest-bearing money because you could get par and 22/32 for them any time you wanted, marketable government securities. And I think that if you are faced with a constant increase in spending and during a period of high utilization of resources and generally favorable employment, if the government does not contribute to a budget surplus and use that period as an opportunity to reduce its debt, I do not know when in the world it will.

I do not think money and credit policy can do much except to put its little finger in the dike against that, and I think it is important to do that. I am not saying it is helpless; I say it is important to stick your finger in the dike. But if you have a flood of spending that threatens to overwhelm the bounds of available income, I would not want to depend too much on money and credit policy to stop the leaks.

Q. Well, ever since these hearings started with Secretary Humphrey and Secretary Burgess, and I noticed in your own statement, there has been some discussion about the accord, as of March 1951.

If I understand the Federal Reserve policy correctly, after the accord of March 1951, you abandoned that policy of continuous market support in order to assure artificially low levels of interest rates, but you did from time to time aid the Treasury in refunding by buying substantial amounts of maturing Treasury issues.

In other words, while you ended that in 1951, as I understand it, it was not completely ended; is that correct?

A. It was a gradual process, Senator, starting in April of 1951 -- March actually -- with the unpegging of the government market. We had to recognize that you do not stop something that is done for 10 years with just one jolt. You have got to recognize that we have a responsibility for a market. Free markets are not markets that participate in the law of the jungle, and we recognized our responsibility to make the transition.

During the period of 1951 and early 1952, we intervened in the Treasury market. We always want to help the Treasury finance, but to try to help them and gradually move toward the time when we would not be monetizing a large portion of their new issues by direct purchases. We finally ceased that direct intervention in November of 1952. We actually floated our first Treasury issue in the latter part of 1952 without any Federal Reserve intervention whatever.

In 1953, we went through the entire year without intervening in the Treasury market, and the Treasury financing was conducted not perfectly but quite successfully.

We did the same in 1954, and in 1955 we had one difficult period. The demand for credit was growing constantly, and in late 1955, November of 1955, we raised the discount rate. And that was pretty close to the Christmas season, which is one of the difficult periods in the money market. The transfer of funds at the Christmas period is a colossal undertaking at that time of year, and the increase in the discount rate and the general situation in the Treasury at the time led to considerable apprehension about an issue that they were putting out. And after a long debate, all of which you have the record of in our annual report, we decided to buy up to $400 million of Treasury securities. We only had to buy $167 million of them.

But that is the only instance of intervention in the period since the accord up to the present time.

* * * * *

Q. Practically during your occupancy of the chairmanship there has been no real support of the bond market by the Federal Reserve?

A. That is correct, sir.

Q. Then as I understand -- and the chairman has brought in a question there that I think is very appropriate at this time, because there is some criticism of the Federal Reserve because of the inflexibility of it -- in other words, you have a very rigid program and you stay with it, but you did follow that program in 1951, 1952, and in 1953 you began to change it, and in 1954 you continued and in 1955 you again eased up and purchased some of these securities. Is that not right?

A. We did; and under unusual circumstances we would be prepared to do it again.

We do not intend to be inflexible. But we do think that as a general principle, that both the Treasury and the Federal Reserve should work to see that their financing is achieved with a minimum monetization of the debt. And that while we want to help them in every way we can, we want to see that their securities stand on their own feet in the market.

Q. Then am I to conclude that it is now your policy not to assist the Treasury in any way whatsoever except by refraining from demanding cash payment for your maturing securities?

A. Well, we help them -- if you are talking about a direct sense, yes. If you are talking about -- well, we work with them just as closely as we can, advise them, help them, do everything we can to see that their issues are adequately financed. But so far as direct intervention is concerned, yes, sir.

Q. That was not true back in 1951 and 1952, then, when you had an accord? That would be a direct intervention, would it not?

A. I would say that the accord provided for moving as rapidly as we could in the direction of monetizing the monetization of the debt, but recognized that we had a very difficult transition period. You do not spend 10 years in a pegged market and then come out of it the day after tomorrow without confronting some problems that require a different -- let me put it this way: You have to re-educate the entire business and banking community to what the ingredients and requirements of a free market were.

Q. Well, do you believe that your anti-inflationary policy requires such a completely negative and unhelpful attitude toward the financing of the obligations of the United States?

A. Well, I would not want to say that it is completely negative, our present policy. I think there is much to be desired in improving the government securities market, and we are working constantly in that direction. We have not always agreed on what the best way to do that is, but it seems to me that we can work out with the Treasury some way in which we can put them in a position where they won't be under the pressure that they have been in the last couple of years, and we intend to work with them in that direction without pegging the government securities market.

Q. I believe at about the last day that Secretary Burgess was at the stand, one of the last, that they increased the discount rate in the Federal Reserve Banks in Kansas City, Minneapolis, Chicago, and I believe Philadelphia.

A. That is right, sir.

Q. And I, I would not say I complained bitterly, but I did ask a question or two as to why they would increase the discount rates out in the great agricultural Midwest and I know there is some problem with credit.

Now, since that time I understand that several other banks have done the same, but I noticed here in last Friday's issue of The Wall Street Journal the heading says, "New York Federal Reserve Bank Again Declines to Hike the Discount Rate," and I could read some other section here but I am sure you are familiar with it. What interpretation can you place on that situation?

A. I think that there has obviously been some difference of estimate between the New York bank and some of the others as to the desirability or necessity of increasing the discount rate at the present time.

Now, on the economics of the situation, I do not think there is any disagreement between the New York bank and the Board or the other banks in the System. It may well be that before long the New York bank will raise its rate.

Now, we have the authority in the System, but we have not exercised it, to order banks. We have tried to make this operate as a System.

This is a technical problem, in my judgment, and it seems to me that the problem is that the banks that are closer to the loan demand than we are -- we follow it very closely, but after all, banks are the first line on the matter of loan demand, and they decided to go up in their prime rate to 4-1/2 percent.

Now, with a 4-1/2 prime rate and a discount rate of 3 percent -- and we have had a bill rate in excess of 3 percent for nearly nine months, it means that the policing of the discount window by the individual Reserve Bank has a good bit more strain with a 1-1/2 percent spread than it had with a quarter of one percent spread.

I believe you can police the window effectively, but our judgment in the Board and throughout a good portion of the System was that this was a technical situation; that we would have just as much difficulty explaining not going up in the rate as we would explaining going up in the rate; and that we recognized it as a technical operation and therefore improved the rate.

Now, if the demand for loans this fall does not materialize, then the banks were in error in raising their prime rate. If there should be a decline in loans of a substantial amount this fall, and business should taper off, we might want to consider reducing the discount rate.

I am not saying we are; I am just saying that is one of the problems we have to deal with consistently, and at all times, and I am delighted that the boards of these individual Reserve Banks give as much time and attention as they do to the problems, and we have never tried to insist that they do our bidding unless we should reach a point where we felt that national policy just required that a decision had to be made.

Q. Well, the Reserve Bank, a regular national Reserve Bank then has an economy in its own right, they determine their own operations and action without pressure, so to speak, from Washington?

A. We want them to, and I believe that is in the legislative record of the Federal Reserve Act: that the hazards of a managed currency are such that you should have, as far as you can, a decentralized central bank and not have just a little group of men in Washington to decide that, at the drop of a hat to do something, and move.

Q. Well, of course, we folks out in the Middle West will be very happy when we are able to reduce the discount rate out there and certain ly not have it go up any higher than it is.

A. Well, I would say the soundest and the surest way to get lower interest rates, to get a relaxation in the cost of money today, is to use this phrase that I am getting tired of saying, but it is to reduce spending and increase savings. I believe that will bring it about much faster than people realize; and I think the capacity to increase saving in this country is very, very strong. I think it does not take as long as some people think for savings to pile up. I think in the last year we have had over-spending and under-saving.

Q. Well, that is the question I was going to get into now, and I think maybe you have answered this. Have you caused interest rates to rise?

A. We have not -- the demand for credit, to use the phrase I am used to now, is, I think, tantamount to a California gold rush, it has been persistent, at times overwhelming. I put some figures on corporate and state and local securities into the record a few days ago. There never has been a time in the history of the country when there has been as many capital flotations as have been occurring or a time in my judgment when money in the overall sense has been as loose as it is.

We have a misnomer: tight money. The reason interest rates have been rising is because unless there were some governor in the credit mechanism, you would have just been creating money and pushing prices up, and there ought to be some incentive to save and some dis-incentive to spend. The only way we have is interest rates.

Q. I think you have made the record clear, at least for me, that we do have sufficient money in this country. There has been some criticism over the fact that we did not have sufficient quantity of actual money in this nation for the growth and expansion of our economy in peaceful employment.

As I understand, there is sufficient money, and the velocity of this money has been higher than it ever has been or for some years at least.

A. Higher than it ever has been at any time in my experience; and I think that we have an over-riding responsibility to see that the legitimate credit needs of the community are met. I do not think we ought to ever lose sight of that. We do not want to starve this stream, this money stream; but we ought to, after allowing for some additions to the money supply, we have got to recognize, I think, that all inflations are in large measure connected with the money supply, define them any way you want.

Q. These hearings, of course, have been built around and much of the testimony has been around, first, tight money, and, second, high interest rates, so that we are going to discuss interest rates now for just a little bit.

Thinking of interest rates now, do you consider your attitude has been passive, and that you merely have freed interest rates, with the result they have fluctuated with market influences?

A. I don't think, with varying degrees of emphasis, our attitude has been passive. We do have an influence on the money market. There would not be any reason for our existence if we did not, but we do not control the money market. And I am fond of saying that whenever we think we can control the market, the money market, whenever we think we can make the trend, I think we are attributing to ourselves more power than we have.

Now, I think that the influence that we have been exerting clearly in the last few years has been to not interfere with the forces of supply and demand in the money market, not to force interest rates up, because--I want to keep testifying to this because I happen to believe this--I think that for the growth of the country and the development of the country we ought to have as low interest rates as we possibly can have without producing these inflationary pressures, because I think that will make the major contribution to the formation of capital. But we can not just make interest rates low against the forces of supply and demand when we are not only not adding to capital formation, but we are adding to a spending stream, particularly in the form of debt that is just pushing prices up.

Q. You just stated that you did not think your attitude in regard to interest rates had been passive. Do you consider that you have affirmatively acted in such a way as to cause an upward movement in interest rates?

A. No, I do not think we have acted affirmatively to cause an upward movement in interest rates. I think we have permitted the forces of the market to operate; and insofar as we can influence them at particular times, we have not discouraged the movements that were in the economy.

Q. Has this upward movement been the incidental result of your action in limiting the availability of credit?

A. Yes.

Q. Have you intentionally caused interest rates to rise for the purpose of discouraging borrowing?

A. We have not been disappointed that interest rates have moved up to discourage borrowing, because it seems to me that is one of the policy objectives that we have hoped would come about, but we have tried to keep the money stream fluid and adequate. In fact, I am inclined to think, as I said in here the first day, that we have probably contributed a little bit more money to the stream in terms of availability, if we had been a little bit less free in supplying money to the stream we might not have had the inflation get ahead of us to the extent that it has. But still I would rather err on the side of seeing that there is no starvation in the money stream than be dogmatic or rigid in contracting the money supply.

Q. Well, is that not your hope, that as the interest rates have risen--and I think we are all agreed to that--that it will discourage some borrowing, at least temporarily?

A. That is correct.

Q. Do you consider higher interest rates are an effective deterrent to borrowing?

A. I think they work in that direction. I do think that if people are convinced that they can make money, interest rates are a small charge and they are not the compelling cost; and one of the things in inflation is that when people are convinced that inflation is taking place or they can make a speculative profit out of inflation, then interest gets smaller and smaller as a factor.

I remember being on the floor of the Stock Exchange just at the time of the collapse and interest rates had gone up and up, because in terms of stock prices, people thought they might make 5 points in the day, so they did not mind paying any interest rate. But that is a situation that comes at the end of a move, and it is not a controlling factor.

I think interest rates have much more effect than people recognize. They do not have it immediately, but I refuse to believe that they have no effect, as is prevalent in some quarters.

Q. Now, do interest rates at 4 per cent, 5 per cent, or even 6 per cent discourage industrial borrowing in a time of substantial profits and rapidly rising prices?

A. Well, they make the borrower, as they go up, stop, look and listen. I know you have corporation executives and others who say they do not pay any attention to it if the outlook is good. I do not believe that. I think that it is one of the factors that they consider, and I think that its consideration means that they have to make a business judgment that they would not make if they were not moving up in price.

Q. Now, under our present tax structure is it not true that an interest rate of 4 per cent today which the government is willing to pay those who buy its notes, does not really yield a corporation investor anything like that amount, actually, because of the 52 per cent corporation tax rate, the government takes back 2.8 per cent of it from the lender and the lender retains only 1.92 per cent of the so-called 4 per cent interest rate? Is that actually a practical statement?

A. That is correct.

Q. Does that not have some effect in the financing of some of these large expenditures for production?

A. It does.

Q. Is it not true that the individual never pays 5 per cent on mortgage money he borrows? For if he is in the initial income tax bracket, his interest rate automatically becomes 4 per cent?

A. That is right.

Q. Let us go back a few years when 6 per cent was the usual rate for mortgages. There was little income tax deduction for the borrower, while for the lender 6 per cent meant 6 per cent income and the government had no take. Therefore, is it not true that interest rates based on actual cost to the borrower were much higher at that time?

A. I think that is right.

Q. Let us take during the 1920's when corporate tax rates were around 11 per cent, so that there was no such deduction as there is today to benefit the borrower as a business expense. It seems to me that with the government taking 52 per cent of all income from corporations and businesses that we are virtually on a fifty-fifty partnership basis with the government on these loans.

Then would it not be true that the actual interest rate for corporations and businesses is about 50 per cent of the actual rate paid?

A. I think that is about right.

* * * * *

Q. * * * Do you consider that consumers will borrow less at the current rates as long as the repayment can be spread over long periods with no great increase in the amount of the monthly installment?

A. Well, I wish the consumer understood better what he was paying than he does. I am not against consumer installment credit, but we have gotten in the habit of quoting prices on things in terms of how much down per month instead of what the actual price and cost is.

We have had record levels of consumer installment credit and mortgage credit for a long time, and a great many people have not adequately figured what their cost is.

I am confident, however, that availability of money, as well as interest costs, the interest cost there does have some impact on consumer spending.

Q. Well, do you consider that home construction is reduced by reason of higher interest rates despite reduced down payments and extended terms?

A. Well, I think that higher interest rates on mortgages make it possible for money to be attracted to the mortgage field. They have a better chance of competing as a result of it, but I do not think that the cost of housing has gone up substantially, and I think that the volume of housing in relation to the cost, I think, is extremely high. I think the problem is to get housing on a cost basis that the consumers can pay, and after they have paid it, keep the house and not just have something that may be foreclosed the first time they have the slightest bit of adversity, because we are going to have some adversity sometime. We are not going to have perpetual prosperity.

Q. Do you consider that higher interest rates have a psychological deterrent?

A. I do.

Q. Really outside of proportion to the additional money costs?

A. That is very difficult. I think at different times they do. But I think it has a psychological effect.

Q. Well now, if you have considered higher interest rates a desirable deterrent to over-expansion in the past, do you consider that interest rates even higher than at present may be necessary in the immediate future?

A. I do not know, Senator. I hope that we are reaching a leveling out place. I do not want to forecast the economy at all, but there are certainly soft spots in the economy as well as strong spots in the economy at the present time, and I think that savings are increasing, and I am inclined to think that we may have a leveling out process here and we may find that interest rates will stabilize and may even decline. If that is a forecast, I do not want to make a forecast.

* * * * *

When Carlson concluded Chairman Byrd said, "As I understand your testimony, Mr. Martin, this morning, you think one of the chief factors in this present and new inflation is too much spending and too little savings?"

A. That is correct, sir.

Q. Now, the federal government owes, as you know, approximately $275 billion and it is spending from 98 to 99 per cent of its current income. Would you agree with me that perhaps the federal government is perhaps the chief offender in a program you suggested that has brought about inflation?

A. I do agree with that, sir.

Q. Would you agree to pay on the public debt would be one of the best things to do to avoid any further inflation?

A. I do indeed.

* * * * *

The hearing then recessed for luncheon and when it reconvened Senator Malone began his questioning which covers 306 pages of transcript.

His questions were much the same as those he asked Secretary Humphrey and Under Secretary Burgess. He is vehemently against foreign aid, against present gold and other policies, wants a return to full gold standard. Arthur Marget took on some of the technical questions on gold. The first 200 pages of transcript relate only to gold, and incidentally, silver policy. At one point after a series of long questions, Malone continued:

Q. I want you not to make a speech now, because I am going to stay here until you answer these questions.

A. I will stay here all night, Senator.

Q. I know you will. You do not have to affirm that.

* * * * *

At 6:30 Senator Bennett, presiding, suggested a recess, but Malone wanted to continue and Martin said he preferred to go on. Bennett left, and press, spectators and all others had long since departed, with the exception of committee staff and Federal Reserve Board staff. Malone assailed foreign lending and repeatedly returned to his theme that money can not be "honest" unless fully redeemable in gold. Malone said that out of two and three hundred thousand Government employees "there aren't ten per cent who could go out and make a living in business." He referred to them as "jokers." He took frequent shots at the tariff laws.

Malone went at length into how reserves are created, and what collateral the borrowing member banks can put up, and then into the authority for paying over to the Treasury excess earnings of the System. Then:

Q. * * * The cheapening of the inflation didn't start yesterday under you, and I might say I think you have done a good job. You are not responsible for it. You have done a good job, according to your lights and your interpretation of the Act. The bad inflation started when you left the gold standard. Do you agree with that?

A. I agree that inflation started then.

* * * * *

Q. * * * The people have known for a long time that something is wrong. They worship the President. They like to believe in the Congress. Their confidence is very hard to shake. But we have shaken it. And they are thinking and you are going to hear from them, and when you do, this Congress will change over night.

I believe--I actually believe this--that if the people of this nation could come to believe suddenly and know and believe what the Congress has done to them over twenty four years, they would move on Washington, they wouldn't wait for an election. That is what I believe about it. There will be a lot of you fellows who will be hard to find when they do it.

So its Congress' fault. It is not your fault that all these things make a pattern, and they do, Mr. Chairman. You are just one little tadpole in the puddle, but you have authority you should not have, just as the man in the White House who can write off taxes for one outfit and say somebody else should pay. Somebody has to pay. Just as the men in the White House and in Geneva can say that you break the zinc and lead miners, that you break the textile producers, that you break the machine tool producers, Mr. Chairman.

Why, nobody ought to have that authority, Mr. Chairman, but a principle laid down by the Congress of the United States that would operate with only the latitude of an official deciding what to do on a principle laid down, that is my opinion.

I am not going to ask you whether you agree with it or not. I think we have gone all over that. I appreciate your patience. I think we need to build this record. As long as I am acting Chairman, I am going to say that I will take the liberty of summation of what you have said today, just as I did with the Secretary of the Treasury, and I know you will not object to it.

A. Not a bit, Senator. I have enjoyed very much having this opportunity to get an inside into your thinking.

Q. I don't say that I have decided anything. I came here eleven years ago. I am going to try desperately, as I have in the foreign trade field, to understand the workings of this financial setup, so when we have to vote here, I will have made up my mind.

I hope I am guided enough in it that I won't make a mistake. I can't tell you I won't. I don't know. No man knows all these things. We only set them up in the last twenty-four years to give one man the authority to say, "You shall sink or swim in a certain industry. You shall have a certain per cent interest that will come about by the amount of money in circulation. You shall have one man who is a judge here whether the economic system needs more money or less."

Congress did that, you didn't do that. And in my opinion they made a terrible mistake. They have made terrible errors in the last twenty-four years, because they are afraid to vote their convictions. It is fear, and nothing else, and fear is going to put them back on the track, Mr. Chairman. We are adjourning the meeting right now at the call of the Chair.

And with that the hearing adjourned at 8:35 p.m.

* * * * *

Author(s): Porter, Sylvia

Article Title: “Your Money’s Worth: Investigative Farce Predicted.”

Journal Title: Evening Star

Date: Monday, June 11, 1957

Page Numbers: A23

Article Title: “Imperfect-- Yet Best."

Journal Title: The Journal of Commerce and Commercial

Date: June 13, 1957

June 28, 1957.

Dear Carl:

I enjoyed seeing the Herald Tribune's cartoon and appreciate your sending it to me.

With all good wishes,

Sincerely yours,

Wm. McC. Martin, Jr.

Mr. C. E. Allen,
President,
Federal Reserve Bank of Chicago,
Chicago 90,
Illinois.

FEDERAL RESERVE BANK OF CHICAGO

To:

Dear Bill:

Even the Chicago Tribune cartoonist is showing interest in monetary matters -

Carl

6/25/57

From C. E. ALLEN

Author(s): Holland, Ed

Article Title: “Why Don’t Those Brakes Hold Better?”

Journal Title: Chicago Tribune

Date: June 25, 1957

Article Title: "Inflation Scare."

Journal Title: Chicago Daily Tribune

Date: July 10, 1957

FEDERAL RESERVE BANK OF CHICAGO

To: Bill Martin –

Here is another cartoon from the Chicago Tribune –

Carl

7/18/57

From C. E. ALLEN

ackn by [illegible] 7/19

This cartoon is protected by copyright and has been removed.

Author(s): Orr, Carey

Article Title: “Mirror, Mirror, on the Wall--”

Journal Title: Chicago Tribune

Date: July 18, 1957

Article Title: "Review and Outlook: The Obstacle of Language."

Journal Title: Wall Street Journal

Date: August 12, 1957

Article Title: "Martin Testimony Slated Tomorrow on Money Policies--Discount Rate Under Fire."

Journal Title: The American Banker

Date: August 12, 1957

Article Title: "Martin Defends FRB Policies."

Journal Title: Dow Jones News Wire

Date: August 13, 1957

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Article Title: "Martin's Stand On New Interest Boosts Awaited."

Journal Title: The American Banker

Date: August 13, 1957

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Article Title: "Martin Hits Critics of Reserve Policy: Urges Cut in Spending."

Journal Title: New York World Telegram and Sun

Date: August 13,1957

Author(s): Shanahan, Eileen

Article Title: "Martin Asks Further Bars to Inflation."

Journal Title: The Journal of Commerce

Date: August 14,1957

Article Title: “"Spending Brake to Stem Inflation Urged by Martin: Tight Money Minor Factor."

Journal Title: The American Banker

Date: August 14, 1957

Author(s): Mooney, Richard E.

Article Title: "Martin Proposes Inflation Curbs: Federal Reserve Head Calls for Larger Budget Surplus, Continued Credit Control."

Journal Title: The New York Times

Date: August 14, 1957

Article Title: "Martin Says 'Rolling Readjustment' Is Needed to Avert Crash in Economy: FRB Chief Tells Senate Unit Deflationary Impact Should be Gradual and Spread Out."

Journal Title: The Wall Street Journal

Date: August 15, 1957

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Article Title: "Government Policy "Undermines" Business Boom, AFL-CIO Says: Executive Council Charges "High Interest Rates" Squeeze Business and Consumer Demand."

Journal Title: The Wall Street Journal

Date: August 15, 1957

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Author(s): Slevin, Joseph R.

Article Title: "Reserve Holds Off On Tighter Credit: 'Is Watching Situation,' Martin Says."

Journal Title: New York Herald Tribune

Date: August 15, 1957

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Author(s): Mooney, Richard E.

Article Title: "Adjust Economy, Martin Suggests: Federal Reserve Head See More Prosperity Ahead if 'We Don't Fritter it Away'."

Journal Title: New York Times

Date: August 15, 1957

Author(s): Mooney, Richard E.

Article Title: "Martin Proposes Inflation Curbs: Federal Reserve Head Calls for Larger Budget Surplus, Continued Credit Control."

Journal Title: New York Times

Date: August 14, 1957

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Author(s): McFarland, Kermit

Article Title: "Reserve Board Chief Vs. Inflation: He Doesn't Defend, He Explains."

Journal Title: Washington Daily News

Date: August 15, 1957

Article Title: "No Money Supply Drought, Martin Informs Probers."

Journal Title: **The American Banker**

Date: August 15, 1957

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Article Title: "Good News--and Bad"

Journal Title: The Washington Post

Date: August 15, 1957

Author(s): Shanahan, Eileen

Article Title: "Martin Urges Nation Make Adjustments: Holds US Must Force Corrections Gradually Lest Ills Accumulate"

Journal Title: Journal of Commerce

Date: August 15, 1957

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Author(s): Mooney, Richard E.

Article Title: "Changes Advised to Stop Inflation: Federal Reserve Head Says Imbalances in Economy Must Be Adjusted."

Journal Title: The New York Times

Date: August 15, 1957

Author(s):

Article Title: "Outlook is 'Good' Reserve Head Says."

Journal Title: The New York Times

Date: August 16, 1957

Author(s): Slevin, Joseph R.

Article Title: "U.S. Fiscal Probe Put Off Until Fall: Other Issues and Rush to Adjourn Cited."

Journal Title: New York Herald Tribune

Date: August 17, 1957

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Article Title: "Martin See Interest Rates Stabilizing."

Journal Title: Dow Jones News Wire

Date: August 19, 1957

Author(s):

Article Title: "Review and Outlook: Facing the Enemy"

Journal Title: Wall Street Journal

Date: August 19, 1957

Article Title: "Senators Differ on Possibility of Spurt to Inflation."

Journal Title: The Washington Evening Star

Date: August 19, 1957

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Author(s): Shanahan, Eileen

Article Title: "First Phase Closing: Money Probe Results Assayed"

Journal Title: Journal of Commerce

Date: August 19, 1957

Article Title: "Martin Tells Senates Interest Rates May Level Off Soon or Even Fall, Sees Savings Increasing Rapidly: Federal Reserve Chief Says Discount Rate in New York May Go Up Before Long"

Journal Title: Wall Street Journal

Date: August 20, 1957

Article Title: "Martin Vows Discount Rate Cut If Inflationary Pressure Eases: Senate Unit Reassured as Hearings Recess"

Journal Title: American Banker

Date: August 20, 1957

Author(s): Slevin, Joseph R.

Article Title: "Martin Expects Stabilized Rates: Senators Told Interest May Even Decline"

Journal Title: New York Herald Tribune

Date: August 20, 1957

Author(s): Kraus, Albert L

Article Title: "The Discount Rate: An Appraisal of Its Changing Role Since Reserve System's Founding"

Journal Title: New York Times

Date: August 21, 1957

Article Title: "Review and Outlook: The Chief Offender"

Journal Title: Wall Street Journal

Date: August 21, 1957

Article Title: "Union Economist Says Inflationary Pressures Haven't Halted in Steel: Brubaker Asserts That "Too-High" Steel Prices Can Undercut Tight Credit Policies"

Journal Title: Wall Street Journal

Date: August 22, 1957

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Article Title: "Inflation and Appeasement"

Journal Title: New York Times

Date: August 23, 1957

Author(s): Mooney, Richard E.

Article Title: "Prices in July Set Record; Food Highest Since 1952"

Journal Title: New York Times

Date: August 23, 1957

Author(s): Brophy, Charles

Article Title: "N. Y. Federal Boosts Discount Rate to 3 1/2%: Cleveland Acts; All 12 Now in Line"

Journal Title: New York Herald Tribune

Date: August 23, 1957

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Article Title: "A Stock Market Appraisal"

Journal Title: Wall Street Journal

Date: August 26, 1957

Article Title: "Appraisal of Current Trends in Business and Finance"

Journal Title: Wall Street Journal

Date: August 26, 1957

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Author: Slevin, Joseph R.

Article Title: "Money Markets In a Test Period: Experts Feel Turning Point Has Arrived"

Journal Title: New York Herald Tribune

Date: August 26, 1957

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Author: Dawson, Sam

Article Title: "First Talk of Deflation is Heard Across Nation"

Journal Title: Evening Star (Washington, D.C.)

Date: August 27, 1957

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Article Title: "Tight Money Exaggerated, Banks Say in ABA Survey: 53.6% Report No Policy Change, 45.5% More Choosey"

Journal Title: American Banker

Date: August 28, 1957

Article Title: "Banks are More Selective on Loans, Survey Finds"

Journal Title: Journal of Commerce

Date: August 28, 1957

Date: August 26, 1957

TO: Mr. Martin

FROM: W. RANDOLPH BURGESS

Room 3326 Ext. 2352

This document is protected by copyright and has been removed.

Article Title: "An "Easy" Explanation of "Tight" Money"

Journal Title: Kansas City Star

Date: August 5, 1957

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Article Title: "Martin Answers Byrd's "Tight Money" Criticism: Defends High Rates as Loan Rationing Tool"

Journal Title: American Banker

Date: September 3, 1957

1958

Article Title: "Martin Opposes Tax Cut at Present Time"

Journal Title: Dow Jones Newswire

Date: April 22, 1958

Article Title: "The Challenge to America"

Journal Title: New York Times

Date: April 21, 1958

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Article Title: "Job Drop Now Laid By Martin to 'E5-'56 '0ver-Employment'"

Journal Title: American Banker

Date: April 24, 1958

Article Title: "Martin, Cautious, Refuses to Predict When Upturn in Business Will Begin: Urges Measures to Meet Future Recessions"

Journal Title: American Banker

Date: April 23, 1958

September 12, 1957

Chairman Martin

From Mr. Riefler

As requested at the open market meeting on September 10, I have prepared the attached summary of my comments on the arguments presented ~~to~~ the hearings before the Senate Finance Committee by critics of the System's policies.

<u>INFLATION CAN BE STOPPED: Print More Money and Reduce Interest Rates</u>

The above caption may seem bizarre to specialists in the behaviour of money, but it epitomizes, not too unfairly, the case presented to the Senate Finance Committee by an important group of critics of the Federal Reserve System.

It is crucially important that all elements in the Federal Reserve System understand the reasoning by which these conclusions are reached. Essentially they rest on five assertions, only one of which (and not the crucial one) is easily demolished. The remaining four are highly plausible, so plausible that many people, unless they thought the problem through, might well find themselves assenting. The tactic used is to get assent to each one of the five assertions individually. Then, the seemingly inescapable conclusion is drawn, namely, that easy money, including more spending and less saving, is the only way to stop the rise in the cost of living.

The first, and most easily refuted proposition, is that since interest rates are costs, higher interest rates lead to higher costs. Therefore, higher interest rates account for an important part of the inflation of prices.

This proposition is still being asserted, but less confidently asserted than when the Hearings began. Statistics presented at the Hearings, showing that interest costs are in fact a very small proportion of total business expenses, have made this assertion a pretty farfetched one.

When it comes to the remaining four principal assertions, refutation is not so easy a matter. Hence, they are still being pressed by Federal Reserve critics with vigor and confidence. They run as follows:

Assertion I--The American economy today is not characterized by a shortage of manpower, since unemployment is one-third higher than in 1952 when prices were stable.

Assertion II--The American economy today is not confronted with a shortage of physical capacity to produce since new capacity has been and still is being greatly enlarged.

Assertion III--Consumer disposable income, in terms of real purchasing power, has not grown during the past year.

Assertion IV--It is generally recognized that more production is the best cure for inflation.

Given assent to these four assertions, the conclusion follows that measures to stimulate consumer spending, rather than saving, would so increase the output of goods and services, for which both manpower and capacity are available, as to cure inflation. This conclusion really asserts that the creation of more money, by increasing the demand for output, would curb inflation.

The logical validity of any conclusion can be tested by stating it in reverse. In this case, the reverse proposition would be that the sure way to cure a deflation would be to raise interest rates and force contraction of the money supply.

But such logical refutation of the main conclusion does not meet the need of refuting each of the assertions separately. This must also be done. Accordingly, the discussion below is devoted to their respective pitfalls.

I. What About Excess Manpower?

It is true that the percentage of unemployment today is higher than in 1951, '52 and '53, a period of price stability, but this does not mean that the current rate of employment is not pressing on our manpower resources. In his opening statement the Chairman of the Board stated, "Despite the existence in some lines of reduced employment and slack demand, many employers face 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. Before the Hearings adjourned, the Chairman placed in the record the appended technical appraisal of the unemployment figures cited in the Hearings. It throws considerable light on the statistical problem of measuring unemployment and should be studied carefully.

There is always a labor supply at a price outside the current labor force (housewives, students, retired workers, etc.). The facts are that the rate of unemployment in this inflationary period has been very low and at frictional levels; there has not been a margin of manpower available at current wages with which to raise total output above levels actually realized. When such a margin obtains, the curve of unemployment takes a definite U-shape, being quite high at the younger and older age groups as well as higher for all age groups. When the demand for manpower is active, unemployment stays relatively high at lower age levels, though lower than when demand is less active, but declines sharply to middle-aged groups, from which it tapers off without much rise in the oldest age group. This kind of pattern has obtained consistently since early 1955.

II. Elimination of Specific Shortages Does Not Necessarily Expand Overall Capacity.

The Chairman's 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 was seized on by critics as an affirmation that we are suffering from underutilization of resources. The problem, of course, is much more complicated. Employment figures show that consumer demand has shifted somewhat away from goods and toward services, private and government. Under such circumstances, particular segments of the economy can have unutilized plants without the economy overall being in a position to expand greatly its total output. So-called excess capacity, furthermore, does not mean that materially higher rates of utilization would not entail rising costs. It might or it might not. That would depend upon the technical efficiency of the reserve capacity as well as many other considerations.

III. <u>It Is Inflation Not Underemployment That Has Impinged on Real Earnings.</u>

The assertion that consumer disposable income has not increased during the past year disregards the inflation, which is our problem, by resort to statement in terms of ex-inflation dollars. Consumer personal income available for spending has <u>grown</u> 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.

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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 II 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 per cent 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 per cent. From mid-1950 to the sping 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 has frequently been pointed out, one man's expense in general is another man's income. Consequently, increases in production in themselves add to the stream of spending as well as to the stream of goods. Increased output is desirable to the full extent permitted by our capabilities, provided 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 an acute inflation crisis.

9/12/57
WWR

TECHNICAL APPRAISAL OF 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 seasonal 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 to the labor force, a much larger increase in the labor force than would have been expected on the basis of growth of the population of working age, reflecting the continuing strong demands for workers. This fact also indicates the frictional nature of current unemployment in that it has been necessary to go outside of the labor force to meet demands for additional employees.

Other indications of the current low level of unemployment are about two-thirds of the unemployed have been looking for work less than 6 weeks and that only 500,000, or less than 1 per cent of the labor force, were reported as having been unemployed for 15 weeks or more in July. Except for the very young age groups who are just starting their work careers or looking for summer work, unemployment rates among adult workers are very low. In each age group 25 years and over the unemployment rate was substantially below the average. For married males with wife present, the unemployment rate in July was only 2.3 per cent. While there are a number of areas which report substantial labor surpluses (unemployment rates of 6 per cent or more) they consist mainly of textile towns and mining areas, in which the age, sex, past work experience, and geographical location have in large part prevented the absorption of these persons into gainful employment in a period of expanding demands for workers. In contrast, there are still reported shortages for engineers, teachers, and other professionals along with some kinds of skilled workers.

Comparison of current unemployment with 1951 to mid-1953

1. In the first half of 1957 average unemployment was about 800,000 to 1 million more than in comparable months in 1952 and in 1953. (Old definition used in both instances for purposes of comparability.) Since 1952 some 6 million people have been added to the labor force. If the data is standardized to take account of increases in the labor force and differences in age and sex distribution in the two periods, unemployment would have increased by 200,000.

2. The major differences in unemployment in the two periods primarily result from the Korean hostilities. Between mid-1950 and the defense peak the armed forces increased by 2.3 million. This resulted in a sharp reduction in the number of unemployed males under 25 years of age. Since mid-1953, however, the armed forces have been reduced by 800,000 men, from 3.6 million to 2.8 million, and this to some extent accounts for a slightly higher unemployment rate among younger men in 1957 than in the earlier period.

3. During the period of the Korean conflict there was a well advertised manpower shortage. Public agencies and many employers conducted an active and extensive drive for workers. This apparently had a number of effects. It tended to reduce unemployment as well as the length of unemployment for those seeking work. On the other hand, it led to hoarding of workers and use of less efficient workers on the part of employers who feared that sufficient manpower might

not be available in the future. On the whole in this period it appears that there was a good deal of under utilization of manpower and there was very little growth in productivity. It was not until after cessation of hostilities that output per manhour started to rise again.

4. It seems likely, although it is difficult to prove, that during periods of hostilities (World War II and Korea) people interviewed in the Census household sample surveys may have been reluctant to admit to being unemployed -- on the assumption that unemployed persons were not contributing to the defense effort in view of stories of worker shortages delaying war efforts and other patriotic appeals. During World War II, reported unemployment fell to the very low figure of 500,000.

5. Since 1953 there has been a reduction in manpower requirements in the railroad, mining, and textile industries which has resulted in some increase in longtime unemployment and is reflected in somewhat higher rates of unemployment among older workers now than in the 1951-1953 period. As mentioned earlier in this memorandum, this has resulted in what might be called some chronic unemployment; but the number of such persons appears to be small.

6. In 1956 and 1957 there have been a number of mixed trends in the employment situation resulting in some layoffs. In 1956 the reduction of automobile production was definitely reflected in the unemployment totals but was offset by other gains. In 1957, while unemployment among automobile workers declined, reductions in residential construction,

lumber, electrical machinery and more recently aircraft employment have tended to keep the unemployment totals fairly constant, but probably slightly higher than if all activities were currently rising.

7. The unemployment series is based on a sample survey and has all the difficulties of such data including sampling error. A difficult factor to evaluate has been the improvement in unemployment data resulting from two changes in the Census sample since 1952-1953. In 1957, Census interviewed about 35,000 households in 330 areas each month. In 1952-1953 only 21,000 households were interviewed in 68 areas each month. Sampling error for unemployment in 1952 was calculated as 190,000. In 1957 the sampling error is 100,000 for unemployment.

The Census sample was increased from a 68-area sample to a 230-area sample in January 1954. The results of the new sample showed that for January 1954 unemployment exceeded the old sample figure by some 700,000, or 31 per cent, a considerably larger difference than could reasonably be attributed to sampling variability. An examination of the evidence by the Census Bureau's staff and a special technical committee led to the conclusion that the old sample figure was understated, partly because of inadequacies in interviewing during the period of transition to the new sample. On the basis of comparing the total unemployment statistics with the number of persons receiving unemployment compensation, it was concluded that the understatement started in September 1953. On this basis an adjustment was made by arbitrarily graduating downward the percentage difference between the old and new sample estimates of unemployment from January 1954 to September 1953 and no change was made for prior months. In April 1956 the sample was again expanded, this time to 330 areas but the unemployment figure was reported as approximately the same for both samples.

9/12/57
WWR

August 16, 1957

UNEMPLOYMENT AND LABOR FORCE
July of each year

	1950	1951	1952	1953	1957 (Old definition)	1957 (New definition)
Number unemployed (thousands)	3,213	1,856	1,942	1,548	2,686	3,007
Unemployment rate						
Total all ages	5.0	2.9	3.0	2.4	3.8	4.3
14 to 19 years	12.0	8.1	8.8	6.6	10.9	11.8
20 to 24 years	7.0	3.6	4.2	3.2	5.5	6.2
25 to 34 years	4.5	2.2	2.3	1.9	3.4	3.8
35 to 44 years	3.3	2.0	2.3	1.8	2.3	2.8
45 to 54 years	3.6	2.1	1.8	1.5	2.5	2.7
55 to 64 years	3.8	2.4	2.3	2.3	2.7	3.0
65 years and over	3.6	1.7	2.2	1.4	3.0	3.3
Total labor force (thousands)	65,742	67,477	67,642	28,804	73,056	73,051
Armed forces (thousands)	1,315	3,095	3,466	3,590	2,823	2,823
Civilian labor force (thousands)	64,427	64,382	64,176	65,214	70,233	70,228

8/16/57

~~Financial Investigation Material -- Senator Long:~~

COPY

The Federal Reserve Board attempted to explain the slowdown of production and the corresponding decline in per capita real consumption by saying that, if the figures were correct, they represented a decline in productivity. This is completely incorrect and confusing. Productivity is output per man-hour worked, and therefore productivity is a measure of efficiency or technology. If the slowdown in total output and the corresponding decline in per capita consumption were due to a cessation of growth in productivity, then we would not have the steep increase in unemployment, the virtual abandonment of overtime worked, and the greatly excess plant capacities in almost every major line.

All of these trends show that productivity is continuing to increase, but that total production is not increasing accordingly, with consequent unemployment of manpower and of plant, because consumer demand is not growing rapidly enough to make full utilization of the increasing productivity. It is just because productivity is increasing that we have the economic power to continue to raise the standard of living, and it is just because productivity is increasing that the only alternative to a corresponding expansion of production and consumption is rising unemployment, unused plants, and ultimate recession. I cannot understand the confusion on the part of the Federal Reserve Board as to the distinction between productivity and production.

FEDERAL RESERVE BANK OF CHICAGO

To: Dear Bill

Here is a copy of Senator Byrd's letter.

2/19/58 C.E.A.

From C. E. ALLEN

United States Senate

COMMITTEE ON FINANCE

February 17, 1958

Mr. Carl E. Allen
President, Federal Reserve Bank of Chicago
Chicago, Illinois

Dear Mr. Allen:

As you know the Senate Finance Committee has undertaken an inquiry entitled "Investigation of the Financial Condition of the United States." We have had testimony from three witnesses so far: former Secretary of the Treasury, George M. Humphrey; former Under-Secretary of the Treasury, W. Randolph Burgess; and Federal Reserve Board Chairman, William McChesney Martin, Jr. Under separate cover I am sending to you a copy of these hearings.

I am anxious that the Finance Committee have available for study and guidance your thoughts and opinions about vital matters affecting our economy. In preparing your reply it is suggested that you use the attached list of questions merely as a guide. Please feel free to answer part or all of the questions and make any further comments you deem desirable or appropriate.

For your information I am also addressing a similar letter to the individuals shown on the attached list. It is my present intention to recommend to the Finance Committee that the answers to this letter be compiled into a compendium for use by the members of Congress.

We must have a strong and sound economy to undergird our continued progress as a free nation. Your cooperation in answering these questions and adding your further comments will be a valuable contribution. I will appreciate your getting your answers and comments to me by April 1, 1958 if at all possible. In the event you will not be able to furnish your answers by that date, it would be most helpful if you would kindly indicate an approximate date when you could conveniently furnish your answers and comments.

Cordially,

Harry F. Byrd

Harry F. Byrd
Chairman

1. Give a definition in your own words of deflation and inflation.

2. Explain how you believe the economy of the United States can best avoid either inflation or deflation. If you think present laws should be changed or new laws are required, then make specific suggestions.

3. Comment generally on the monetary control policies of the Federal Reserve System as exercised within the following years: 1942 to 1957. (You may wish to divide the period into two parts, 1942-1950 prior to the accord, and 1951-1957.)

4. Beginning in August 1956 there was an increase in the Consumer Price Index each month through September 1957, thereby causing a decline in the value of the dollar. What factors contributed most to this decline in the value of the dollar.

5. What effect does the management of the current Public Debt have upon the national credit structure and the economy of the United States?

6. (a) Discuss in their relationship to one another and according to your judgment of their relative importance, the following three objectives of economic policy in the United States:

   1. Price Stability
   2. Stability of production, demand, and employment
   3. Economic growth in production, demand, and employment

   (b) With respect to these three objectives, discuss and appraise the significance of what you consider to be the most important trends since World War II--during the most recent two or three years--and especially during 1957.

7. Give your opinion of the effect on our economy of current Federal, State, and local Government spending.

8. Give your opinion of the effect on our economy of current Federal, State and local taxation.

9. Will you distinguish between fiscal policy (embracing expenditures, taxes and debt) and monetary and credit policy, and then relate them, one to the other. Please discuss these policies stating how they may be used to restrain inflationary trends and otherwise aid in preserving a stable economy.

10. (a) Comment generally on the adequacy or inadequacy of the United States Monetary System. (For the purpose of this question consider that the monetary system includes bank deposits and bank credits). Also please furnish your ideas for the correction of any inadequacies that you feel now exist in our monetary system.

(b) Comment briefly on the adequacy or inadequacy of the United States fiscal system.

11. (a) What is the explanation of the seeming paradox that at times inflation and unemployment exist side by side in our economy.

(b) Shall we accept, as some have suggested, a gradual inflationary trend as desirable (or necessary) to achieve and maintain full employment goals?

12. To what extent and in what way do you believe that the growth of private debt in recent years may have become a threat to the stability and vitality of the American economy.

13. Considering the financial condition of the United States, at what point, if any, in terms of unemployment, production, and consumer demand, should the Federal Government move in major ways, such as a tax cut and/or large increases in public works, to counteract a downturn in the economy.

14. 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?

15. Can full employment goals be attained while maintaining a dollar that has relative stable purchasing power?

16. Are escalator provisions in wage or other contracts compatible with achieving economic stability?

17. List and briefly discuss what you consider the causes of the present recession, and what should be done to terminate it.

LIST OF ADDRESSEES TO RECEIVE QUESTIONNAIRES

Presidents of the Twelve Federal Reserve Districts

J. A. Erickson, President
Federal Reserve Bank of Boston
Boston, Massachusetts

Alfred Hayes, President
Federal Reserve Bank of New York
New York, New York

Alfred H. Williams, President
Federal Reserve Bank of Philadelphia
Philadelphia, Pennsylvania

W. D. Fulton, President
Federal Reserve Bank of Cleveland
Cleveland, Ohio

Hugh Leach, President
Federal Reserve Bank of Richmond
Richmond, Virginia

Malcolm Bryan, President
Federal Reserve Bank of Atlanta
Atlanta, Georgia

Carl E. Allen, President
Federal Reserve Bank of Chicago
Chicago, Illinois

Delos C. Johns, President
Federal Reserve Bank of St. Louis
St. Louis, Missouri

Frederick L. Deming, President
Federal Reserve Bank of Minneapolis
Minneapolis, Minnesota

H. G. Leedy, President
Federal Reserve Bank of Kansas City
Kansas City, Missouri

Watrous H. Irons, President
Federal Reserve Bank of Dallas
Dallas, Texas

H. N. Mangels, President
Federal Reserve Bank of San Francisco
San Francisco, California

Corporations

K. S. Adams, Chairman
Phillips Petroleum Company
Bartlesville, Oklahoma

S. C. Beise, President
Bank of America National Trust and
Savings Association
300 Montgomery Street
San Francisco 20, California

Ralph W. Burger, President
The Great Atlantic and Pacific Tea Company
420 Lexington Avenue
New York 17, New York

L. L. Colbert, President
Chrysler Corporation
341 Massachusetts Avenue
Detroit 31, Michigan

Ralph J. Cordiner, President
General Electric Company
570 Lexington Avenue
New York 22, New York

Harlow Curtice, President
General Motors Corporation
General Motors Building
Detroit 2, Michigan

Richard C. Doane, President
International Paper Company
220 East 42nd Street
New York 17, New York

Frederick W. Ecker, President
Metropolitan Life Insurance Company
1 Madison Avenue
New York 10, New York

Corporations (continued)

Edmund Fitzgerald, President
Northwestern Mutual Life
Insurance Company
720 East Wisconsin Avenue
Milwaukee 2, Wisconsin

Frank M. Folsom, President
Radio Corporation of America
30 Rockefeller Plaza
New York 20, New York

Arthur S. Genet, President
Greyhound Corporation
Board of Trade Building
Chicago 4, Illinois

George Gund, President
Cleveland Trust Company
Euclid and East 9th Street
Cleveland 1, Ohio

Clifford F. Hood, President
United States Steel Corporation
71 Broadway
New York 6, New York

Porter M. Jarvis, President
Swift and Company
Union Stock Yards
Chicago 9, Illinois

D. B. Jenks, President
Chicago, Rock Island, and Pacific
Railroad
139 West Van Buren Street
Chicago 5, Illinois

F. E. Jerome, President
Seattle First National Bank
2nd Avenue between Columbus and
Cherry Streets
Seattle 24, Washington

Henry J. Kaiser, President
Kaiser Aluminum and Chemical Corporation
Kaiser Building
Oakland 12, California

Edmond H. Leavey, President
International Telephone and
Telegraph Company
67 Broad Street
New York 4, New York

J. T. Leftwich, President
F. W. Woolworth
Woolworth Building
New York 7, New York

H. J. Livingston, President
First National Bank of Chicago
38 South Dearborn Street
Chicago, Illinois

Robert T. Marsh, Jr., President
First and Merchants Bank
Richmond, Virginia

Fowler B. McConnell, President
Sears Roebuck and Company
925 South Homan Avenue
Chicago 7, Illinois

Peter V. Moulder, President
International Harvester Company
180 North Michigan Avenue
Chicago 1, Illinois

Frank Pace, Jr., President
General Dynamics Corporation
445 Park Avenue
New York 22, New York

M. J. Rathbone, President
Standard Oil Company of New Jersey
30 Rockefeller Plaza
New York 20, New York

William S. Richardson, President
B. F. Goodrich Company
500 South Main Street
Akron 18, Ohio

Corporations (continued)

R. G. Rincliffe, President
Philadelphia Electric Company
1000 Chestnut Street
Philadelphia 5, Pennsylvania

J. S. Rockefeller, President
First National City Bank of New York
55 Wall Street
New York 15, New York

George W. Romney, President
American Motors Corporation
14250 Plymouth Road
Detroit 32, Michigan

Herman D. Ruhm, Jr., President
Burlington Industries
301 North Eugene Street
Greensboro, North Carolina

C. R. Smith, President
American Airlines, Incorporated
100 Park Avenue
New York 17, New York

Dr. Theodore O. Yntema
Vice President
Ford Motor Company
Dearborn, Michigan

Philip Sporn, President
American Gas and Electric
Service Corporation
30 Church Street
New York 7, New York

James M. Symes, President
Pennsylvania Railroad
Suburban Station Building
Philadelphia 4, Pennsylvania

Gardiner Symonds, President
Tennessee Gas Transmission Company
Post Office Box 2511
Houston 1, Texas

Henry Tuttle, President
Michigan Consolidated Gas Company
415 Clifford Street
Detroit 26, Michigan

Clarence H. Wright, Chairman
Sunray Mid-Continent Oil Company
Post Office Box 2039
Tulsa 2, Oklahoma

Heads of Associations and Business Organizations

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Chairman Martin

MEMORANDUM OF EXPLANATION by Sen. Harry F. Byrd (D. Va.) Chairman of the Senate Finance Committee, IN RE COMMITTEE QUESTIONNAIRE INCIDENT TO THE INVESTIGATION OF THE FINANCIAL CONDITION OF THE UNITED STATES. March 1, 1958.

The Senate Finance Committee has mailed a letter containing a questionnaire relative to the Committee's investigation of the financial condition of the United States which was started last summer.

The letter has been sent to the 12 Federal Reserve Bank Presidents, a number of corporation officials, economists, professors, and the heads of some of the business and trade associations.

The questionnaire invites comment on various aspects of the economy of the United States. The questions are general in nature and deal with the country's monetary and credit systems, monetary and fiscal policy, inflation, deflation, the current recession, the national and private debt, the decline in the value of the dollar and federal and local taxation.

This investigation of the financial condition of the United States was undertaken by the Senate Finance Committee to study (1) the revenues, 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 their effect upon 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 may apply to public and private debt.

It is expected that the replies to the questionnaire will be of assistance to the Committee in its study.

A copy of the questionnaire is attached.

1. Give a definition in your own words of deflation and inflation.

2. Explain how you believe the economy of the United States can best avoid either inflation or deflation. If you think present laws should be changed or new laws are required, then make specific suggestions.

3. Comment generally on the monetary control policies of the Federal Reserve System as exercised within the following years: 1942 to 1957. (You may wish to divide the period into two parts, 1942 - 1950 prior to the accord, and 1951 - 1957.)

4. Beginning in August 1956 there was an increase in the Consumer Price Index each month through September 1957, thereby causing a decline in the value of the dollar. What factors contributed most to this decline in the value of the dollar.

5. What effect does the management of the current Public Debt have upon the national credit structure and the economy of the United States?

6. (a) Discuss in their relationship to one another and according to your judgment of their relative importance, the following three objectives of economic policy in the United States:

    1. Price Stability
    2. Stability of production, demand, and employment
    3. Economic growth in production, demand, and employment

   (b) With respect to these three objectives, discuss and appraise the significance of what you consider to be the most important trends since World War II--during the most recent two or three years--and especially during 1957.

7. Give your opinion of the effect on our economy of current Federal, State, and local Government spending.

8. Give your opinion of the effect on our economy of current Federal, State and local taxation.

9. Will you distinguish between fiscal policy (embracing expenditures, taxes and debt) and monetary and credit policy, and then relate them, one to the other. Please discuss these policies stating how they may be used to restrain inflationary trends and otherwise aid in preserving a stable economy.

10. (a) Comment generally on the adequacy or inadequacy of the United States Monetary System. (For the purpose of this question consider that the monetary system includes bank deposits and bank credits). Also please furnish your ideas for the correction of any inadequacies that you feel now exist in our monetary system.

(b) Comment briefly on the adequacy or inadequacy of the United States fiscal system.

11. (a) What is the explanation of the seeming paradox that at times inflation and unemployment exist side by side in our economy.

(b) Shall we accept, as some have suggested, a gradual inflationary trend as desirable (or necessary) to achieve and maintain full employment goals?

12. To what extent and in what way do you believe that the growth of private debt in recent years may have become a threat to the stability and vitality of the American economy.

13. Considering the financial condition of the United States, at what point, if any, in terms of unemployment, production, and consumer demand, should the Federal Government move in major ways, such as a tax cut and/or large increases in public works, to counteract a downturn in the economy.

14. 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?

15. Can full employment goals be attained while maintaining a dollar that has relative stable purchasing power?

16. Are escalator provisions in wage or other contracts compatible with achieving economic stability?

17. List and briefly discuss what you consider the causes of the present recession, and what should be done to terminate it.