NOMINATION OF LYLE E. GRAMLEY

HEATHNES

BEFORE THE

COMMITTEE ON BANKING, HOUSING, AND URBAN AFFAIRS UNITED STATES SENATE

NINETY-SIXTH CONGRESS

SECOND SESSION

ON

THE NOMINATION OF

LYLE E. GRAMLEY TO BE A MEMBER OF THE BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

APRIL 15 AND 16, 1980

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NOMINATION OF LYLE E. GRAMLEY

TUESDAY, APRIL 15, 1980

U.S. Senate, Committee on Banking, Housing, and Urban Affairs, Washington, D.C.

The committee met at 9:35 a.m., in room 5302, Dirksen Senate Office Building, Senator William Proxmire (chairman of the committee) presiding.

Present: Senators Proxmire, Morgan, Stewart, and Garn.

The CHAIRMAN. The committee will come to order.

Mr. Gramley, would you rise and raise your right hand? Do you swear the testimony you are about to give will be the truth, the whole truth, and nothing but the truth?

Mr. GRAMLEY. I do.

The CHAIRMAN. Thank you, sir. Be seated.

Mr. Gramley, do you have a statement you would like to make?

STATEMENT OF LYLE E. GRAMLEY

Mr. Gramley. I would like to make just a very few brief opening

remarks if I may, Senator Proxmire.

I have become aware that Senator Culver is opposing my nomination for this post and that his view is shared by the National Association of Home Builders. There's nothing personal in that opposition but Senator Culver has indicated that he believes this current vacancy on the board should be filled with a person with personal knowledge of the financial requirements of the small business and agricultural sectors of our economy, and the National Association of Home Builders would be interested in having somebody concerned and knowledgeable about the financial problems of the builders.

So I would like to say just a few words about what my back-

ground is in those areas.

First, my family has a background in the farming sector. My father was a farmer. He lost his farm in the collapse of farm prices after World War I and but for that fact I would have been born and raised on a farm. I have relatives who are actively farming in my native State of Illinois. My wife, whose native State is Iowa, also has relatives who are active farmers today. I worked on a farm both during my high school years and also afterward before I joined the Armed Forces in 1944. I can milk a cow, both with a machine and by hand. I have cared for, harnessed and driven teams of horses. I have shocked oats, thrashed oats, made hay. I think I know what the farming business is all about.

I have not worked for a small business nor have I been an enterpriser myself, but there were three occasions when I was a Federal Reserve staff member when surveys were done of the credit problems of small businesses—in 1955, 1957, and again in 1959. The 1959 survey is, I believe, the definitive, quantitative survey of credit sources of small businesses even to this day. It's very badly outdated, but to my knowledge, nothing better has ever been done and I was one of five staff members at the Federal Reserve who designed that survey.

I would also mention that the Federal Reserve staff did a major study during the early 1970's of housing finance and cyclical fluctu-

ations in housing. I directed that study.

But beyond that, Mr. Chairman, it seems to me that dealing effectively and intelligently with credit problems in these sectors and doing so within the context of an overall sound and sensible monetary policy requires more than just a personal familiarity with the credit problems and with the credit requirements of small businesses, farmers and builders. Credit problems in these sectors cannot be dealt with in isolation. They have to be treated in the context of the overall economy.

Doing so effectively, in my judgment, requires knowledge of the overall functioning of credit markets and how individual credit markets relate to one another. To develop an understanding of how monetary policy affects commercial banks, financial markets more generally, and ultimately real economic activity, seems to me essential, and that is the area in which I've worked the bulk of my

professional career.

That completes my opening comments.

The CHAIRMAN. Well, Mr. Gramley, you have precisely the kind of background that I have always called for in Governors of the Federal Reserve Board. You had a brilliant record in college at a very good college, Beloit College in Wisconsin.

Mr. GRAMLEY. It certainly is.

The CHAIRMAN. You have a Ph. D. from Indiana University. What was your field?

Mr. Gramley. My field was business cycles, investment opportu-

nities and business cycles, together with monetary economics.

The CHAIRMAN. You have a solid background in the Federal Reserve, the Federal Reserve Bank of Kansas City for 7 years as an economist. You also taught economics. You were a staff economist on the Board of the Federal Reserve Board. You have been a member of the Council of Economic Advisers. You're one of the top economists in the country, recognized as such by everybody. As I recall when you were appointed to the Council of Economic Advisers it was considered to be a very good appointment and I think it was and it was heavily supported.

Mr. Gramley. Thank you, Senator.

The CHAIRMAN. So often we have had people who have been appointed to the Federal Reserve Board and very good, able, and intelligent people but no background in economics, particularly in monetary economics, and I have felt it's far too complex and difficult an area to get on-the-job training. We have to have people who can move right in and do the job right away, and I'm sure you could.

Frankly, I am concerned about the point that Senator Culver raised. It's a good point. I think you're qualified. I think your responses this morning have been extremely relevant and reassuring. But what concerns me is that we are in a very, very serious situation for our home builders, one that I think has not really been appreciated by most people here in Washington, including some of the top economists. Those people are in a depression where some are failing, as you know. More will be failing. And I mean good, efficient firms where they're way over their head in the interest they have to pay on the inventory they can't sell, where they have laid off 90 percent of their employees and they're suffering very severely.

Somehow, it seems to me we have to find a way so that this credit restraint program, which I enthusiastically support and say we have to have, isn't so grossly unfair as it is to home builders and it's beginning to have the same serious effect on farmers.

As you know, farm income is expected to drop this year. Farmers are debtors. They have to borrow to put their crop in and to buy their equipment. These interest rates are very cruel and tough for them if they can get the money at all, and because the credit restraint policy is so uneven, I think we should be looking for ways in which we can exercise the overall restraint which I think is absolutely essential to find some way of alleviating the very unjust and unfair effect it has on farmers, home builders, and some other small businessmen particularly.

So I hope that as Governor of the Federal Reserve Board you would be very sensitive to that and helpful to us and your fellow Governors in seeking ways that we can ease that unfair pressure.

One other point is that it's not only unfair to them, but I think it's bad policy for the economy. In the home building operation efficient firms are being knocked out, firms that should be in it, and when we begin to recover from the situation you're not going to have their efficiency and their capability and their experience there to help the home building industry be as efficient as it should be.

Mr. Gramley. Mr. Chairman, I agree with those views entirely. I would like to say in this respect that I think one of the important purposes of the President's new anti-inflation initiatives announced on the 14th of March was to accomplish just that—to reduce the degree to which we are relying on high interest rates as a means of slowing the economy and checking inflation.

There are two respects in which the President's program does this. First, it puts in more fiscal restraint and thereby takes some of the heat off monetary policy. Second, in invoking the Credit Control Act of 1969 what I think we are going to accomplish is more restraint on the credit side by lenders saying no rather than by simply raising interest rates. I do think it's important that we bring interest rates down as soon as we can, but I don't think it would be right for the Federal Reserve to begin pushing interest rates down now in anticipation of a moderation of inflation. I think that would be most unproductive and it would lead to a revival of inflationary expectations and make the problems the builders are facing even worse.

The CHAIRMAN. I agree wholeheartedly with that and I think there's a strong sentiment in favor of that, certainly in the business community and perhaps in Congress, but I think we have to find ways of doing that but also providing some way in which these home builders who are so hard-pressed can do it.

Mr. Gramley. I agree with that, too. As you know, we in the administration are looking for what we can do and ways to do it that would help the builders. Although no final decision has been made, certainly we are looking very sympathetically at those prob-

lems.

The CHAIRMAN. Thank you. Senator Garn. Senator GARN. Thank you, Mr. Chairman.

One thing that concerns me in general, certainly not with Mr. Gramley particularly or any of the individuals I am going to mention, but as I have watched the last several Federal Reserve Board appointments, they all seem to come generally from the same geographical area of the country or at least from the Fed. Look at Chairman Volcker from the New York Fed; Mr. Schultze, the only exception, a Florida businessman; Governor Partee, an economist with the Federal Reserve Board; Nancy Teeters, Congressional Budget Office; Rice from the Washington, D.C. Bank; Governor Wallich, the professor formerly with the New York Fed; Governor Coldwell came from the Dallas Fed; and it disturbs me in general that we are picking people from within the Fed system's geographical area that tend to be getting away from the geographical requirement of not more than one from one Fed district by picking where they were born regardless of where they have lived or worked for a long number of years. I just make that as an editorial comment with no reflection on you whatsoever, Mr. Gramley, or any of the others; but it disturbs me that we seem to be picking from one area and I would have hoped that we would have stuck with the geographical requirements over the years because certainly the West, Midwest—anything but in the East Coast—that's about what has been picked and also from the Federal Reserve System itself.

I hope we are not getting an inbreeding there that is not good for

the long-term makeup of the Board.

Mr. Gramley, in 1976 the inflation was about 4.8 percent. Today it's over 18 percent. It's quadrupled. The primary responsibility of the Council of Economic Advisers is to advise the President how he should direct and guide the country in fiscal policy and with what has happened, you being a prominent member of the Council and have been for the last 3 years, why should we confirm you to this new post at the Fed when you have been part of a group that at least this Senator considers has performed so poorly the last 3 years?

Mr. Gramley. Well, as I look at what's happened to the rate of inflation since 1976, I think the administration has to take responsibility for at least a part of what has happened, but certainly a great part of the acceleration of inflation has occurred for reasons that have been beyond our control. The increase of energy prices

has been a very large contributor to inflation.

Senator GARN. It's my understanding that last year it was 2.2 percent of the 13.4.

Mr. GRAMLEY. Right.

Senator Garn. Housing was another 2 percent.

Mr. Gramley. If you were to parcel out the increase in inflation from the 5 percent figure in 1976 to the 13 percent figure in 1979, about 2½ percentage points of that would be the direct effects of rising energy prices of last year; about 2¾ percentage points would be a consequence of increased cost of home purchasing and finance. One or two percentage points would be the result of the awful productivity experience we have had for which I think neither the Carter administration as a whole nor the Council of Economic Advisers is responsible.

Another 1 to 2 percentage points would be a consequence of the fact that last year food prices rose by about 10 percent. They

actually declined somewhat in 1976.

So there is something left for which the administration's fiscal policy could be considered responsible. Had we followed a more conservative fiscal policy—and had we known productivity would decline, I think we would have done so—the inflation rate in 1979 might have been 12.3 instead of 13.3, but we would still be dealing with a very, very serious problem.

Senator Garn. Mr. Gramley, how can you separate out all those things—food prices and whatever, and not take some responsibility—not the administration along, but some of us are rather upset by this sudden born-again conservatism that occurred since January. What happened differently from January until March? I'm no economist, but as I look and as Chairman Proxmire and I have sat here together for years, we have been calling for balanced budgets for 5 years, reduced expenditures and fiscal responsibility on the part of this administration, this Congress. What happened suddenly from January to March that suddenly the Council of Economic Advisers, this administration and this Congress suddenly want to balance the budget?

Some of us think it should have been done a long time ago and the inflation rate would not be 13 and it wouldn't be 12. It would

be considerably lower.

Mr. Gramley. Well, Senator Garn, I do think that the opening months of this year brought surprises for us in the administration as well as for economic forecasters and businessmen around the country. We had been expecting since the middle of 1979 that the economy would slip into recession. It did not do so and indeed, even today, although signs of recession are multiplying, I'm not at all sure the economy is going into a recession. The economy was considerably stronger early this year than we anticipated.

As a consequence of that, and of the worsening of inflationary expectations that have been developing, the inflation rate acceler-

ated to the 18 to 20 percent annual rate range.

We felt we had to do something about this. We felt the situation was threatening to get out of hand. In retrospect, sure, we would have been better off to do it in January instead of waiting until March. Still, it's better to do it now than to continue to let the economy progress along as it had been with inflation worsening, with inflationary expectations getting worse, and risking a very severe economic collapse later on.

Senator Garn. I'm still puzzled. You said in retrospect. That's why I made the point that it's not hindsight at all. We have been calling for these kinds of actions for a long, long time—not in January, not last October—for a considerable amount of time. Arthur Burns last September—this is not hindsight—he said, balance the budget, implement a comprehensive plan to eliminate anticompetitive and over-costly regulations, maintain restrictive monetary policies, reduce business taxes to increase productivity performance.

There are a lot of people, not just politicians, not just Senators, but noted economists who were giving this kind of advice, not retrospectively, not in hindsight; and that's why I'm asking you

these questions.

Why were so many people ignored who were noted economists? In other words, it doesn't seem to me it had to be hindsight to see the condition of this economy. I think there have been some major failures in economic policy by this administration and certainly not the administration alone but by this Congress who suddenly have become born-again conservatives, primarily because of political pressure during an election year rather than looking at economic trends that have not just occurred since January of this year when

a budget was put together.

Mr. Gramley. Well, Senator, I do think that we have followed a fiscal policy which has reduced the deficit over time. In retrospect, we would have been wiser to follow a still more conservative fiscal policy, to balance the budget sooner. I have to say that I think some people were more correct than we were in assessing the dangers of the inflation that was developing in our economy. Our assessment was wrong in large part I think because we failed to appreciate the effects that inflationary expectations were having on spending decisions of consumers and businesses and we failed to appreciate how poor productivity was going to be, and as a consequence, how rapidly our economy would reach its potential output. In light of this, given what we know now, if we had the chance to do things differently, we would.

Senator Garn. Again, as I have said on this committee for 5 years, we have heard about declining productivity and how we needed to do something about it; but when you mention that the budget deficit has been reduced, why? Because of reduced expenditures, cutting the size of Federal Government and its involvement as a percentage of GNP and interference in the economy of this

country, or because of increased taxes?

Mr. Gramley. Well, we have in fact reduced the Federal expenditures share of GNP, although we have not achieved the target that we had hoped to, which is under 21 percent by fiscal 1981.

Senator GARN. I'm not aware—I've figured that next year receipts of the Government will be the highest level in history.

Mr. Gramley. For receipts, that's correct.

Senator GARN. Even in terms of wartime financing, World War II at 21 percent, the largest tax burden ever borne by the American people.

Mr. GRAMLEY. Right, but the share of expenditures in GNP did decline in the early years of the administration, not as fast as we

would have liked, but---

Senator GARN. But nevertheless, the major reason we have reduced the budget deficit somewhat and have hopes of balancing it is due to massive increases in revenues.

Mr. Gramley. There's no question but that the tax burden has

increased greatly.

Senator GARN. Because we're playing that game again this year. We're talking about \$15 billion worth of expenditure reductions roughly and we are talking about \$90 to \$100 billion of increased revenues, and yet the impression is attempted to be given that we are going to balance the budget because we are drastically cutting back the size of the Federal Government. We didn't spend \$100 billion in the country in 1 year, Mr. Gramley, for defense or for interest on the national debt or for everything we did until 1962, 7 more years before we spent the second \$100 billion, 2 or 3 years for the third; and when I came to the Senate the budget was only a little over \$300 billion and I have only been here 5 years and now we are having an increase of \$100 billion approximately in 1 year and then we're going to balance the budget. I don't think that kind of balancing the budget will have a significant impact on inflation at all—one or two-tenths or three-tenths of a percent—I think we're kidding people until we have some significant reductions in expenditures, until we have some significant tax cuts on the supply side to stimulate productivity; and that's why I'm disturbed.

I don't have much faith in the Council of Economic Advisers this one or previous ones—or the fiscal integrity of this Congress and the willingness to make the tough decisions that must be

made.

Let me go on. Do you favor the current Fed high interest rates? Mr. Gramley. I favor the policies that the Federal Reserve has been pursuing as a means of trying to get inflation down, but as I said in response to Senator Proxmire's comments, I think it's important that we see interest rates come down as soon as possible. I think the present level of interest rates is doing a great deal of damage to home builders, to farmers, to small businessmen and to others. So I am strongly supportive of the President's recommendations in mid-March to tighten up on fiscal policy to take some of the heat off monetary policy and to use the Credit Control Act of 1969 as a means of getting more restraint in the credit area by having lenders say no rather than simply raising interest rates.

Senator Garn. Well, I think until we come up with a much tighter fiscal policy—and we have relief in my entire career in the Senate primarily on monetary policy and the Fed to try and control inflation without the cooperation of the fiscal side, and the sad thing with me is we are not looking at just marginal operators who come in and out of the business; we are dealing in my state with some of the best businesses that have been around for a long, long time, been doing well, not marginal ones at all. Automobile dealers—I expect within 6 months possibly as many as 25 percent of the automobile dealers in my State will be out of business. They can't carry \$250,000 a year carrying costs and then they see Congress unwilling to take some of the tough decisions where people that are producing nothing in the society—the transfer payments, the entitlement programs that have grown out of all reason—but

we are going to solve the problem of inflation on the backs of the

productive members of our society.

Well, I'm sure my time is up. The lights are not running but I would hope, Mr. Gramley, on the Fed that you would work for a more balanced approach.

Mr. Gramley. I certainly would.

Senator GARN. To the problems of inflation and not election year cosmetic solutions of balancing the budget with \$15 billion reductions and \$100 billion of tax increased burden on the American people.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Morgan.

Senator Morgan. Mr. Gramley, I have just seen your nomination questionnaire and I haven't had time to examine it very carefully, but insofar as qualifications on paper, you appear to be imminently well qualified, especially if we use the same standards we have been using for previous board members and for economic advisers.

Now I would comment that I do agree with Senator Culver's letter—he's not here—that it's somewhat discouraging that I don't see anything on your résumé that indicates any experience at all with the business community as such, certainly with small business, farmers; nor do I see that anywhere on the Reserve Board.

Is that not necessary or would that not be helpful?

Mr. Gramley. Senator Morgan, I did make an opening statement.

Senator Morgan. I'm sorry I missed it.

Mr. Gramley. In that statement I pointed out that although I have never worked for a small business nor have I managed a small business, during my career in the Federal Reserve there have been three studies of small business financing problems, one of which I think is probably the most definitive, quantitative survey of credit sources to small businesses and credit problems of small businesses that exists today. It's outdated. It's old, but it's probably the most definitive study, and I was one of the five staff members that designed that survey.

I pointed out also that I think dealing with the credit problems of particular sectors, like builders or farmers or small businesses, requires not just personal knowledge of the credit problems in those areas but how those credit problems relate to the overall functioning of the economy and how monetary policy can effectively deal with them. Those are the areas in which I have worked the

bulk of my professional career.

Senator Morgan. Well, I can understand that, but it seems to me that somewhere, either on the board or the Council of Economic Advisers—and we went through this with the last nomination there ought to be somebody with some real experience. You know, we can sit up here and make studies and read studies, but it's not as meaningful as it is when you go back home and talk to the people and have the experience yourself.

For instance, I went back home during Easter weekend and I had trouble renting my farm. I never had trouble renting my farm before. I wasn't even concerned about it because there were always people lined up before that had their names posted at the county agriculture committee wanting to rent farms. I couldn't hardly rent them because nobody could get credit. When I did rent them, I rented them at considerably less than I rented them for last year.

It just seems somewhere we are lacking in experience.

Well, let me go to something else. I'm for a balanced budget. I have always been for a balanced budget because I come from a State where we are required by law and by the constitution to have a balanced budget. I want you to tell me something. During the last 2 years of the Ford administration we had the biggest deficit in the history of this Nation and yet we had an inflation rate of only 5 percent. So if only to balance the budget is going to bring—if that's all that's required to do something about inflation, tell me why we had the low inflation rate with the biggest deficit in the history of the Nation?

Mr. Gramley. Senator Morgan, I don't think there's any single solution like balancing the budget or slowing the growth of the money supply that's sufficient to end the kind of inflation we are dealing with in the United States, and I think if you look at the experience of other countries you find confirming evidence of that. The rate of inflation in West Germany obviously is much lower than it is in the United States and yet their government deficit as a proportion of their GNP is about the same as ours. The Japanese economy has a lower inflation rate than we have and their deficit

as a proportion of their GNP is three times ours.

Balancing the budget, moving toward fiscal restraint, is one part of a larger process that has to be engaged in if we are going to get control of inflation. We have got to do a lot of other things, too. We have got to solve our energy problem. We have got to increase our energy independence. We have got to take steps, as Senator Garn indicated, to improve productivity, and I believe we will.

Senator Morgan. I think we all realize that there are a number of factors, and that's an interesting point, but it's also true that while we had the biggest deficit in the history of the Nation, we

had some pretty high unemployment rates, didn't we?

Mr. Gramley. Indeed we did. The main reason for the deficit in that period was the fact that the economy was so very depressed. Unemployment went to a peak of 9 percent in the spring of 1975. Whenever you have an economic collapse, you're bound to have a drop in revenues and a very large increase in governmental expenditures for unemployment insurance and other things.

Senator STEWART. Would the Senator yield at that point?

Senator Morgan. I would rather finish. I haven't got much time. You know if our unemployment rate goes to 9 percent now, would you expect our inflation rate to come down substantially?

Mr. GRAMLEY. An increase in unemployment to that level will help a little bit, but I don't think big recessions are productive in dealing with the kind of inflation that we have now.

Senator Morgan. I don't think they are productive.

Mr. Gramley. Certainly, I would not want to see the economy go through a recession like that.

Senator Morgan. I know nobody wants to, but the point I want to make is we did have unemployment at 9 percent.

Let me ask you, in the first place, what do banks have to pay for money they get at the discount window?

Mr. Gramley. They are paying 13 percent.

Senator Morgan. And they are loaning it for 20 percent plus? Mr. Gramley. They are paying lots more for the bulk of the money they are raising in markets other than the discount window.

Senator Morgan. How much can they get at the discount?

Mr. Gramley. The discount window is not available to banks for large amounts of continuous borrowing. The Federal Reserve requires banks to utilize the discount window cautiously and carefully. Indeed, for larger banks, a surcharge has to be paid for continuous borrowing.

Senator MORGAN. How much surcharge? Mr. GRAMLEY. Three percentage points.

Senator Morgan. Now all this talk about high interest rates in all that I have heard and the last financial institutions deregulation act was to preempt all usury laws. Now I hear from the legislators back home who are not willing to face the music in their own legislature, they want us in Congress to preempt all usury laws. Have we come to the time when usury laws have no place in our society?

Mr. Gramley. Well, I think usury laws have always been problematic when interest rates fluctuate as widely as they have in the postwar period. It's very difficult to maintain lines of credit for borrowers, available credit for borrowers, when interest rates go well above usury ceilings. What happens is the credit markets dry up. I think that's a problem basically, however, that the states themselves should deal with.

Senator Morgan. It's problematical too if interest rates on all loans were 15 percent and then the banks would have to loan someone at 15 percent or else they wouldn't be loaning their money.

Mr. Gramley. They could easily buy Government securities.

Senator Morgan. Of course. That's where your balanced budget comes in. But if the Government itself didn't pay any more—it seems to me if we just throw all caution to the wind and everybody wants to remove all usury rates everywhere—they want us to do it here in Congress——

Mr. Gramley. As a general principle, I do not believe you can control interest rates any more effectively than you can control wages and prices with direct controls, even less so.

Senator Morgan. Would you advocate removing all usury laws? Mr. Gramley. No, I wouldn't. I think this is a step the States themselves have to take rather than to do it——

Senator Morgan. Mr. Volker and his crowd were over here urging us to preempt State usury laws. Do you feel we should preempt State usury laws?

Mr. Gramley. I think we have gone far enough in the recent

financial legislation.

Senator Morgan. We have pretty well exempted all of them. There are a few left. Would you like to see them exempt the others?

Mr. Gramley. I think we ought to stick where we are for now. Senator Morgan. You talk about West Germany and Japan's inflation rate. The price of oil has gone up about 115 percent or

more since January last year. How much has our inflation rate

gone up in the last year?

Mr. Gramley. Well, in 1979 we had an inflation rate of a little over 13 percent as opposed to a figure of 9 percent the prior year. In the first 2 months of this year our inflation rate has been 18 to 20 percent. The other countries besides the United States are experiencing the very same problem with rising prices.

Senator Morgan. Let's start with 1979 because we have them. In

1979 our interest rate went up how much over 1978?

Mr. Gramley. Our inflation rate?

Senator Morgan. Inflation.

Mr. Gramley. About 1 percentage point up.

Senator Morgan. Over 1978?

Mr. Gramley. In 1979, no. It was about 4 to 5 percent.

Senator Morgan. Over that same period of time, didn't the inflation rate in West Germany more than double?

Mr. Gramley. I don't have the figures in my head, Senator. Senator Morgan. Well, I would have asked you the same thing

about Japan. It did double.

Mr. Gramley. I doubt very seriously that the Consumer Price Index doubled in Japan. Wholesale prices have been more volatile and for a while in Japan the depreciation of the yen was leading to very rapid increases in the wholesale prices, and I wonder if that's not the statistic you're citing.

Senator Morgan. I think I'm citing the inflation rate. I'll have to

check it out.

Mr. Gramley. There are different measures, Senator, and you're undoubtedly correct for the measures that you're citing, but the Consumer Price Index for our country as well as others does deviate quite differently from the wholesale price indexes.

Senator Morgan. Mr. Chairman, are we going to hear from

Senator Culver?

The CHAIRMAN. Yes. He will be here tomorrow morning. He couldn't be here this morning.

Senator Morgan. Thank you.

The CHAIRMAN. Senator Stewart.

Senator STEWART. Mr. Chairman, are we going to vote in committee on this particular nomination?

The Chairman. Yes. We always do that if any member of the

committee asks.

Senator STEWART. I ask that we vote in the committee and I also ask that Senator Culver and perhaps others be given an opportunity to make statements before this committee.

The CHAIRMAN. He will be here tomorrow. He was scheduled to

be here today and couldn't come today.

Senator Stewart. There may be some others and I would ask that they be allowed to be given that opportunity and I ask that the committee be given proper time to discuss this nominee and I want to pick up on a number of things Senator Garn talked about.

Mr. Gramley, I mean no disrespect to you, but I am concerned, Mr. Chairman, about picking from the Fed or from within the Fed individuals to serve on the Federal Reserve Board, and I'd like us to have ample opportunity and I would hope to discuss this with

the chairman after this committee meeting because I am very much concerned about it.

Mr. Gramley, you have had an opportunity to appear before me both at the Small Business Committee and you and I have had the opportunity, along with other members of this committee, to discuss the problems that are now being experienced by the housing industry in this country.

What do you see as the possibilities for Federal Reserve activity in that area? Are you aware of the difficulties they are having now? Do you still feel the same way you felt when you appeared before Small Business that perhaps it's not as difficult a situation as the folks in the housing industry would have us believe?

Mr. Gramley. I think the situation is vastly different now than

it was last November, Senator Stewart.
Senator Stewart. What would you do about it if you were a

member of the Federal Reserve?

Mr. Gramley. I think the first and most important thing we can do is to get our inflation rate down and I think the track we're moving on now, by imposing more fiscal restraint, by using the Credit Control Act of 1969 to try to get some restraint in the expansion of credit through means other than just raising interest rates is the most effective long-run solution to the problem.

Senator Stewart. Well, they're using interest rates as a part of

Mr. Gramley. As a part of it, but not entirely.

Senator STEWART. Explain to me. My folks have difficulty in understanding the rest of the policy. They feel the impact of the interest rates and they have difficulty understanding the rest of it. The farmers Senator Morgan was talking about and the housing industry that Senator Morgan was talking about and I have talked about on different occasions-I'd just like to know what this administration plans to do and what you would do as a member of the Federal Reserve to help alleviate that situation. I know that the large size concerns have no difficulty in obtaining their money. Many, many times they have no difficulty in passing that cost on to other people. What in the world are you all going to do about the difficulties that are now taking place within those industries? What would you do about it?

Mr. Gramley. I think, Senator Stewart, that we have taken

effective action. We've gotten a start.

Senator Stewart. What is that? Tell me.

Mr. Gramley. We have put in fiscal restraint now which is going to slow the economy. It's going to help moderate inflationary pressures. It is taking some of the heat off monetary policy.

Senator Stewart. When did you all decide to do this credit allocation? After all the large size concerns borrowed all they

needed?

Mr. Gramley. The steps that we took were taken after we saw that the activities of the Federal Reserve—the switch in monetary policy that the Federal Reserve had engaged in in October 6—was no longer restraining credit to the desired degree in early 1980. During the final 3 months of last year the growth rate of business loans subsided substantially and it looked as though the October 6 program was sufficient toSenator STEWART. What happened to that growth rate in the

business loan sector from January through March?

Mr. Gramley. In January and February the growth rate in business loans accelerated to over a 20-percent annual rate and it was those developments that led the administration to the view that something was needed in the way of allocation by the Credit Control Act of 1969.

Senator Stewart. So now you're allocating credit and you're allocating credit in those small business areas of the farmers, the homebuilders, the retail merchants. Those are the people that the bankers are being encouraged to allocate credit between, to make the choices between, as a result of this credit policy.

Mr. Gramley. Bankers are being asked in the voluntary credit restraint program to restrict the growth of their loans to a range from 6 to 9 percent. That exempts small business, farmers, and

others who are heavily dependent on credit.

Senator STEWART. So if a fellow operates a bank in a small town in my State and he's got a farmer that's productive and he's got a retail merchant that's been there for 25 or 30 years and he's productive, he's asked by the Fed—they're not and you wouldn't if you were there—to allocate credit between those people, to make a decision as to whether or not one or the other of those continues in productive life.

Mr. Gramley. The banker is being asked to favor those borrowers, who are heavily dependent upon banks for credit and to restrict the growth of credit to other borrowers, particularly large—

Senator Stewart. Who are the other borrowers that little bank down there doesn't loan to? There's not many people other than

those that he would be extending credit to.

Mr. Gramley. There's no question, if you talk about very small banks, their nonconsumer loans are primarily to smaller businesses, homebuyers, and farmers. So they have a difficult time confining the growth of their total loans to 6 to 9 percent without in effect choking back loans to those borrowers too. That's something that I personally think should be looked at sympathetically.

Senator STEWART. How would you look at it sympathetically if

you were a member of the board?

Mr. Gramley. One way would be to adopt different standards for loan growth for larger banks than smaller banks in recognition of the fact that the customers they serve differ.

Senator Stewart. Do you think the Fed would be responsive to

that?

Mr. Gramley. I don't know. You'd have to talk to them. I'm expressing my own view on the situation.

Senator STEWART. You would make a difference in the amount or percentage of loan growth that was allowed for small banks?

Mr. Gramley. I would certainly want to consider that sympa-

thetically, yes.

Senator Stewart. What would you do about the outflow of money from those small rural areas into the large money centers that took place because of the lack of activity on the part of the Fed? What would you do about that? That occurred during the

same period of time the large size firms in this country were

borrowing tremendous amounts of money.

Mr. Gramley. I think the outflow of funds from the rural areas and the small towns of the country to the money market centers will depend primarily on what happens to interest rates. The Fed in its use of the authority granted under the Credit Control Act of 1969 did in fact take into account what was happening to attract funds to the money market centers by the money market mutual funds; and they put on a reserve requirement to reduce the amount of funds that were drawn into the money market centers and being lent to businesses and being drawn out of the smaller communities, and I think that's been helpful.

Senator STEWART. You're saying the flow of those funds from the small communities to the large size money centers was a result of

interest rates?

Mr. Gramley. High interest rates.

Senator STEWART. Who in the world exercised the use of interest rates in an attempt to control monetary policy if it wasn't the Fed?

Mr. Gramley. Well, I believe the way to look at this is that what the Fed did was to try to slow the growth of money and credit, and given the accelerated demand for credit growing out of an economy that was rising and an inflation rate that was getting vastly worse, interest rates simply had to go up.

Senator Stewart. What counsel have you offered to stimulate the housing industry that's in just a depressed state in my State? I don't know how it is countrywide, but it probably is the same. What counsel have you offered as a member of the President's

Council of Economic Advisers?

Mr. Gramley. Besides the general measures that I discussed earlier, Senator Stewart, of need——

Senator Stewart. I want to know what specifically you suggested.

Mr. Gramley. We have been looking at ways to try to assist the home builders, the housing industry. The administration has made no final decision yet, but among other things, we are looking at a modification of the 235 program, a program which involves deep subsidies. We are looking at lessening the depth of those subsidies and providing the assistance of that program more generally. There are potential problems with it, but we are looking at it sympathetically and we should know what the administration's decision—

Senator Stewart. How long are we going to wait? Until most of them go bankrupt or until 50 percent of them go bankrupt? How long are you going to wait?

Mr. Gramley. The decision should be made in a few days.

Senator STEWART. When Chairman Volcker appeared before this committee to explain the Fed's most recent credit tightening moves, he made a statement that the Fed, where appropriate and possible, would adjust the lending rate to small businesses and others. Do you agree with that statement of Fed policy?

Mr. Gramley. I do, and I think that's what has been done with the Credit Control Act of 1969 as it has been used by the Board. There's definitely an effort there to try to allocate the credit to

smaller firms, to farmers, to home builders.

Senator Stewart. If we look at the report—how often, Mr. Chairman, are we supposed to get reports from the Fed? Is the committee supposed to get some kind of general report as to what kind of

activity has taken place?

The Chairman. We get a regular report on monetary policy every 6 months, and the House gets a report every 6 months. We also have periodic oversight hearings on monetary policy when they seem appropriate. A special hearing was held, you will recall, on March 18 to consider the use of the Credit Control Act of 1969. Since the beginning of 1979 the Federal Reserve has testified over 15 times either on legislation or on oversight matters.

Senator Stewart. I would suggest we get something a little more often on how the credit control actions are being pursued by the Federal Reserve, Mr. Chairman, from the Fed in light of the diffi-

culties the people are having now.

The Chairman. Senator Sarbanes and I have written to Chairman Volcker to make it very clear that we expect the committee to be kept fully informed of development under the special voluntary credit program. Chairman Volcker has responded positively to our request, and I am sure that once the Federal Reserve has processed the April reports from the banks that we will get a complete report. We can discuss the need for additional hearings when we have an executive session of the committee on the nomination of Mr. Gramley.

Senator STEWART. That would be fine.

The CHAIRMAN. Which we will have probably on Friday.

Senator Stewart. That would be perfectly all right.

The CHAIRMAN. Any other questions?

Senator STEWART. Not right now, but I've got some more I'd like to ask him in writing and get some answers before our meeting tomorrow if I could.

The CHAIRMAN. All right. Fine. Senator Garn, do you have any

further questions?

Senator Garn. Mr. Chairman, I have maybe one or two more questions. I would like to ask that the nomination hearing record be included in this record from Mr. Gramley's nomination of January 26, 1977. There are some good questions there with responses from Mr. Gramley. I understand the only record we have is in our own hearing book and there are no copies of that testimony, so I would ask unanimous consent that it be included in the record. It is not long.

The CHAIRMAN. Without objection, so ordered.

[The earlier hearing record is reprinted as follows:]

NOMINATIONS OF WILLIAM D. NORDHAUS AND LYLE E. GRAMLEY

WEDNESDAY, JANUARY 26, 1977

U.S. SENATE. COMMITTEE ON BANKING, HOUSING AND URBAN AFFAIRS. Washington, D.C.

The committee met at 10:05 a.m. in room 5302 of the Dirksen Senate Office Building; Senator William Proxmire, chairman, presiding.

Present: Senators Proxmire, Sparkman, Stevenson, and Biden.

The Chairman. The committee will come to order. Gentlemen, will you rise and raise your right hand.

[Witnesses sworn.]
The CHAIRMAN. Some of the Senators may come. They have indicated they will come a little later, but we usually have a little tardiness on the committee.

We are glad to have you two gentlemen before us-you have most impressive backgrounds in economics, both in your academic training and in your writing, and work since then.

It is interesting that we have sort of a different standard now on

public officials.

I can remember when I was observing the Senate back in the 1940's. I used to hear people who were appointed to various positions and critics would always say they have never met a payroll.

As far as I can see, neither of you gentlemen have ever met a payroll, but most people appointed to office and elected to the Senate these days, for that matter, have never met a payroll either.

At the same time you have a very big economic responsibility, and neither you nor Mr. Schultze have been in positions in business or in

labor unions.

As I say, you have most distinguished backgrounds as economics instructors and as economics experts: Dr. Gramley, at the Federal Reserve Board, and Dr. Nordhaus, as a most distinguished professor; but there is that interesting lack of what some people used to call

practical experience.

I would like to ask each of you if you feel any kind of limitation or any way in which you would meet the criticism of some business people and perhaps some labor officials that the advice of those who come to a position where you will be giving important advice on the economy and have not had that kind of pragmatic experience which many business people feel qualifies them on the real practical economy we face?

Dr. Gramley, would you like to start off with that?

Dr. Gramley. Senator, in my own case, I would say my contacts with the business community during my period at the Federal Reserve have been rather extensive.

We have contacts throughout the network of Federal Reserve banks, with the directors of the Federal Reserve banks, and I feel

that we have kept close contact with business thinking.

I have not had direct contact with people in the labor field, but on the staff of the Federal Reserve Board, we have always had several people who are experts in the labor field, and I have leaned heavily on their advice. And I would intend to maintain my contacts with people in the labor field and people who know business thinking.

The CHAIRMAN. How about in the farm area?

Dr. Gramley. Again I am not an agricultural economist. I don't pretend to know much about the agricultural sector of our economy, and I would be leaning on the experts on the staff, just as I have leaned on the staff at the Federal Reserve Board.

The CHAIRMAN. Sometimes in the past we have had agricultural economists as members of the Council of Economic Advisers, and neither of you gentlemen have direct experience in the field of labor,

business or agriculture; is that correct?

Dr. Gramley, Correct. Dr. Nordhaus, Correct.

The CHAIRMAN. What would be your observation, Dr. Nordhaus?

Dr. Nordhaus. I think that is an important observation, and it is true the Council in the past has been made up of people with academic

training. I think that tradition is continuing.

On the other hand, although we are not engaged in meeting payrolls, we are engaged in studying behavior of the economy and also consulting very closely with those who either meet payrolls, or receive them on the labor side.

I think there is some difference, perhaps, between the responsibilities

of the Council and other departments.

The Council by statute is responsible for advising the President on

macroeconomic policies.

This is an area in which it is important to study the economy as a whole, as well as to understand the individual components. Unlike programs in the labor area, those of the Department of Labor or the Department of Commerce, where it is terribe, important to have close contact, perhaps even experience, with business.

I think on the macroeconomic side, it is also important to give close

attention to studying the tea leaves or whatever device is used.

The Chairman. You talk about the macro approach. I think that approach has been vital and necessary, but there has been a feeling on the part of many people that there ought to be more of an interest in the micro aspects of the economy, in particular industries and particular specific problems that develop and without an understanding of that kind of thing, without an appreciation of that sort of thing, the macro approach is likely to be pretty sterile and not very useful. How do you feel about that?

Dr. Nordhaus. Well, I think it is very important to keep both the macro- and the micropictures in mind. From year to year the situation

differs.

For example, in 1973, 1974 and 1975, it was obvious that the macropicture was largely colored by influences in the energy area.

In 1973, before the energy crisis, obviously, agriculture was really critical.

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If we had gone along without knowing those basic economic facts, macroeconomic policy would have been probably not too coherent.

It is important to keep both the aggregate picture in mind and also

the individual sectors.

The CHAIRMAN. Dr. Gramley, you have one very appealing and distinguishing element in your biography.

I notice you got your BA degree from Beloit College in Wisconsin. Dr. Gramley, Yes, indeed.

The CHAIRMAN. It is a fine college. You graduated in 1951, I notice. Dr. Gramley, your nomination to the Council differs from almost anyone I have seen, in that you seem to have been a Federal Reserve Board insider for most of your career. Not only that, but you say you intend to go back to the Fed; and not only that, you have been extremely close to Dr. Burns, and you were perhaps his principal staff

I think it is good to have coordination on monetary policy, and the

rest of our economic policy, it is very valuable and useful.

It may be helpful in securing a degree of coordination we have

lacked in the past.

At the same time, I am sure you can understand our concern, or at least my concern, with the possibility that Dr. Burns, who is an extraordinarily able and wise and effective economist, might be extending his counsel over the Council through you, particularly in light of the fact that you have been identified with him for so long, and you expect to go back to the Federal Reserve Board. You tell us that in your biography.

You say you intend to return to the Federal Reserve Board when

you are through.

What is your reaction to a feeling that under these circumstances, you may be too close to the Federal Reserve Board? Dr. Burns has indicated a philosophy and attitude which is quite different from that of the Carter administration. And perhaps it is the dominant feeling in Congress and the country that we need expansion of the economy, and Dr. Burns seems more cautious and more concerned with inflation and less with stimulus.

Can you assure us that your position will be one of vigorous independence, and that you will be free to criticize the Federal Reserve Board when they deserve criticism, as we should expect from a Member

of the Council of Economic Advisers?

Dr. Gramley. I would like to say a couple of things about that,

Senator.

First, if one reads the full statement of what I have indicated in the materials I have submitted to the committee, one gets a slightly different perspective on my intentions for the future.

I said I personally intend to return to the Federal Reserve Board upon my completion of Government service, but I also said that I have not received nor given any commitment in that regard.

And I have also said that I intend to serve the full term on the

Council.

If that term proves to be 4 years, at the time I would be thinking about returning to the Federal Reserve Board, the constituency of the Board is likely to be considerably different than what it is now, particularly in view of the rapid turnover of the Board members in recent years. Whether the Board wishes to have me back, I don't know.

All I am indicating is that the natural course of my career would lead me not to preclude the possibility of going back to the Federal Reserve Board, and I wanted to be candid about that in my statement to this committee.

The CHAIRMAN. I appreciate that candor.

You see, the problem is, the Federal Reserve Board may change

in makeup and I am sure it will.

You are right. There has been turnover, a great turnover. I think Dr. Burns is the only person who has been on the Board more than 2 years, more than 2½ years, and Dr. Burns' term expires within the next year or so, and he may or may not continue.

His term as Chairman expires, I should say.

Dr. Granley. Expires in 1978. But he could remain as a member until 1984.

The second thing I would want to say about this, Senator, is that while I have worked closely with Dr. Burns, and I have considered it a privilege to work with him, I do not consider my views to be identical with his.

I have an independent mind. The traditions of the Federal Reserve Board Staff have always been that the staff maintains its own views. It expresses its own views, openly, within the Board, and frankly.

I have found that on not infrequent occasions I have found myself disagreeing with the Chairman.

The CHAIRMAN. For example?
Dr. GRAMLEY. Well, I think if I were to cite specific things, they could be blown out of context, but let me give you one example.

You remember in the summer of 1975, when the recovery first got under way, there were a number of economists who looked at the target growth rates of the monetary aggregates, which had then been expressed by the Federal Reserve Board, and they said that the increases planned by the Federal Reserve Board would be inadequate to finance a good recovery.

There were some economists who thought the growth rate of M1 during the first year of recovery might have to be as high as 8 to 10

percent.

Generally speaking. I sympathized with that view, and so indicated. As it turns out, the Chairman, who disagreed with that view, was more right than I.

There was a very rapid increase in money turnover during the first

year of recovery—we saw an increase of 8 percent.

That was one occasion where I disagreed quite substantially with

him, and I so indicated to him.

The CHAIRMAN. How about the more distant and, therefore, I presume, kind of historical occasion, we can comment on it, perhaps how about the 1972 posture of the Board, when they vigorously stimulated the economy, increased M₁ by a substantial amount, although unemployment was relatively low and the economy was recovering, we were in an election year and many people argued that was one of the most serious mistakes the Fed ever made?

What position did you take at that point?

Dr. Gramley. I would say, Senator, first, I think we ought to look back and remember there were quite a few Members of Congress who thought at that time that the monetary policy pursued in 1972 was appropriate. Internally, I did express concern that growth rates of the monetary aggregates were too rapid at that point.

In retrospect, I think that view was right.

I would like to add one comment about that, Senator. There has been an allegation, frequently in the press, that a good part of the price inflation on 1973-74 was due to excessive by expansive monetary policy in 1972. I disagree with that view wholeheartedly. I think the inflation of 1973-74 was very heavily influenced by the sorts of special factors Mr. Nordhaus was mentioning.

The Chairman. That wasn't so much a political observation. There

were some people, perhaps including myself, that argued that this was a help to President Nixon when he was running for reelection in 1972. But the real criticism came from people who were monetary economists, Professor Friedman and Dr. Beryl Sprinkel, who were primarily outraged by what they thought was a monetary policy that was most inappropriate and highly inflationary.

It was the economists rather than politicians.

Dr. Gramley. I am not a monetarist. I think it's important to look at the monetary aggregates by way of evaluating the effects of monetary policy on the economy. But I think we have to look at other things, too.

The CHAIRMAN. I want to come back. I have a number of questions.

Senator Sparkman is here.

Senator Sparkman, Thank you, Mr. Chairman.

There is a great difference between the chairman and me. He is a trained economist and I am not in any sense of the word. All I can do is tell when the times are good and when they are bad. I am interested in many of the problems that affect our economy. But I gather from the exchange with the chairman, your position as to the Federal Reserve and as to Dr. Burns is that you are not beholden to Dr. Burns or anybody else on the Federal Reserve. You are a free agent on that, aren't you?

Dr. GRAMLEY. That's correct. I have not been beholden to the Chairman during my period of service there. I have worked for him, but I have maintained an independent judgment and I would intend

to do so in the future.

Senator Sparkman. That's what the Federal Reserve Board is . supposed to do, isn't it?

Dr. Gramley. Indeed it is.

Senator Sparkman. Tell me, I know that you wrote a book or at least a paper, I don't know which entitled "Ways to Moderate Fluctuations in Housing Construction." It's a staff study. You were the author of it?

Dr. Gramley. I directed the staff study. I did not author it.

Senator Sparkman. Well, did you find a way to do that?

Dr. Gramley. We had some ideas, but that's a very difficult problem, Senator Sparkman. We recommended a number of things. Some of our recommendations the Board accepted in broad outline and sent forward to the Congress as recommendations. I could go over briefly, if you like, what we had in mind.

Senator Sparkman. Well, just briefly, I don't care to go into it

in depth.

Dr. Granley. Let me mention four things we thought were important. One was to bring an end to inflation. I think the inflation of prices during the postwar period has been an important reason why the mortgage market has dried up from time to time and why we have had such severe declines in housing.

A second recommendation was that we needed to use fiscal policy more actively as a macropolicy instrument, as a means of restraining the economy when demand became excessive. In that respect, we thought some consideration should be given to countercyclical varia-

tions in incentives for business investment.

Based partly on the staff study, the Board's recommendation in this respect took the form of a variable investment tax credit. I have had some second thoughts about that, but I think it's worth further

thought.

We recommended also steps to try to control the variability of funds flowing to the thrift institutions. We thought it would be worthwhile for the thrift institutions to devote a small part of their total assets to loans like consumers' loans, which would increase the current income of the institutions.

We also suggested that very careful thought be given to variable

rate mortgages, with appropriate safeguards.

We also suggested lengthening of the liabilities of the institutions, something I think has been done in recent years, to try to get a better match between the maturities of their assets and their liabilities.

We suggested that over time we ought to work toward removal of regulatory ceilings on deposits, which at times have impeded the capacity of the institutions to bid for funds and keep their deposits.

Those are the basic recommendations that we made.

Senator Sparkman. Well, I remember, it may have been about that time, that Dr. Burns was most helpful to the housing programs generally. I don't remember what the details were, but I felt at the time that he really pulled us out of the doldrums and made it possible for us to have a good program.

It may have been that it had to do with FNMA and GNMA and the tandem. I think also about that time there was an arrangement made with reference to bonds that the Treasury could offer and a new fiscal policy from which housing could profit, but anyhow I did feel that the Federal Reserve Board did do a great job in the field of

housing at the time that it needed it badly. That's all.

The CHAIRMAN. Senator Biden.

Senator Biden. Thank you, Mr. Chairman.

I don't have any specific questions at this time other than to note that from the number of questions I am sure you have, the resumes of both the nominees are quite impressive and I think that the Chairman of the Council should have a good deal of leeway in determining with whom he would like to work. Unless there is any significant conflict or conflict at all and/or any significant departure from a philosophic point of view held by the Chairman of the Council, I would know of no reason why I should not support both these men.

One thing has been drawn to my attention. I understand you have already answered and I guess I should read it in the record rather

than taking the time, that was Mr. Gramley's response to your question about whether or not there is any conflict, potential conflict in his having been with the Fed and expressed as I understand it, from the statement, an intention that he would hope that he would end his career at the Fed.

Is that correct?

Dr. Gramley. Yes; what I did say, Senator Biden, was that I am speaking of a possibility, which may exist 4 years from now of my returning to the Federal Reserve Board. Whether such a possibility will materialize or not I don't know. Lots of things could happen between now and 4 years from now, but I wanted the committee to know that I would think of a normal course of progress for my career as going back to the Federal Reserve Board, or to a Federal Reserve Bank, perhaps, as a means of finishing my career.

It's a natural kind of thing because my work during the 20 years of my professional career has been in the area of nonfinancial economics

and monetary policy.

I have enjoyed public service very much and I would want to continue in that area. The Federal Reserve would be a natural place where I would seek employment.

Senator Biden. Hopefully, there will be no need for you to seek employment at the end of 4 years; perhaps it should be 8 years with

a little luck.

Your response to the Chairman's question in regard to whether or not-what your relationship with Dr. Burns was, whether or not that would be of any consequence in your performance of your re-

spective duties. Any comment on that?

Dr. Gramley. What I said was that I have worked very closely with the Chairman, I have very great respect for the Chairman, he is a very wise man, a man of great knowledge, a man of great experience, and I have considered it a privilege to work for him; but he has no respect for a staff member who won't stand up for his own judgments and who won't express them.

I have felt entirely free during my period as a staff member there

to tell the Chairman precisely what I think.

Senator BIDEN. You would have no inhibitions about telling your new boss-

Dr. Gramely. None at all.

Senator Biden. [continuing]. If you thought the Chairman of the Fed, Dr. Burns, was incorrect, you would strongly and vigorously

oppose Dr. Burns' position in your new capacity?
Dr. Gramley. Absolutely. I spoke with Mr. Schultze concerning my association with the Chairman and concerning my general intention at some point perhaps to return to the Federal Reserve Board, I think the last thing Mr. Schultze would want is Chairman Arthur Burns' representative on the Council. He does not consider it a problem and neither do I.

Senator BIDEN. Have you discussed with anyone at the Fed or Dr.

Burns in particular, any specific plans about returning?

Dr. GRAMLEY. I have not.

I have asked no commitment.

I have given none. Senator BIDEN. Fine. That satisfies it.

Thank you very much.

The CHAIRMAN. Senator Stevenson?

Senator Stevenson. I have no questions, Mr. Chairman.

The CHAIRMAN. I have questions, for you, Dr. Nordhaus, but first I want to follow up, because we have been talking with Dr. Gramley

on his background, his interests.

First, let me ask you, Dr. Gramley, how you feel as an expert on the Council of Economic Advisers on monetary policy, particularly in view of the fact that you will be able to act in a way that should coordinate our overall economic policy? We are all very aware of the independence of the Fed, independent of the executive branch. You will be in the executive branch. How do you view your role in that particular respect? What can you do to enable us to arrive at a more

effective monetary policy?

Dr. Gramley. I think I am bringing two things to the Council. One is a long experience in economic forecasting. That will be one of the roles that I will play on the Council. To assist in the development of national economic forecasts. The second thing I think I am going to bring to bear is a long history of assessing the impact of monetary policy on economic activity. I have done that at the Federal Reserve. I will continue to do that. My association with the Federal Reserve helps in that respect, not because of my association with Chairman Burns, but rather because I have watched monetary policy work. I have assessed the effects of monetary policy and I will continue to do so.

The Chairman. Well, you assess the effects of it. Will you be saying, in view of the fact the Fed is going to adopt a particular monetary policy, therefore we need more or less fiscal stimulus, or would you feel that in view of your expert knowledge of how the Fed works, you might have some influence on the Fed on what they might do, you might talk to Dr. Burns or other members of the Federal Re-

serve Board?

Dr. GRAMLEY. I would certainly be talking with members of the Board, but I think the conversations would probably be more between myself and Mr. Schultze and Mr. Schultze and the Board members. I wouldn't try to strongarm the people on the Federal Reserve. After all, that is an independent agency.

I think the independence of the Federal Reserve is something we

ought to preserve.

I think we will need to consult with them. I will be talking with Mr. Schultze about my views on what monetary policy ought to be and what my views are with respect to the adequacy of monetary policy, as it is being planned by the Federal Reserve and announced in terms of its longer range growth targets, to meet the objectives of the

administration and of the Congress.

The Chairman. You see what I am concerned about, and I think a lot of other people would be concerned about; we want to stimulate the economy right now, for instance, and maybe for the next several years, much more vigorously than Dr. Burns may want. He has indicated he would follow a more cautious monetary policy. He just told us he has reduced the goal for this year for the upper level of M₁, indicating he would expect the growth of the money supply to be less than he indicated before.

I take it your function would be to recommend to Mr. Schultze what we could do with the rest of our economic policy to adjust to the given fact of a fairly conservative and perhaps restraining monetary

Dr. GRAMLEY. Yes. That plus-

The CHAIRMAN. That seems to be a one-way street. In other words, the Fed decided what it wants to do and everybody has to adjust to

Dr. Gramley. I don't think that is the position the Federal Reserve has taken, as I understand it. The Chairman has said that the growth rates of the monetary aggregates will need to be reduced over the longer term, in order to have any reasonable hope to regain price

stability. That is a view with which I would associate myself.

Last year the growth of M₁, the narrowly defined money supply, was 5.4 percent. All of us know that kind of growth in M, can't continue indefinitely. If we want to get back to price stability it has tocome down. But the Federal Reserve target for the year ending the third quarter of 1977 is a range of 41/2 to 61/2 percent for the growth of M1. I view that as adequate. For the fourth quarter of 1975 to the fourth quarter of 1976 we had an increase of about 5% percent in M₁ and that produced a growth of 10 percent in the gross national

The CHAIRMAN. We had an unusual velocity. We often have that in the initial stages of recovery. You can't expect to continue it. If you have it, you will have to have a bigger increase in the money supply,

either that or-

Dr. Granley. It seems to me reasonable, for the next year to expect that an increase of 41/2 percent in velocity could be realized. There are innovations going on in the financial markets that I would expect to continue during 1977. They might add as much as 1 to 11/2 percentage points to the increase in velocity. We will be going into the third year of the recovery but we are doing so from conditions in financial markets that approximate those at the trough of a recession. Interest rates are now, in fact, lower than they were at the trough of the recession. We have an economy that is liquid.

The CHAIRMAN. That is right. That is the reason the Fed has been able to get away with this policy. That is what we are concerned

People don't care about really M1 or M2 or M6, for that matter; as long as the interest rates stay down, the Fed won't have a problem. When they begin to rise, that is when the test between the Fed and the Council, depending upon the viewpoint, I would expect that is when the real test would be, and that is when we will be concerned with how they will react.

Let me ask you this: Dr. Schultze said, the most distinguishing element of the new Council of Economic Advisers, when he takes over, will be their concern with international economic policy, and the blending of international with domestic policy, to be putting that together.

So that is the difference. That is the big difference. That is what he

stressed and emphasized.

I got the impression from him that one of the members of the Council would be an expert in international economic policy.

You gentlemen are both extremely well qualified. I am sure you will have no trouble getting confirmed. I don't envision any opposition at all.

But at the same time you do not seem, either one of you, to be particularly specialists in that area or with a background in that area.

In view of the stress that Dr. Schultze put on this what happened?

In view of the stress that Dr. Schultze put on this, what happened?

Where is the expert on international economic policy?

Dr. Schultze is a distinguished economist, but that isn't his forte. I don't think it is Mr. Nordhaus' forte; he is distinguished in many other areas. If it is though, he can inform us. How are we going to get this input on international economic policy that will be sufficiently impressive and expert that you will be able to have a new kind of policy blend we haven't had before?

Dr. Gramley. I believe Professor Nordhaus is the proper person to

answer.

Dr. Nordhaus. I think there are really two separate aspects which should be separated. I think, on the one hand, the monetary and financial side, my presumption is that Dr. Gramley with his long experience will have some say in that, and I know he has considerable

expertise in that area.

Then, if we look at what might be called the real side of the international scene, which involves coordination, synchronization, international macroeconomic outlooks and some of the other issues such as energy, trade, and so on, the presumption at this stage is that I will be the person primarily responsible for that. I am not really sure how you want to discuss it, Senator.

I think there are two things, One is, although my primary focus has been on domestic, in some of my micro-analytic work. I have spent considerable amount of time studying particular problems such as the international energy market and a certain amount of time worrying about international commodity agreements as well as the international aggregate macro situation which almost everybody worries about. If you would like to go into any particular details——

The Chairman. I know you are an expert in the energy area. You have written very eloquent, persuasive articles in the energy area. Of course, that has international implications. But the great area of monetary, international monetary policy, is that one that you have

been concerned about---

Dr. Gramley, No. I have not, My work has been principally in the domestic field.

The CHAIRMAN. There we have the problem.

Dr. Gramley. I think we all will be learning, expanding our horizons

a little bit.

The CHAIRMAN. Let me ask you. Dr. Gramley, about housing. I am concerned about that. This committee has responsibility for housing. The former chairman of this committee. Senator Sparkman, was, I thought, very generous with the Fed in his remarks on their assistance in housing.

I wouldn't be quite as favorable on their effect on housing in the past. As you know, housing is the No. 1 victim of every credit crunch. In 1966, it just went through the floor. The rest of the economy wasn't affected too much. A little bit perhaps by the increase in the interest rate, resulting from the slowdown in credit, but housing just

went into a nosedive. That has happened again and again, because interest rates are such a vital determining element in the purchase of housing.

What do you see as the basic solution to this kind of thing?

As I say, there is not the same pressure now, because although interest rates for housing are high, they have been stable for some time. Around 9 percent.

If we have another crunch and mortgage interest rates go up to 10, 11, or 12 percent, we are going to have a very, very rough con-

frontation. What do you see as the solution to this problem?

Dr. Gramley. There is no easy solution to that problem, Senator. One of the things we found in the Federal Reserve staff study of fluctuations in housing was that variations of this kind are not confined to our country. Practically every country suffers from them. It is, in part, a function of the nature of houses themselves, as durable assets, postponable purchases, so that the operations, not only of the financial markets, but also the real markets, tend to work in such a way that housing is crowded out during a period of excess aggregate demand.

The Chairman. In almost every wher country they place a priority on housing and find ways to assist housing to a greater extent than

we are successful in doing.

Dr. Gramley. We have tried also, but we haven't been entirely successful. I think we have done a good bit in the way of Federal housing assistance. I think the best way to avoid the roller coaster movement in housing in the future is to run stabilization policies in

ways that avoid periods of excess aggregate demand.

The Chairman. Here we have the President 2 weeks ago announcing an economic package, a stimulus to the economy. No mention of housing. I am convinced this is the most effective, the least inflationary, with the least possible effect on the deficit that he could have announced. This morning we are told again, there is an additional stimulus. The economic package has been increased because the winter was so cold. Again nothing at all on housing, no housing element at all. No mention of it. No apparent realization of what a useful and constructive way this would be to stimulate the economy.

With the private sector taking over most of the work, with very little inflationary effect, there is a need for housing. Last year was the worst housing situation we had in 40 years. Why is this? How would you gentlemen be able to help get the kind of economic input that we obviously are lacking somewhere, in using housing as a way of re-

storing employment and economic activity?

Dr. Gramley. Senator, I would say to you, there is much to be done in the housing field. I sympathize with that view; but I think to ask now that the housing industry be pumped up as a means of pumping up the rest of the economy is likely to put us right back on that roller coaster again.

The Chairman. Well, housing takes it on the chin when you have a credit crunch. Then when you have a situation that calls out for housing to be used as a stimulus, they say we shouldn't use it for a

stimulus. The time never comes, it seems.

We have set a goal in this committee in 1968, signed into law by the President of the United States, 2.6 million housing starts a year. We have never achieved that. 1975 we had 1 million. This year, this past

year, 1976, maybe 1.6, 1.5. This year, 1977, the expectation would be

1.5, 1.6. A million short.

Every housing start is two man-years of work, a million more starts means 2 million jobs. We are not asking to blow up housing out of proportion to where it ought to be; we are just saying: Go back to the goals. When HUD made a study they didn't agree with many of our proposals. They indicated the goals ought to be around 2.3 million. But on any basis, we are far short of the kind of housing we ought to have.

Even if you forget about economic stimulus, we ought to increase the number of housing starts. And you tell me that this isn't something

that should be in a package?

Dr. Gramler. What I said was, I don't think we ought to try to continue to use the housing industry as the balance wheel for the rest of the economy. I think that is the way you get on the roller coaster. That is the way it is going to be perpetuated. I think if we are going to promote a program for better housing, more housing, we have to do so in a very careful way. We ought not to look upon housing as the way to stimulate an economy at a time when the housing industry right now is moving up and the prospects for housing look to be quite

The CHAIRMAN. Dr. Gramley, the prospects for housing, as I say, the estimates are 1.5 million for next year. In the last 2 or 3 months, the reason we got the increase was why? The increase was entirely in expensive houses; average cost of house, \$50,000. Virtually no houses in the Government-assisted area. Very few; less than 100,000. There is a great disproportion, a great need for houses for people of modest

income.

Dr. GRAMLEY. I agree fully.

The Chairman. Why couldn't we have a program that would

achieve that and move ahead with it?

Dr. Gramley. I think that program has to be worked out carefully. The CHAIRMAN. I agree. The President indicates he wants a \$31 billion package over 2 years. If it doesn't include housing, we will come along with that in this committee. I am sure Mrs. Harris will probably make recommendations. And the President has called for a \$31 billion stimulus; any more is likely to be inflationary. Some of the people in business and some of the economists are saying that now. Why shouldn't housing be incorporated with the stimulus package?

Dr. Gramley. I wasn't privy to the planning for what was done in terms of the fiscal stimulus package, but I think the objective of that package was to insure that we get an adequate real economic growth rate in 1977, that we do it by means which are reasonably sure of success, and in ways that are not going to generate the sorts of problems

we had in housing before.

Senator Stevenson. I was interested in Mr. Nordhaus' comments about macroeconomics in reference to energy a moment ago. The feeling has been that it neglected many structural defects in the national and international economy, to even begin to quantify the consequences of, for example, energy prices for both inflation and GNP. I have a general proposition to put to both of you: Is it enough to rely on macroeconomic efforts to, for example, stimulate the demands for substantial rebates? What will happen? Are they not likely to end up in

increased spending, or to shore up oil and steel prices? In other words,

inflationary consequences.

Again, to cite another example, in light of what Senator Proxmire was saying a moment ago about housing, if I am not mistaken, experts attribute about 2½ times as much to GNP now as housing; and that raises large questions in my mind about an unselective approach toward stimulation of demand. What is in this package for experts? How do we begin or continue, if we should, to finance the oil-induced payments deficits which are reaching pretty serious proportions in most of the oil-consuming countries? Could you address yourselves generally to such structural problems and the response to them and the adequacy for conventional approaches to the recession and inflation, paired with the need for macroeconomic income policies, for example?

Dr. Nordhaus. Senator, there are a number of questions you asked. Let me start with one of the last ones. I think the stimulation package which has been proposed is largely designed to raise the level of aggregate activity, with particular attention to the jobs question. That is, of course, why the jobs and public services employment part

is so substantial.

Another point is the timing, where we are trying to find particular components which can be put into effect and have their effect very

quickly, that is in the current fiscal year.

As far as some of the individual items, I do not think there is anything in the package primarily designed to promote exports. I think that is really something that has been deferred at the present stage, will be handled by Vice President Mondale's trip, and also will be discussed extensively within the administration over the next few months and discussed in the International Summit.

I presume the main way we are going to export that growth, which is the goal of the next few years, is to have general synchronized expansion of those countries around the world, or the OECD, especially the United States, Japan, and West Germany. That is on the international front. As far as international macro situations are concerned, I think really we are looking downstream a little bit to more coordinated policies, although we haven't really put that together yet.

There were some other questions. I am not sure which you wished

to focus on

Senator Stevenson. I raised a number of subjects illustratively. The basic proposition is, can you rely on traditional aggregate demand policies to stimulate the economy without inflation, or must we face up to some structural problems such as are reflected by increasing demand, increasing prices, rising unemployment and wage inflation at the same time? One of the more specific examples was income policy, the incomes policy which was mentioned.

Could you both respond to that?

Dr. Nordhaus. Maybe I will say one word on the first question. Then Dr. Gramley will, I am sure, have his own view. Here I am really speaking more in my views as an economist rather than the administration.

The economic package at the current state of the economy will have very little impact on inflation one way or the other. I think it is

possible that, without worrying about the composition, over the next 2 years the inflation rate might be, 0.1, 0.2, and 0.3 percent higher because of a higher level of activity. This is a result of real growth rates that raise the real level of economic activity by 2 or 3 percent after an extended period.

On the other hand, I think there are parts of the package that will offset that. In particular, my understanding is that the social security tax credit, which is part of the package, will have a downward effect

and may completely offset the upward effect.

On the incomes policy question, we have not really even studied this yet. I think this is going to be one of the most important policy issues for the Congress and the administration, but I think there will be some discussions forthcoming over the coming months.

Dr. Gramley. I do think there are a number of things that need to

be done.

I would classify them generally as structural policies, policies that are designed to make our labor and product markets work more competitively than they have in the past, so we can break the cycle of continued inflation in the midst of high unemployment.

I think we will need also to increase the rate of business investment. One of the problems of the recent past was that when we got up to fairly full levels of resource use in the labor market, we found our

capacity was strained-we ran into shortages.

I think the rate of business investment will need to be increased over the longer term. That will require, over the longer term, making sure the Federal deficit moves down as the economy moves to higher levels of resource utilization.

It will include also, I believe, some careful consideration of incen-

tives to business investment.

Those are tasks for the future. They have to be thought out very

carefully.

The CHAIRMAN. Dr. Nordhaus, I am intrigued by your proposal to use the corporate tax systems to enforce a set of national guidelines on wage and price behavior. As you suggest, this could be done by imposing a sliding scale of tax penalties on items whose prices or wage increases exceed the standard.

Do you think such a system could be implemented and practiced? Would you favor going ahead with it? I know you have written about

it?

Dr. Nordhaus. I am surprised, Senator. I don't ever remember writing a word on that. I remember a story that was fabricated by a journalist——

The CHAIRMAN. Attacking you for doing this even though you

didn't do it?

Dr. Nordhaus. I have never published a single word on it. I will be happy to speak later on it. If you were reading Business Week

perhaps, that is a fabrication.

The Chairman. It's the last page of an article I have, under your byline. It reminded me sometimes we get a terribly intemperate letter from a constituent and we write back, we say, Mr. Smith, did you know some degenerate is writing letters under your name?

I'm sure if you say you didn't write it, you didn't write it.

Dr. Nordhaus. There was something in the press, but in an article

I wrote as I recall published in May of 1976—
The CHAIRMAN. This was an article entitled "Inflation Theory and Policy." in the American Economic Review, May 1976, pages 59 to 64. Sets forth a framework and explains inflation and so forth. William D. Nordhaus.

Dr. Nordhaus. I did in that article point a finger at the economics profession for not being terribly innovative in their thoughts about anti-inflation policy.

I mentioned proposals that had been put forth by Governor Wallich

and Dr. Weintraub.

The CHAIRMAN. I am glad you make that clear. Perhaps you suggested in the course of the article, this is something that might be thought about. You didn't propose it as a solution.

Dr. Nordhaus. That's correct.

The CHAIRMAN. How do you feel about that kind of approach? Do you think it has any practical possibilities or do you think it's

unlikely to be something we could do in the next few years?

Dr. Nordhaus. Well, I will speak only as a private citizen on this because I have not really had a chance to discuss it. But I do feel that the economics profession has not been imaginative in helping people devise schemes which would improve performance on the macroeconomic level and inflation and incomes policy in general.

There have been a number of attempts, I'm sure you know of in particular, on the Continent, in Europe, and in Great Britain, to implement incomes policy. I think with the exception of the social contract in Britain over the last 2 years, these are regarded as being either failures or inconclusive. Thus we should study the matter, but we should not simply go back to things that we tried over the last 10 to 15 years as the only answer to solving our inflationary problems.

The CHAIRMAN. Dr. Gramley told us about his feelings, that we should take action to encourage a greater investment in the capital sector. You published a paper recently, Dr. Nordhaus, showing a long-term decline in the share of GNP going to capital. Do you recomment tax goal changes now to help investor recoup their share or will the market yield whatever incentives are necessary to investors and savers under the existing situation?

Dr. Nordhaus. Again, speaking as a private citizen, I am slightly

skeptical about this approach for two reasons.

One is that I view the long-term decline in the rate of profit in the American industry as a reflection of fundamental conditions; namely, the fear of Great Depressions had receded, and things were much less uncertain than they had been, say, in the early postwar period.

Therefore, the current lower rate of return on capital is not because, as was viewed in the current economic report, that Government was overrestrictive, but rather that this was simply a secular movement in

the rate of return, reflecting longrun conditions.

On the second point, I am perhaps less worried about the rate of investment on the long term. My own personal opinion, and I haven't looked at studies on this in the last day or two, is that the rate of investment today is pretty much what you would expect given the fact that we are in a depressed economy.

The CHAIRMAN, In what?

Dr. Nordhaus. A depressed economy. If we were to get the economy back to high levels of utilization, then the rate of investment would climb more rapidly than GNP and would climb back to more normal levels.

I think the data put forth in chapter 1 of the last Economic Council report does indicate that, in fact, the ratio of investment to GNP is higher today than it was at similar levels of utilization in the past.

The CHAIRMAN. Then right now, do you feel that the wisest economic policy is to stimulate the consumption, stimulate demand, so that we can get more economic activity and reduce the amount of vacant capacity and thereby create a situation in which there would be more interest on the part of business in investing in plant and equipment?

Dr. Nordhaus. Again, my opinion would be that some kind of balanced expansion is not a bad idea. It doesn't really make a lot of difference whether the lion's share is consumption or it's balanced—some consumption, some investment, some export, whatever—but the main point is, I think there'll be a sizable recovery of investment when the utilization of capacity gets high enough so it's worthwhile for investors to expand their capacity.

The CHAIRMAN. Writing about inflation policy, you speak about the distinction between auction markets and administered markets:

The administered markets contain much of the manufacturing, utility, and government sectors, and the labor markets are progressively becoming administered.

If that's so, how do you escape the dilemma that the reduction of inflation is achieved only at a staggering cost in unemployment?

Dr. Nordhaus. I don't think we do. I think that is a correct conclusion. I think it's correct that to use unemployment as a policy to reduce inflation involves enormous social costs.

The Chairman. Then is your answer the answer that I thought Mr. Gramley gave us, that the only way to overcome this is through structural policies, through making labor more mobile and manpower training activities that kind of thing?

training activities, that kind of thing?

Dr. Nordhaus. Well. I think starting at the point we are now, with very low levels of utilization and high levels of unemployment, that we can expand the economy for a considerable amount before we run into the danger zone of rapidly rising prices and wages.

The CHAIRMAN. When would you be able to get down to, say, 6 or

Dr. Nordhaus. Five percent, plus or minus a half percent, is where I personally think the danger zone is. I should add that by "danger zone." I mean not that you get hyperinflation, but you get some noticeable increase in inflation. Once the danger zone is reached, you then have to think carefully about how you want to proceed. Once the danger zone is reached it is important to use micromeasures of the kind in both the labor market and the product market; and at that point the question we alluded to earlier, of overall or incomes policies becomes relevant. Since we are still a long way from the danger zone, price policies are not terribly relevant at the present time.

The CHAIRMAN. Yet in the last half of 1976, we had a considerable increase in industrial wholesale prices.

Dr. Nordhaus. That is correct.

The CHAIRMAN. How do you explain that with a slack economy? Dr. Nordhaus. I think it is pretty clear from the evidence that I have seen that, by and large, the pricing behavior in the industrial sector, which is the non-auction or administered market, is based on average normal cost pricing behavior.

Since we are in an economy where wages are continuing to rise at 8 or 9 percent, and productivity growth is on the order of 3 percent—

The CHAIRMAN. Unit labor costs aren't rising that high.

Dr. Nordhaus. Right. You would expect an administered pricing firm will have pricing behavior that gives it an average rate of inflation around 5 to 6 percent, even in an period with some slack.

The CHAIRMAN. During May to December, we got a bigger increase

than that.

Dr. Nordhaus. Are you talking about the wholesale price?

The CHAIRMAN. Industrial wholesale price.

Dr. Nordhaus. We are really getting off track. I would be delighted to talk about—

The CHAIRMAN. Is the index accurate, do you think?

Dr. Nordhaus. In the long run the index hasn't been too bad. Since November of 1972, which I pick because it is a statistical point, not a political point, the wholesale price index has behaved in a way that is unrepresentative of underlying behavior. In August of 1973 the official price index rose approximately 50 percent faster than any sensible price index you could have looked at. It is just due to the defects of this index.

I think the Bureau of Labor Statistics is aware of that, although

they don't appear to be promulgating it.

The CHAIRMAN. Dr. Gramley, as one who has sat at the feet of Chairman Burns so long and been so closely associated with the Board and Dr. Burns' philosophy, how do you respond to the answer that Dr. Nordhaus gave to me, to wit, we cannot escape from the dilemma that to reduce inflation, under present circumstances, by relying on fiscal policies, fiscal monetary policies, we can only do it at the staggering cost in unemployment?

Dr. Gramley. I agree. I think we paid a very dear price to try to

get inflation down.

I think we need to move forward with a stimulative program, but I also agree that we are not going to succeed in reducing unemployment much below the range of 5 to 5½ percent without generating stronger inflationary pressures unless we do something to make our labor and product markets work better.

I do think we need to do something in the way of structural policies. The Chairman. Dr. Nordhaus, much of your work has been in the

energy field.

What would you advise President Carter to put his major emphasis on in energy policy?

Do you think oil and gas regulation should be maintained, phased

out or abolished forthwith?

Dr. Nordhaus. I am not the President's counselor on energy, as

you know.

The Crange But he will look to you as to the economic

The CHAIRMAN. But he will look to you as to the economic consequences.

Dr. Nordhaus. We haven't discussed this, but I will give you some

personal beliefs on it.

I think there are clearly three quarters that have to be asked in this area. One is the macroconsequences for which I think the Council will be primarily concerned; and second would be the distributional consequences of the policies. And the third would be the efficiency.

I think, as you know very well, there have been very serious reservations about letting energy prices rise, especially in the last 3 years, because it is widely recognized that those are like excise tax increases or they behave as such and, therefore, would choke off expansion before it ever got underway.

Therefore, I think we have to be very careful.

If we do have any kind of price increases, I think they have to be offset by appropriate macroeconomic stimulus, so that the economy

doesn't head again into the nosedive, as it did in 1974.

There is the second question, which is the one of distribution. I am very concerned personally, as I am sure everyone is, that there not be windfall gains to those who for historical reasons had certain contracts which are now changed or windfall losses on the part of consumers in certain areas.

I think, again, I don't know how much we can do, but that has to

be kept in mind, I think,

Finally, on the efficiency side, I am concerned that in a Nation which stresses energy conservation and independence, we are heavily subsidizing the use of our nonrenewable energy resources.

This is a fundamental point of efficiency of our own resource allocation that has to be kept in mind in viewing the schemes that we

brew up or may come out of Congress.

The Chairman. Let me get back for a minute to that wholesale price index, because I think it is so important that we get our facts

as straight as we can, and we rely on these indexes so greatly.

An abstract of your publications provided to me by the Law Library of Congress, attributed to you and your colleague, John Shoven, contains the view that the price index grossly exaggerates the extent of inflation. You say the shortcomings and peculiarity of this index may have distorted inflation figures for 1972 and 1973 by at least two-thirds. Is that accurate? If so, what do you think we can do to eliminate that distortion in the wholesale price index?

Dr. Nordhaus. I don't have those numbers at my fingertips.

That is a correct—

The CHAIRMAN. That is an astonishing piece of information. We are going to take the wrong kind of economic policies, if our intelligence is that bad.

Dr. Nordhaus. I think it is a serious problem.

I remember distinctly why we did that piece of research, because our local distinguished newspaper, the New Haven Register, would continue to put eight-column headlines, "Wholesale price up 2.1 percent, at an annual rate of so much."

We said "My gosh, is that really true?"

We looked at that index carefully, and we decided there were two fundamental flaws.

The first one was, in general, certain goods are double-counted, triple-counted or quadruple-counted.

For example, wheat is counted three different times. When it passes through as wheat, then when it passes through as processed, and then as it passes through finally in the wholesale transaction as

A wheat price increase—that was the period from November 1972 to August of 1973, of the great wheat inflation—was so magnified by the particular construction that we thought we were having much worse inflation that we actually were. At least so thought the people at the New Haven Register, and I think it was also displayed else-

There is another area-I won't stress this at this stage-but this index has a very narrow construction, and covers only about a third

of the economy.

That is another problem. It also happened, but not as badly. during the oil price situation.

If we base our macroeconomic policies on that index, we are basing it on something which is grossly distorted.

The Chairman. I am a member of the Joint Economic Committee.

and have been concerned about the statistics that come out.

Statistical information is the most important element in making sound economic policy. Can you give me in writing an indication of what you think we might do to make that index more accurate?

Dr. Nordhaus. Of course.

The CHAIRMAN. I would like very much to get that. Dr. Shisken comes before our committee every month. We are in touch with him much more often than that.

He is, as you know, a highly competent economist and very anxious

to do things the right way.

We will certainly be in touch on that.

Dr. NORDHAUS. Let me comment on that.

There was a conference at the Bureau of Labor "tatistics, as I recall, in October of 1975.

There was some question about whether they were going to make some revisions.

I don't know that they have done anything But they are aware of this policy.

The Chairman. What areas of responsibility will you be asked to

assume on the Council? Energy? Inflation? Something else?

Dr. Nordhaus. I don't think that is really completely spelled out. I would say that I would probably be in charge of frontline duties on the international and energy and some other macro issues.

The CHAIRMAN. You have talked about the current inflation. What policies would you recommend, Dr. Nordhaus, to reduce inflation further at the present time? Voluntary methods, guidelines,

what do you think would be practical?

This committee, as you know, has a responsibility in this area. We have jurisdiction over wage, price controls or halfway measures or even voluntary measures. I would like very much to get your advice.

Dr. NORDHAUS. Again we have not discussed this either in the

Council or with other members of the administration.

I will give you my own personal opinion. I am very hesitant to use macroeconomic policy because of the enormous social cost. I

think it is probably pretty clear without structural measures you cannot get the unemployment rate down to 1 percent but that doesn't mean we have to keep it at 9 percent and as long as we keep away from the great danger zone of maybe 1 or 2 percent, I think that is wisdom. I just have not yet formulated my opinion enough to give you more than that at this time, but I assure you we will be studying that.

The Chairman. We are very concerned about the approach of the Council on Wage and Price Stability. Whether there should be pre-

notification and a number of things.

Dr. Burns has suggested some very constructive action we might take in this area. So, any ideas you have we would be delighted to hear.

You wrote in 1974 about resources as a constraint on growth How do you interpret that as it affects the U.S. economy over the next 4 years? Do you see any restraint on our growth because of the availability or unavailability of energy resources or other resources?

Dr. Nordhaus. I would be surprised, Senator, if there were any serious resource problems over the next 4 years. Really, that literature

worries about the 21st century and beyond.

I think the only questions that are really important are those involving energy. Here, I don't think it is a problem of availability of energy. It is productive capacity and our problems of international energy relations.

The Chairman. Would you then feel it is desirable to have proposals to favor a conservation of resources, tax incentives, penalties.?

Dr. Nordhaus. Here we are on thin ice. I alluded to this earlier. I think as a nation we are subsidizing energy consumption, in that oil is our marginal source and costs \$2.25 to \$2.50 per Btu. Most energy prices paid by consumers are anywhere from 10 to 100 percent of that.

So, I think the first thing we have to do is decide whether we want

to continue to subsidize energy consumption.

The Chairman. I think you have indicated it would be desirable to subsidize less, but we have to be careful how we phase that in or we will abort the recovery.

Dr. Nordhaus. Absolutely. That is correct. But there are really two kinds of conservation. One is induced by prices; another one is

nonprice conservation.

The Congress up to now, my interpretation, has favored the nonprice energy conservation in the form of standards on automobiles, housing, speed limits and so on.

I think there is also the consideration of appliances and those items. I think those have a useful role to play. I think price conserva-

tion also has a useful role to play.

The CHAIRMAN. One of your articles has the intriguing title, "The Political Business Cycle." How do you expect the political decisions of the new Council to differ in their impact on the economy from those of previous Councils?

Dr. Nordhaus. I can't hear that.

The CHAIRMAN. Let me ask you the first one and give you a crack at the second part. How do you expect the political decisions of the new Council to differ in their impact in the economy with that of the Greenspan council?

Dr. Nordhaus. I don't really know, Senator.

I would expect that in line with the policy of this administration, that the Schultze council will be primarily oriented toward getting the economy toward the appropriate level of economic activity, and one that is obviously higher than under the Greenspan council.

The CHAIRMAN. That was the purpose of the Greenspan group, too. They just had a—they certainly wouldn't—I don't think they would agree that their purpose was to do anything except to give us what they thought was long-term effective growth and greater degree of employment and greater utilization of resources. That was their objective.

But I am asking how you would differ. Dr. Greenspan certainly has

a philosophy quite different from that of Dr. Schultze.

I think the other members of the Greenspan council may differ from you and Dr. Gramley, but I would like to know if you can give us some specific indications of how this might work out in practice.

Dr. Nordhaus. Well, my own reading of the last Council's work, they were interested in economic growth in the 1980's and 1990's, but not in the 1970's. They might have been concerned about the level of utilization of the economy in the short run, but their forecasts, and presumably the policies which were proposed or implemented to obtain those forecasts, were not ones that were designed to insure a rapid recovery. I think they were terribly concerned about inflation, much more concerned about that than unemployment; and they had a view which I don't share, that you were buying a lot of anti-inflation policy by having very high unemployment rates.

That is a difference of scientific opinion.

The CHAIRMAN. How about your view of business confidence as it

affects investment?

Dr. Nordhaus. I think we may have alluded to this earlier. My impression is that investment is not that far-off the track of what it would have been in a Republican administration. I regard the main current problem of investment and business confidence is that we do not have an economy at a high level of utilization.

The Chairman. Dr. Gramley, I don't mean to be a Johnny-one-note on this Fed situation, but it is one of the intriguing aspects of your appointment. In his testimony before this committee on January 11,

Dr. Schultze said the following, and I quote:

The Federal Reserve ought to accept as its basic objective the explicit and implicit targets for real economic growth and unemployment which are involved in the Congress' action on the President's proposal.

Do you think the Fed actually does accept this?

Dr. Gramley. Yes. I believe so. I don't believe the Federal Reserve tries to set its own independent target for what the unemployment rate ought to be or what the rate of economic growth ought to be. I know from both private conservations with the Chairman and his public statements, that he expects a rate of real growth in 1977 somewhere in the neighborhood of 6 percent. That is the sort of increase which Mr. Schultze was talking about in his testimony before this committee. So, I don't think there is any divergence there.

The CHAIRMAN. Well, there certainly has been a very clear, very gentlemanly and very thoughful and sincere difference of opinion between Dr. Burns and what I would view as the predominant view

in the Congress, and I think the Carter administration. There seems to be a very powerful concern with Dr. Burns, that if we do stimulate the economy too much, if, for example, we act with a vigorous jobs program and a tax rebate, that that will have inflationary consequences, which he would feel would be most adverse and wrong. Am I unfair to

Dr. Burns in saying that?

Dr. Gramley. He has made general statements also of that kind but I have not heard any opinion expressed by him as to whether or not he thinks the package of fiscal stimulants that are under consideration now is likely to have significant inflationary consequences for 1977. My own view is we have enough slack in the economy now so that we can afford to go ahead with the kind of prudent, moderate program which the administration is considering—a program which will reduce the degree of fiscal stimulus as the economy improves during the course of 1977 and on into 1978—without undue concern about the inflationary potential inherent therein.

I would want to say to you that I also am very concerned about the problem of inflation. I think it needs to be carefully considered. I think we cannot afford to follow policies either this year or next year which are likely to set the spiral of inflationary price and wage increases going again. We need to work carefully, cautiously and prudently and I think the administration's program is designed to do just that.

The Chairman. Do you think the Chairman of the Fed would have no difficulty approving the jobs proposals made by the Carter ad-

ministration?

Dr. GRAMLEY. I wouldn't try to answer for Chairman Burns on

that. I just don't know what his view would be.

I know he is concerned about the need for programs to increase employment and in the past, as far as I know, he has not objected to public service employment programs in principle.

The Chairman. Have either of you gentlemen given thought to the problem of our cities, as peculiar and unique, different from the prob-

lems of the rest of the economy?

The fact that in our inner cities, for example, unemployment is very,

very high.

And also, as you know. New York City has a very difficult fiscal problem now, and many people feel that problem may be shared by a number of other large cities in our country.

Let me ask Dr. Nordhaus, do you think that on the basis of your knowledge, study, that other major cities in addition to New York

may face the possibility of default or bankruptcy?

Dr. Nordhaus. I am afraid I am not really up to date on that, Senator. I would just say one thing: that is, the fiscal difficulty of our cities grew out of the depth and duration of the current recession.

The CHAIRMAN. That is what I wanted to follow up on. I agree with that and I think most people do. Do you think the proposed economic stimulus package will be of really significant help to the cities in recovery and avoiding that kind of problem?

Dr. Nordhaus. Well. I think it is a step in the right direction. I presume that the countercyclical revenue sharing will continue, and maybe even be beefed up a little bit over the next few years. By continuing countercyclical revenue sharing we can avoid one unfortunate consequence of the recession. We are going to be looking at that carefully, but I have no further thoughts on that at this time.

The Chairman. As I said, unemployment is running much higher in the central cities than elsewhere. Some people suggest the Federal

Government ought to provide special incentives, perhaps an urban development bank to get the industry to locate there.

Many people feel that is counterproductive and you should let the market decide these things, it would be better in the long run. Do

you have a view on that?

Dr. Nordhaus. On the unemployment question it is pretty clear that the main reason that unemployment rates are high in the cities, higher than they were 3 years ago, is because of the state of the economy. We do expect there will be considerable improvement in center city employment just as a result of the improvement of the economy over the next few years.

economy over the next few years.

In addition, the public service employment package which is under consideration, and will be considered by Secretary Marshall, will be targeted—I don't know this for a fact, but just a hunch, a guess—more to the higher unemployment cities and also will lead to an amelioration of unemployment. I don't think that it is really

decided for sure.

The CHAIRMAN. President-elect Carter indicated a special concern for the cities, a welcome concern. How do you believe that the new administration should go about formulating a policy toward the cities? What should be the role, if any, of the Council of Economic Advisers in that process?

Dr. Gamley. I have no comment on that, Senator. I have not been involved in the discussions with Mr. Schultze to the point where I know what role he expects the council to play, or what role the rest

of the administration expects to play in that process.

The CHAIRMAN. Dr. Nordhaus? Dr. Nordhaus. I would echo that.

The CHAIRMAN. It seems to me the council could be very helpful because it is a big economic problem as well as a social problem, and your advise would be very significant for that reason. I am just about through. I may have a question or two left.

Let me ask each of you gentlemen this simple, blunt question. First. Dr. Nordbaus and then Dr. Gramley, what do you regard

as full employment? What percent?

Dr. Nordhaus. Well, there are two answers to that. One is what I would like unemployment to be, if there were no constraints on the system. And the other is what I regard as attainable with current institutions. That is not meant to be a waffle, but a realistic appraisal.

I would think an unemployment rate well under 4 percent would be where I would aim if somehow I knew how to get there without having undesirable side effects; but I think it is unattainable without institutions and that we really can't hope to aim for much below 5 percent. That is sort of a fuzzy range. We don't really know. I don't think we can aim much below that without worrying about inflation and imbalances in the labor market. That is my own personal opinion.

The CHAIRMAN. Dr. Gramley?

Dr. Gramley. I would have to concur with Dr. Nordhaus' judgments. I don't think it is possible for any economist responsibly to

suggest a single number which represents full employment.

The CHAIRMAN. Well, we have had 4 percent for some time. Now the administration, the last administration, Dr. Greenspan came before the Joint Economic Committee on January 19 and said they have revised that to 4.9 percent.

Senator Humphrey, who was present, said that this is like you have a flu epidemic and the administration announces the normal temperature is not 98.6 but really 100.

Therefore, is nobody really sick?

Because people with temperatures up to 100 degrees don't really count. It was an interesting analogy.

You have to-you don't have to, but Dr. Greenspan picked 4.9

and others have said 4.0.

Let me put it this way: If we are aiming at a pragmatic goal, what

would you have us aim at over the next 4 years?

Dr. GRAMLEY. A pragmatic goal for the present, I mean by that a goal which is achievable without setting off a new spiral of wageprice inflation, is probably under the present circumstances in the neighborhood of 5 to 5% percent.

I don't think we can be satisfied, as a Nation, resting at that level. I think we have got to do what we can by way of structural policies to get the rate of unemployment consistent with price stability down

considerably, down to somewhere in the 4 percent range or below. The CHAIRMAN. May I ask you, Dr. Nordhaus, would you support

the new Humphrey-Hawkins bill?

The bill, as you know, is different from the old bill. It makes full

employment 4 percent in effect instead of 3.

But provides that the target for inflation will be no higher than it was when the Humphrey-Hawkins bill is put in effect, so we should not adopt policies that would be inflationary.

It provides that the wage to be paid would be the minimum wage it has a whole series of structural actions, including manpower training

and so forth.

Do you think this is a proposal that you could support, or might

support, at least in principle?

Dr. NORDHAUS. I support the philosophy, but personally I think it is terribly important not just for the next years but really over my lifetime, that we take care of some of the problems mentioned in the bill.

Economists have not been terribly kind to the bill. There are three

aspects to the bill:

One is an unemployment target, and another one is the inflation target, and the third one is what institutions are going to be used to attain those.

I think those three things are unattainable. I think you can have

any two of them but not all three at the same time.

But I don't see how we can attain very low levels of unemployment over a sustained period of time, with the rates of inflation that are envisioned implicitly in that bill.

Of course, we may be wrong, but that's my impression.

The Chairman. Well, as I understand the way the bill would be designed to operate, it would, maintain that goal of keeping inflation, say, at the present time to 4.8 percent of an annual basis, that's what it was in December of 1975, to December of 1976, that we would just cool it and not be able to proceed with providing an expansion for the economy, if the inflation got above that.

Dr. Nodrhaus. Did you say we would cool it?

The CHAIRMAN. We would cool the expansion. We would not continue to provide the additional jobs if inflation was getting above 4.8 percent, we would just have to settle for 6½ unemployment or 6 percent, whatever it was.

We wouldn't keep driving it to 4 percent if we got into double

digit inflation.

Dr. Nordhaus. I guess that implicitly recognizes there may be an inconsistency between the three goals.

The CHAIRMAN. You have to reconcile it some way. That's the way

they have tried to do it.

Dr. Gramley. Senator, I have not studied the new Humphrey-

Hawkins bill in any detail.

From what I know about it, it has moved in the direction of taking out of the old bill many of the objectionable features, but I would want to reserve judgment until I have had a chance to look at it carefully.

The CHAIRMAN. Gentlemen, I am very impressed with your

qualifications.

I think you are both extremely well qualified to be on the Council of Economic Advisers.

I think you will bring a degree of competence and expertise and

imagination, innovation that we urgently need.

I see one problem, and one shortcoming. The problem is the connections you had, Dr. Gramley, in the past with the Federal Reserve Board.

Others may not view it as a problem, but I do. I think we have to

watch it carefully.

You're a man of great integrity as well as great achievement, but someone who has been on the Board so long and so close to Dr. Burns for so long and intends to go back to the Federal Reserve Board, I think there is something that should be watched and we should be conscious of it.

I don't think it in any way disqualifies you. It may be an asset. The second is, we were given to believe by Dr. Schultze that the great innovation in the new Council of Economic Advisers is their

concern with international economic policy.

You gentlemen are both very well-qualified etonomists. This is not your principal area of interest. I think it's unfortunate that we don't have that degree of expertise.

We can't have everything. Nobody is perfect, but I just wish we

had that.

Thank you very much.

The committee will stand adjourned.

[Whereupon at 11:40 a.m., the hearing was adjourned.]

Senator GARN. Mr. Gramley, what would you do differently from the administration to combat inflation?

Mr. Gramley. Now? Senator Garn. Now?

Mr. Gramley. Right now, I think we have a program in place which is appropriate to the circumstances we face. I think we've got a considerable amount of fiscal restraint entrained. I think it's going to work promptly. I think we are going to see some slowing of the economy in the second quarter. I think we are going to see a substantial reduction of inflation over the remainder of this year.

So I think for now we have taken the steps we need to.

Over the longer run, we as a nation are going to have to do more than we have by way of efforts to improve productivity; efforts to increase energy independence; efforts to accomplish many of our social and economic objectives—a cleaner environment, a safer workplace, and so on—in ways that add less to costs and prices. I think this is the area where public policy is going to have to work much more carefully and cautiously in the future to have real hope of bringing inflation down, but that's a long-run program, not a set of actions for now.

Senator Garn. Well, this disappoints me that you're satisfied with what has been done, because I happen to think that psychology and attitudes have a great deal to do with the economy and how it functions, and some of the longer term solutions that are talked about would have immediate short-term effects on the economy because of the attitudes of business people, individuals to invest, to save. The President's economic plan, as stated several times today, stresses a balanced budget but it does not emphasize reduction in regulations. As a matter of fact, in the President's speech he made no mention whatsoever of the \$100 billion of compliance costs due to regulations and promote production as well.

Are these things considered by the administration?

Mr. Gramley. Senator Garn, I think the effort that we've gotten underway in the Carter administration to make governmental regulations more cost-effective, particularly in the environmental and safety area, is one of the things we will be known for in the years ahead. I think it is important to do something to increase business investment incentives and improve productivity when room in the budget becomes available, but I couldn't in good conscience recommend a tax cut of \$5 billion or \$7 billion or whatever for accelerated depreciation or some other form of investment incentives now because I'm reasonably sure when that emerged from the Congress it would have attached to it a \$15 to \$20 billion individual income tax cut also, and then all hope for budget restraint is lost.

I think we need to move in that direction as rapidly as possible,

but now is not the right time.

Senator Garn. Mr. Gramley, we can't wait for room to be in the budget. We must make room in the budget for tax cuts. That's the thing that disturbs me. I have talked about a \$100 billion increase in revenues. We are talking about a \$15 billion reduction in expenditures, a very miniscule part of a massive increased tax burden on the American people. Now I'm getting tired of the rhetoric that's coming out during an election year about how we're making tough fiscal constraints on this budget. We ran this whole

country on \$100 billion 18 years ago—everything, defense, interest on the national debt. Now this baloney that we are removing this burden to solve inflation this year isn't just you and the rhetoric—it's so damned ridiculous—\$15 billion. I took \$1.4 billion out of the foreign aid budget last year all by myself. Then we're being told how \$15 billion—the American people need to know we are having a \$100 billion increase in revenue and it's coming off their backs. This decreasing productivity, more money available for the Federal Government to spend, and after the \$15 billion reduction we're still going to have \$85 billion more than last year.

Well, I'm obviously not going to get any specific answers other than fiscal policy is fine; we should do more but we can't do it right now; we're going to wait. Well, I feel sorry for the home builders and the automobile dealers and the American people who are

bearing this burden.

I am also concerned about the independence of the Federal Reserve, as I have mentioned, with everybody coming from governmental areas. I wonder where the independence will really come if you, along with many of the others, are going to be confirmed as a member of the Fed, and where that separation between this Congress and this administration and the Federal Reserve Board comes. We're all just going to have a concerted policy to work together and do effectively nothing. I see no point in me pursuing this further, Mr. Chairman. Thank you.

The CHAIRMAN. Well, thank you very much, Mr. Gramley. You've had kind of a rocky time this morning. I reiterate what I said at the beginning. I think you are very well qualified for this job. The questions, as they should be, were vigorous and challenging and I think it's to Senator Garn's credit that he's made such a strong attempt to elicit responses from you on what is undoubtedly

the biggest economic and domestic problem we have.

I want to thank you very much. You have been extremely responsive. I think you are well qualified. We will take your nomination up Friday hopefully.

Mr. Gramley. Thank you very much, Mr. Chairman.

The CHAIRMAN. The committee stands in recess for just a few minutes. Senator Stevenson is holding a hearing on international finance.

[Whereupon, at 10:25 a.m., the hearing was adjourned.] [Additional information ordered inserted in the record follows:]

STATEMENT FOR COMPLETION BY PRESIDENTIAL NOMINEES

Name: Gram	ley		Lyle		El	den	
	(LAST)		(FIRST)		(OTHER)		
Position to whice nominated:_	h Governor	, Federal	Reserve	Board	Date of nomination:_	March	17, 1980
Date of birth:_	14 1 (DAY) (MONTH)	1927 Plac	e of birth:_	Aurora,	Illinois		
Marital status:	Married	Full	name of spo	ouse: Evel	yn Lucill	e Wacht	tel Gramley
Name and ages of children:_	Alan	25					
(-	Lynn	23	-				
Education:		Institution		Dates attended	Degr		Dates of degrees
		ra Colleg		1947-49	·		
	Belo	it Colleg	e	1950-51	BA	<u> </u>	1951
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Memberships:

List below all memberships and offices held in professional, fraternal, business, scholarty, civic, charitable and other organizations.

	Organization	Office held (if any)	Detes			
	American Economic Assoc.		1955 to Present			
	American Finance Assoc.		1955 to Present			
	National Economists Club	Board of Governor	s 1971 to Present			
	Conf. of Bus, Economists		1975 to Present			
	Potomac Hunt Club	Treasurer	1970 to Present			
	Middletown Valley Hunt		1971 to 1978			
	Potomac Polo Club		1970 to 1978			
	National Capital Polo Cl	ub -	1971 to 1978			
Employment record:	List below all positions held since college, including the title or description of job, name of employment, location of work, and dates of inclusive employment.					
	Federal Reserve Bank of	Kansas City, 1955-	-62, Financial			
	Economist					
	University of Maryland, 1962-64, Associate Prof. of Economics					
	Federal Reserve Board, 1964-1977, Staff Economist,					
	Final position: Director of Division of Research & Statistics					
	Council of Economic Advisers, 1977-1980, Member					

Government experience:	List any experience in or direct association with Federal, State, or local governments, including any advisory, consultative, honorary or other part-time service or positions.
	Member of Council of Economic Advisers, 1977-80
	Associate Director of the Maryland Tax Study, 1963-64
Published writings:	List the titles, publishers and dates of books, articles, reports or other published materials you have written.
	Essays in Commercial Banking (coauthor), Federal Reserve Bank of Kansas City, 1962 Scale Economies in Banking, Federal Reserve Bank of Kansas City, 1962 The Maryland Tax Study (Assoc. Director) Bureau of Business and Economic Research, University of Maryland, 1965
	Time Deposits in Monetary Analysis (with Sam B. Chase), Federal Reserve Bulletin, October, 1965 The Informational Content of Interest Rates as Indicators of Monetary Policy, Federal Reserve Bank of Minneapolis, 5/68 Guidelines for Monetary Policy The Case Against Simple Rules, unpublished paper delivered at the Financial Conference of the NICE, February 1969
	Ways to Moderate Fluctuations in Housing Construction,
Political affiliations	(Director), Federal Reserve Staff Study published by the Federal Reserve Board, 1972
and activities:	List all memberships and offices held in and services rendered to all political parties or election committees during the last 10 years.
	None

Political contributions:	Itemize all political contributions of \$500 or more to any individual, campaign organiza- tion, political party, political action committee or similar entity during the last eight years and identify the specific amounts, dates, and names of the recipients.
	None
Qualifications:	State fully your qualifications to serve in the position to which you have been named. (ettach sheet)
Future employment relationships:	Indicate whether you will sever all connections with your present employer, business firm, association or organization if you are confirmed by the Senate. I will.
	As far as can be foreseen, state whether you have any plans after completing government service to resume employment, affiliation or practice with your previous employer, business firm, association or organization. I have no such plans
	Has anybody made you a commitment to a job after you leave government? No
	4. Do you expect to serve the full term for which you have been appointed? Yes.

of Interest:	Describe any financial arrangements or deferred compensation agreements or other continuing dealings with business associates, clients or customers who will be affected by policies which you will influence in the position to which you have been nominated. None				
	List any investments, obligations, liabilities, or other relationships which might involve potential conflicts of interest with the position to which you have been nominated. I have indicated to Federal Reserve Board Counsel that I will liquidate any stocks presently owned that might				
	raise questions about conflict of interest.				
	3. Describe any business relationship, dealing or financial transaction (other than tax-paying) which you have had during the last 10 years with the Federal Government, whether for yourself, on behalf of a client, or acting as an agent, that might in any way constitute or result in a possible conflict of interest with the position to which you have been nominated.				
	None.				
	-				

4. List any lobbying activity during the past 10 years in which you have engaged for the

	any legislation at the national level of government or affecting the administration and execution of national law or public policy.
	Testimony and discussions with members of the Congress in my role as Council Member only.
	 Explain how you will resolve any potential conflict of interest that may be disclosed by your responses to the above items.
	As indicated in my response to question 2.
Civil, ériminal and	
investigatory actions:	 Give the full details of any civil or criminal proceeding in which you were a defendant or any inquiry or investigation by a Federal, State, or local agency in which you were the subject of the inquiry or investigation.
	_None.
	Give the full details of any proceeding, inquiry or investigation by any professional association including any bar association in which you were the subject of the pro- ceeding, inquiry or investigation.
	None.
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Statement of Qualifications

My entire professional career has been spent dealing directly or indirectly with the focal questions of monetary policy.

From 1955 to 1962, I worked as a financial economist at the the Federal Reserve Bank of Kansas City. My responsibilities there included economic forecasting, research and writing on commercial banking, money and capital markets, and monetary policy, and advising senior bank officials on issues in these areas.

From 1962 to 1964, I was an associate professor of economics at the University of Maryland. My area of specialization was monetary monetary theory and policy; courses were taught at both the graduate and undergraduate levels.

In 1964, I joined the staff of the Federal Reserve Board as a financial economist. During the 13 year period of my employment with the Board, my areas of responsibility included economic forecasting, analysis of developments in financial markets, advising the Board and the Federal Open Market Committee with regard to ongoing economic developments and the course of monetary policy. During my final years at the Board, I was the Director of the Division of Research and Statistics and Economist (Domestic Business) to the Federal Open Market Committee. In that capacity, it was my privilege to work closely with the then-existing Chairman of the Board, Arthur F. Burns.

Since the beginning of this Administration, I have been the member of the Council of Economic Advisers responsible for macroeconomic analysis and policy issues. That area includes the analysis of financial markets and monetary policy, as well as economic forecasting and fiscal policy.

Appointment to the Federal Board in these difficult and critical times would be an enormous challenge. If confirmed, I will devote all of my energy to serving the Board and the Nation well.

ANSWERS TO SUBSEQUENT QUESTIONS OF CHAIRMAN PROXMIRE

- Q. Arthur Burns, your former boss when you were Director of Research at the Federal Reserve Board, has indicated that the Credit Control Act should be repealed; that it is a very dangerous law to have on the books. Do you agree with him?
- A. I do not think that the Credit Control Act should be repealed.

 While the Act provides for broad ranging powers to control

 credit, it also contains an important check on the use of

 those powers. While the President can authorize the Federal

 Reserve to impose certain types of controls, the Federal

 Reserve Board must decide whether and how to implement

 those measures. Therefore, neither the Administration

 nor the Federal Reserve can use the powers provided

 under the Act unless both agree that such a course is

 necessary.

- Q. What role, if any, did you play in determining whether and how the Credit Control Act of 1969 should be imposed?
- A. I was one of the economists in the Administration who favored invoking the Credit Control Act of 1969. I considered it necessary that credit growth be constrained in ways that would not force a further escalation of interest rates. The details of the credit control program were decided by the Federal Reserve, not the Administration, but I believe the measures taken will succeed in shifting part of the burden of credit rationing from price to availability.

- Q. Do you know of any evidence that suggests that money market funds have added to inflationary pressure or have in any way increased the amount of available credit?
- A. In early 1980, growth of credit to the business sector was excessive. Business loans at commercial banks increased at annual rates of over 20 percent during January and February.

Money market funds contributed to business credit growth at the expense of other sectors. Some of the funds used to purchase money market fund shares was most likely diverted from small banks and from thrift institutions, reducing the availability of credit for small businesses, farmers, and home buyers. Most of the increase in large business loans probably reflected a diversion of credit from one source to another rather than a net expansion. But I doubt that there was a dollar-for-dollar effect in reduced credit expansion elsewhere. In any event, the redirection of credit flows toward the mortgage market, small businesses, and farmers that will result from limiting the growth of money in market mutual funds seems to me to be desirable at this time.

Q. Does the Federal Reserve have sufficient authority, absent the Credit Control Act, to limit credit expansion during periods of rapid inflation such as this? If not what additional authority should the Board have to limit the quantity of credit through means other than allocation by high interest rates?

Business credit continues to expand rapidly despite the Special Voluntary Credit Restraint Program. Bank loan commitments mushroomed early this year in anticipation of credit controls. Should the Federal Reserve Board have authority to limit the growth of business by bank loan commitments to some multiple of bank capital?

A. The traditional tools of monetary policy enable the Federal Reserve to exert a significant amount of control over the monetary aggregates. Under present circumstances, however, the response of growth in credit to changes in the rate of expansion in the monetary aggregates depends largely on the interest elasticity of spending.

Earlier in the postwar period, restrictive Federal Reserve actions resulted in a fairly rapid reduction in the availability of credit to borrowers. Because of a variety of financial innovations occurring over the past two decades or more, that no longer happens. Changes in real interest rates, not changes in credit availability, have become the principal way that monetary policy affects spending.

One of the motivations in imposing the Credit Control Act of 1969 was to reduce credit expansion without relying totally on interest rates. It is still too early to know

whether the program has been successful, but lenders in the consumer field have taken a variety of steps to restrict credit expansions. Moreover, in the business loan area, the growth of business loans at commercial banks dropped substantially in March.

The Credit Control Act of 1969 provides all of the authority needed to limit the growth of bank credit. Whether more permanent regular devices are needed to permit the central bank to slow down credit expansion through quantitative restrictions needs very careful study, in my view. I was a strong advocate of the regulatory changes, including phasing out of Regulation Q, that have reduced the tendency for monetary restraint to work through reduced credit availability. But sole reliance on interest rates as the cutting edge of monetary policy may be insufficient when the inflation rate escalates as it has this year.

- Q. Do you feel that the monetary targets provide Congress with sufficient information about monetary policy? Let me have your comments on (1) the failure of the Federal Reserve to hit its targets in the past; (2) the very wide width of target ranges; and (3) the relationship between monetary growth and economic activity, that is GNP and employment.
- A. The monetary targets provide useful information about monetary policy, but monetary policy cannot be evaluated by such measures alone. In presenting its reports to the Congress on the conduct of monetary policy, the Federal Reserve goes well beyond the monetary aggregate targets in the information it provides.

During the past three years, the growth of M2 has generally fallen within the Federal Reserve's long-run growth ranges. Growth of M1 has often exceeded the range, although that was not the case in 1979. In my judgment, the tendency of M1 to overrun the target has not stemmed from an inability of the Federal Reserve to hit the targets because of technical or operating problems. It stems from decisions during the process of pursuing the target that achieving it would have resulted in undesired consequences for interest rates and economic activity.

Given the instability in money demand recently, the target ranges are not, in my view, too wide. For example, recent staff work at the Council of Economic Advisers indicates that, since the middle of 1974, estimated equations of the demand for MIA imply that a 2 standard error band in predicting future MIA growth, even with perfect foresight of future economic activity, is two percentage points, even after allowance has been made for shifts in the money demand function through dummy variables.

The relationship between money and economic activity has never been very stable and has become increasingly looser in recent years. For example, the rise in the income velocity of MIA slowed from 5.6 percent in 1978 to 4.3 percent in 1979 for MIA, despite the fact that interest rates rose more sharply last year than in 1978. The introduction of a variety of financial instruments that are close substitutes for money probably accounts for a substantial part of the deterioration of the money-income relationship.

While the growth of the monetary aggregates certainly cannot be ignored in assessing the impact of monetary policy on economic activity, it is not the only financial indicator that should be taken into account.

- Q. Would you agree that the discount rate should be linked to market rates to eliminate the subsidy element?
- A. The question as to whether the subsidy element in discount window borrowing should be eliminated certainly deserves to be carefully examined. I have long held the view that the discount rate should vary more in line with market rates than it has in the past. However, simply pegging the discount rate to market interest rates may not be desirable. This policy would totally relinquish the role the discount rate plays as a signal of changes in monetary policy, and that is something I would be reluctant to see happen.

- Q. Should the discount window be reformulated to match the needs of thrift institutions?
- A. It will almost certainly have to be. The needs for assistance to thrift institutions may be different from those of commercial banks, particularly because thrift institutions have less asset liquidity than banks. However, I would be reluctant to see the discount window used as a source of long-run accommodation to thrift institutions. The proper role of the discount window, it seems to me, is to provide short-run accommodation due to unanticipated or in some cases seasonal fluctuations in deposits and, of course, to serve as a source of last resort.

Due to the number of institutions eligible to borrow from the discount window, the non-price rationing methods traditionally used by the Federal Reserve will be too cumbersome. The discount rate will probably have to be more closely aligned to market rates in the future to achieve adequate control over borrowing. Also, some review of existing rules governing eligible collateral for discount borrowing will need to be undertaken for prudential reasons.

- Q. What would be your advice to this Committee and the Congress on housing?
- A. As indicated in my oral testimony, the policies announced by the Administration on March 14 will, given time, be beneficial to the housing market. The additional budget restraint will take some of the burden of fighting inflation off monetary policy; moreover using the Credit Control Act of 1969 to reduce the growth in consumer and business borrowing will help to make more funds available for mortgages at lower rates.

Other ways to help the housing industry are, and should be, considered. However, extreme caution is needed in the use of budget funds for this purpose. Significant relaxation of fiscal restraint at the present time could easily result in renewed upward pressure on interest rates and do grave further damage to the housing industry.

The Administration has been looking at ways to assist the housing industry without jeopardizing the goal of fiscal restraint. A modification of the Section 235 program is one option under consideration. A decision on this question is expected quickly.

ANSWERS TO SUBSEQUENT QUESTIONS OF SENATOR STEVENSON

Q. When Chairman Volcker appeared before this Committee in February, he said that "we have reached a time where we need perhaps to do some surveys to get firmer information" on the extension of credit for productive, rather than speculative, purposes. However, in response to an inquiry from me, the Chairman stated that there was no data that would permit any submission for the record.

In light of press reports of bank credit used for takeover of a gambling casino nd metals speculation, don't you think that such a survey is needed, particularly as small businesses and farmers have difficulty in obtaining credit to keep their businesses going?

What actions will you take, if you are confirmed as a member of the Board, to assure that the Ped's October direction to the banks to make productive loans is followed?

A. As you know, the Federal Reserve did more than issue numerical guidelines on the growth of credit on March 14. The Board also emphasized that it expected lenders to limit credit extensions for speculation while continuing to make credit available to productive enterprises heavily dependent on credit.

The Board is asking for regular reports from banks and other lenders on their adherence to the guidelines. I believe that these reports should include not only data on the volume of credit extension, but also information on the extent to which lenders are adhering to the allocative guidelines. These reports should allow judgments to be made on the extent to which lenders are meeting the credit needs of productive enterprises.

Let me note that the question of the use of credit for speculative purposes is something that has bothered me more generally because of its potential impact on commodity markets. In light of developments in those markets since last fall, I believe we must consider whether there is a need for increased regulation in this area. This question is currently under review by a number of agencies. I will be interested to see the results of this review and will continue to monitor this situation if I am confirmed.

Q. As high interest rates are used as an anti-inflationary tool in the U. S., central banks in other countries also raise their interest rates to compete for international currencies.

In addition to the informal consultations among central bankers we now have, do you have any suggestions for a more effective international monetary structure to prevent the leap frogging of interest rates and to establish greater coordination of central bank authorities in an interdependent world?

A. First, I think it is important to recognize that central banks in other nations are not raising interest rates solely in response to balance of payments problems or to the increase in the value of the dollar. Like the United States, other nations face a serious risk of a spillover of oil price increases into the rest of their economies. Increases in interest rates are part of the effort to try to prevent such a spillover.

I cannot think of any institution or structure that would substitute for direct consultations among central bankers and other economic officials. No nation is ever going to surrender its autonomy or its control over its own monetary and fiscal policy to an international body. We must continue to work through existing mechanisms for increasing cooperation in the areas of monetary and fiscal policy. I believe that as the perception of interdependence grows the recognition that such cooperation is beneficial to all will also grow.

Q. The Council on Wage and Price Stability has been unable to exert effective influence in restraining inflation. Mr. Kahn has said the Council's record has not been a resounding success.

Would you favor the establishment of an independent agency with authority to require pre-notification of wage and price increases in the largest industries and to suspend temporarily inflationary increases?

If we don't toughen the Council along these lines, isn't it likely that the President will be forced to impose mandatory controls if inflationary pressures don't abate substantially?

A. I do not believe that the difficulties of restraining inflation are a function of the fact that the Council on Wage and Price Stability is a part of the Executive Office of the President instead of an independent agency.

Rather, the efforts of the Council -- and of the wage-price guidelines more generally -- have in large part been overwhelmed by force majeure. Price increases in areas beyond the reach of the program -- in energy and mortgage interest rates -- have been sq large that no program could have been successful in holding down inflation.

I do not believe that prenotification of wage increases is possible in a world of collective bargaining. We have asked for voluntary prenotification of price increases in selected industries. I would not want to go beyond that at this point.

I do not believe that the President will be forced to impose mandatory controls, which I think would be counterproductive. I expect to see a slowdown in inflation in the second half of 1980.

COUNCIL OF ECONOMIC ADVISERS WASHINGTON

April 15, 1980

CHARLES L. SCHULTZE, CHAIRMAN GEORGE O BADS L'LE E. GRAMLEY

Dear Senator Stewart:

Enclosed are written answers to the questions your staff gave me after the hearing this morning. Question 2 has been omitted because I answered it orally.

Sincerely

Lyle E. Gramley

Honorable Donald Stewart United States Senate Washington, D.C. 20510

Enclosures

- Q1. In 1972, when you were on the staff of the Federal Reserve I understand you prepared a study on "Ways to Moderate Fluctuations in Housing Construction." What are some of the best ways, in your opinion, to help smooth out some of these short term cycles in housing production?
- A. The Pederal Reserve staff study published in 1972 contained a number of suggestions for ways to smooth cyclical fluctuations in housing that have since been put into effect. These include relaxation or removal of usury ceilings, more flexible administration of the FHA-VA ceiling rates, movement toward putting depository interest rate ceilings on a standby basis, and granting of consumer loan powers to thrift institutions. Nonetheless, as experience this year indicates, housing is still bearing a heavy share of the burden of monetary restraint.

The channels through which monetary restraint is adversely affecting housing this year appear to differ from those of ten years ago. At that time, monetary restraint affected housing largely by reducing the availability of credit to potential homebuyers. Now, the principal effect on homebuilding appears to be coming, not from inability of borrowers to obtain funds, but from extremely high interest rates on both mortgage loans and construction financing. Increases in mortgage interest rates have been much larger recently than in previous periods of tight money, in large measure reflecting the unprecedented level of inflation and the sharp rise in costs of funds to mortgage lenders.

As the 1972 Board staff study pointed out, cyclical fluctuations in housing would be very moderate if inflation were kept under better control. More reliance on fiscal

policy, rather than monetary policy, to curb inflation would also be of great benefit. Steps to reduce the dependence of the thrift institutions on short-term deposits such as the 6-month money market certificates would also be helpful.

There are, however, steps that can provide help to the housing industry only over the long run. The answer to question 4 below indicates what I believe needs to be done to offer more immediate relief.

Q3. At that same small business committee hearing you mentioned that the Administration had formed an interagency housing committee to appraise the economic outlook for the housing industry. Has that committee reached any conclusions about what can be done to alleviate the depressed industry at this time?

A, The interagency housing committee to which this question refers concluded its appraisal of the then-existing outlook for housing around the first of December. Its findings were reported to the Economic Policy Group. That group discussed with the President the possibility of a supplemental appropriation for the Brooke-Cranston program in the fiscal 1981 budget.

A decision was made not to seek a supplemental appropriation at that time.

Since early December, the outlook for housing has worsened appreciably. The Administration is therefore reviewing options to provide assistance to housing in this difficult period in ways that do not substantially enlarge the budget deficit, including a redirection of the Section 235 program to provide a shallower subsidy to a large number of housing units. A decision is expected shortly.

Q4. What type of government action to relieve the pressure in the housing industry do you feel is justified at this time?

A. As I indicated in my oral testimony, I believe the steps announced by the President in mid-March will help to relieve the pressure on the housing industry. The additional fiscal restraint will help to relieve monetary policy of some of the burden of moderating inflation, and the use of the Credit Control Act of 1969 will help to slow credit expansion in ways other than just higher interest rates.

I believe direct assistance to the housing industry would also be desirable to remove the burden of an inventory of unsold houses that has become extremely heavy because of the recent sharp decline of housing sales and extremely high construction loan rates. As the response to question 3 indicates, the Administration is considering ways to accomplish that without large additions to budget outlays. A decision will be made quickly.

- Q5. When Chairman Volcker appeared before this committee to explain the Fed's most recent credit tightening moves, he made a statement that the Fed "where appropriate and possible would adjust the lending rates and other terms to take account of the special needs of small businesses and others." Do you agree with that stated Fed policy? What do you feel the Fed should do to work towards that goal? (Perhaps some Jawboning, perhaps some buidelines for banks to follow in determining which borrowers should take priority in a time of need)
- A. As I indicated in my oral testimony, I agree with that stated policy of the Federal Reserve. The guidelines for banks set forth by the Federal Reserve in the voluntary credit restraint program are consistent with that position. I also believe, as I indicated in my oral testimony, that consideration should be given to establishing higher target growth rates of loans for smaller banks whose nonconsumer loans primarily consist of loans to builders, farmers, or other small businesses.

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NOMINATION OF LYLE E. GRAMLEY

WEDNESDAY, APRIL 16, 1980

U.S. Senate, Committee on Banking, Housing, and Urban Affairs, Washington, D.C.

The committee met at 9:30 a.m., in room 5302, Dirksen Senate Office Building, Senator William Proxmire (chairman of the committee) presiding.

Present: Senators Proxmire, Stevenson, Morgan, Tsongas, Stew-

art, and Garn.

The CHAIRMAN. The committee will come to order.

Yesterday we had before us the President's nominee to become a Governor of the Federal Reserve Board, Lyle Gramley. In my judgment, Mr. Gramley is extremely well qualified. He, however, was challenged by other members of the committee and this, of course, is an extremely important appointment.

Mr. Gramley will be appointed to the Board for the full 14 year term and, of course, the Board does determine the monetary policy of this country and the availability of credit and has a profound influence on interest rates and on the progress of the economy

generally.

We are very happy to hear from the distinguished senior Senator from Iowa, Senator Culver, who has very strong feelings on this matter. Go right ahead.

STATEMENT OF JOHN C. CULVER, U.S. SENATOR FROM THE STATE OF IOWA.

Senator Culver. Thank you very much.

Mr. Chairman and members of the committee, I appreciate the opportunity to testify this morning regarding the nomination of Mr. Lyle E. Gramley to a 14-year term on the Board of Governors of the Federal Reserve System.

I am here, as you indicate, Mr. Chairman, in opposition to Mr.

Gramley's confirmation.

I wish to make it clear from the outset that my opposition to this nomination should in no way be taken as a reflection on Mr. Gramley's personal integrity or his professional abilities as an economist and monetary policy expert. His record in that regard speaks for itself. It would appear to be a record of demonstrated competence and success in increasingly difficult and complex positions.

My opposition, Mr. Chairman, to this nominee stems from my firm conviction that the current vacancy on the Federal Reserve Board of Governors should be filled with an individual whose background and experience provide a personal knowledge of the financial requirements of agriculture and small business, as well as the

impact of monetary policies on these sectors of the economy.

I have urged the President, Mr. Chairman, to nominate such an individual to the Board twice in the past 2 years. I am not a "Johnny-come-lately" to this concern and to this heartfelt belief that this Board desperately needs broader representation. Once in 1978, I wrote the President and urged this course and again this year after the current vacancy opened up. I strongly believe that we need such an individual on the Board.

It should be noted that over the past 3 years I have been generally supportive of the administration's policies. I am not one of its

detractors.

However, the impact of present Government policy in the monetary and agricultural policies on the Midwest region of the country, in my judgment, threatens the very survival of that economy and that economy is the Nation's greatest food producing region. Obviously, it is not only my own State that is affected. The farm and small business economies of Nebraska, Minnesota, Wisconsin, and the Dakotas and many other States across the Nation are looking at deep recession, if not full-scale depression at point-blank range.

This, in turn, threatens not only the well-being of the entire Nation, but our national security as well. There is much talk these days, Mr. Chairman, about the need for a stronger defense. Without a strong agricultural economy, this Nation would be weak regardless of any buildup of Armed Forces and nobody understands this any better than the Russians who spend one-quarter of their

GNP on agriculture and can't feed themselves.

The administration has failed to keep faith with its pledges to the farm community of America. At the time of the grain embargo, we were told that the farmers would not be called upon to bear a disproportionate burden of the sacrifice. That promise has just not been fulfilled.

What does it take to make the administration understand the gravity of the situation? This is one supporter who has run out of patience. In Iowa, many people rejoiced in the election of a farmer President. Now we feel we have been deserted in our hour of

greatest need?

If standing fast for the nomination of a Federal Reserve Board member with agricultural and small business orientation will help move the administration to change policies that have brought a vital sector of our economy to its knees, I think this committee will have performed a service that is clearly in the Nation's best interest.

Monetary policy, as you know, Mr. Chairman, is a highly complex tool of economic policy and its exercise has far-reaching effects on both the domestic and international economy. It is not a tool to be placed under the control of narrow special interests. By the same token, the exercise of monetary authority should not be concentrated in the hands of a group of narrowly focused individuals with homogeneous experience, homogeneous philosophies, and homogeneous intellectual backgrounds.

The current and traditional makeup of the Federal Reserve Board of Governors borders dangerously close to this homogeneity.

Mr. Gramley's nomination provides no remedy to this situation. It

aggravates the condition.

I sometimes wonder, Mr. Chairman, looking over the membership of that Federal Reserve Board and the history and the fights we had in the House back in 1976 on broadening those Boards—I'm afraid that this incestuous relationship, if it continues, will perhaps mean that we are going to have people on that Board for 14 years with an incestuous breeding that's going to have everyone with an eye in the middle of their forehead before their term expires.

Mr. Chairman, it's time—no, it's long overdue—it's long overdue to diversify the makeup of this Board, the highest monetary policy board in the Nation. I have looked at the background of each and every one of these people. I think it's unconscionable. We talk about no more than one person from any one of these 12 Board districts. All you've got to do is be born somewhere back when and suddenly that qualifies you for that geographic representation. Every one of them is coming out of the New England or Northeast background, out of big banks, big corporations, or academia, or government.

There's no practical experience at all represented on this Board today. Now we need somebody for this. Diversification should start by placing at once on this Board a person who understands and is sensitive to the economic role of small business and agriculture.

Monetary policy, by its nature, is a blunt policy instrument. But I reject the contention that it cannot be exercised with greater sensitivity toward these important sectors of our economy—and small business and agriculture are important. Together they account for nearly 60 percent of the Nation's employment, 50 percent of its gross national product, 97 percent of all the Nation's business enterprises and, of course, 100 percent of our food production.

In addition, small business is responsible for nearly 90 percent of all new net jobs created in the economy. Small business and agriculture are highly diversified, highly competitive, yet most businesses, including farmers, that can be classified as small possess

certain common characteristics.

They are more highly dependent than large businesses on commercial bank financing. In testimony last October before the House Small Business Committee, Mr. Robert Berney of the Small Business Administration presented evidence of this fact of economic life. The smallest size category of manufacturing businesses demonstrated debt-to-equity ratios five times greater than the larger size class of manufacturers.

Similar distinctions exist in construction, wholesale, and retail trades. Mr. Berney also presented evidence that during the past 20 years small companies have become increasingly dependent on bank debt to provide needed capital while large corporations have experienced a decline in their bank indebtedness to total debt ratios.

When these factors are combined with the fact that large corporations borrow more heavily from commercial banks during tight money periods and that large corporations are the first in line for whatever bank credit is available, tight money policies can have severe and dramatic implications for small businesses and, as I have said, our farmers are similarly affected.

Another common characteristic of farmers and small businesses is that they generally operate in more highly competitive environments than large businesses. Consequently, they tend to be price takers. They sell at prices established through the competitive process and buy materials at prices established all too often by large corporations with substantial market power.

Farmers and small businesses, as a result, have substantially less ability than large businesses to pass on the higher cost of financial capital during tight money periods. When such periods coincide with declining economic activity, as is the case today, they are hit

first and they are hit hardest.

There are other common characteristics of farmers and small businesses that should provide guides to economic policymakers in selecting measures for controlling economic activity. I have cited these examples to demonstrate that all sectors of the economy are not affected in the same way by the same policies.

If our economic policy is to be successful, Mr. Chairman, in providing stability and growth, it cannot be done-certainly it cannot be done equitably through measures that are insensitive to the unique characteristics of the small business and of our farm

The devastating impact that scarce money and high interest rates are having on these firms is, in my opinion, clear evidence clear evidence of the insensitivity of Federal monetary officials to their needs and operating characteristics. The record of this impact is being documented daily in the Nation's press. It speaks with convincing force.

I would like to submit, Mr. Chairman, for the record a sampling of articles that illustrate the real world impact of the Federal

Reserve Board's actions.

The CHAIRMAN. Without objection, we would be happy to have those in the record.

Senator Culver. Thank you. [The information follows:]

[From Business Week, Mar. 31, 1980]

HERE COMES THE CREDIT CRUNCH

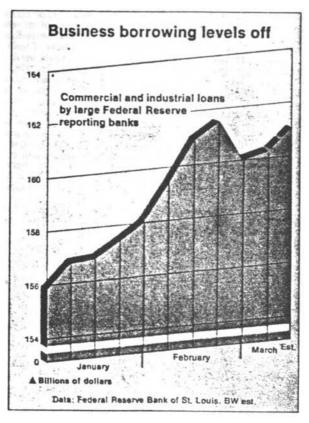
Invoking the martial law powers of the 1969 Credit Control Act as a final blow to an economy that has been stubbornly resisting recession, President Carter has dramatically upped the odds for a fullblown credit crunch. The selective credit squeeze that is already hitting housing, small businesses, and some consumer sec-

tors can be expected to sweep the economy in coming weeks.

Unless the Fed flinches, all but the most creditworthy corporations will soon find credit scarce at any price. Increased bankruptcies seem inevitable. And there is a growing sense that strains on the banking system are reaching the point where a large financial institution or corporation could collapse.

With the prime rate now hitting 19 percent, with banks paying effective rates of 23 percent to sell three-month certificates of deposit, and with big corporations under the gun for the first time since World War II to report on their credit use to the Fed, the deep strains in the financial system will only intensify. The further plunge in February housing starts to 1.3 million annually from 1.4 million in January—provoked by the Fed's earlier tight money policy—is the forerunner of what is to come.

Savings flows, which the Fed hopes to redirect to banks and savings and loans by putting a stiff 15 percent reserve requirement on popular money market mutual funds, are more likely to spill out now in the money market. Because money fund yields will be lower, savers will probably increase their Treasury bill purchases. On Mar. 17, close to one-third of the \$3.3 billion sold went to small investors. And with the depressed bond market closed to all but a handful of top-rated utilities, credit demands at commercial banks will build to a fever pitch.



Not cosmetic.—The flash point for these converging borrowers—as it has been in all previous credit crunches—will be the banking system. But the trigger will be in the hands of the Fed. With the powers it now has, there is little question that the Fed can control loan growth to the 6 percent to 9 percent range it has set for the banking system. It can restrict corporations, consumers, and investors at the source—but the risks to the economy and costs to growing companies will be high.

As bankers and corporate executives combed through some 40 pages of credit control regulations, the dominant question was: How serious is the central bank? "I believe they are [serious]," says Beryl W. Sprinkel, economist for Harris Trust & Savings Bank in Chicago. But, he warns, "We have loan commitments to honor. If there is a conflict between their goals and our word to long-standing customers, then something will have to break."

Fed officials are aware of the conflict. After briefing executives of 50 large domestic banks and top U.S. officers of 15 foreign banks on the new program in Washington on Mar. 17, Fed Vice-Chairman Frederick Schultz said: "This is not cosmetic, and there very well may be conflicts. It is up to the banks to do the rationing. We will be watching them."

Low reserves.—Companies and banks have heard that kind of tough talk from the Fed before, of course, only to see the resolve fade. Now, say many economists, things are different. "Financial institutions cannot operate for any long period in this environment," says Jerry L. Jordan, an economist at Pittsburg National Bank. "Ninety-five percent of the financial institutions may be sound. But it is that other 5 percent that will make the difference," he warns.

Fed officials share the worry that the strain may be too much for some institutions. They publicly signaled their concern by holding the emergency borrowing discount rate at 13 percent when they boosted the rate for larger banks to 16 percent on Mar. 14. Says Fed Chairman Paul A. Volcker: "The quicker we get

through this period the better.'

The paradox is that large banks themselves still feel flush with cash. That was a major reason that few refused the major corporations' requests for massive lines of new credit in the days preceding the Carter program. "In terms of our ability to sell large CDs, we're well below the peaks that we were at in 1974," says Bankers Trust Co. economist Jay N. Woodworth. But broad statistical measures of banking system tightness are at peaks. "The ratio of purchased funds to loans is up more than 40 percent from 1974 levels, and reserves are as low as they were in 1974," says Allen Sinai, of Data Resources Inc. "There will be financial failures and bankruptcies, and some banks may be required to do a very large amount of inventory financing in the next few months," he says.

Offshore loans.—Credit markets are also throwing off symptoms of tightness. Multinationals are scrambling to nail down offshore loans from foreign banks in the hope of beating the Fed's domestic restrictions, and some companies are beginning to work out swaps of dollars for foreign currencies in an effort to get around the Fed (page 38). Low-rated companies, meanwhile, are sprucing up their credit ratings by buying letters of credit from their banks (page 84). And, predicts George A. Needham, managing director of First Boston Corp., there will be a dramatic increase in filings of convertible debentures and other forms of equity financing,

which seems not be covered by the Fed regulation.

The Fed will get to show its resolve soon. Its 6 percent to 9 percent limit on bank loan expansion will bite as companies enter a peak seasonal borrowing period. Heavy Treasury borrowing, such as the \$6 billion in bills sold Mar. 19, will make

market pressures even greater.

But five days after the Fed announced its program, many companies contacted in a Business Week survey were still unaware that they will be required to report to Fed district banks on commercial paper and offshore borrowing. Some 300 selected companies will get a special review if they are using the commercial paper market heavily, warns Vice-Chairman Schultz. But to the extent the Fed closes that route, and some borrowers already cannot sell commercial paper, they will turn to their banks for funds.

Mounting complaints.—Hypersensitive financial markets began questioning the Fed's monetary resolve only hours after they opened on Mar. 17 and 18, when market rates failed to take off. While the Fed's program sopped up \$1.4 billion in new bank reserves overnight, some analysts now fear the central bank will offset

the policy by pumping new funds into the system.

In the political world in which the Fed operates, the concern will be about a crunch. Already, complaints over credit card restrictions are mounting, and they

will snowball if only top-rated corporations are getting loans.

With business borrowing continuing to rip, the immediate test for the Fed will be how tough it will be on business credit. Or as Pittsburgh National's Jordan puts it, the test is "How long it will be before something snaps."

[From the Washington Post, Apr. 10, 1980]

BANKERS FEAR PINCH OF FED'S LID ON LOANS

(By James L. Rowe, Jr.)

New York, April 9.—Many major bankers fear that it will be difficult, or impossible, to meet loan commitments they have made to their business customers and comply with the Federal Reserve dictum that loans should grow no faster than between 6 percent and 9 percent this year.

In early January, loan commitments to businesses were already at a high level, and those commitments grew sharply in late February and early March after rumors began to circulate that President Carter would impose some form of credit

controls.

Businesses went out and hit up their bankers for increases in their credit lines so they wouldn't be cut out if the president invoked lending restraints—as he in fact did on March 14.

"These weren't the kind of companies you could say no to. These were the name

corporations in America," said the chief lending officer at a major bank.

Bankers say privately that they feel they will be caught between the Scylla of their promises to their customers and the Charybdis of the Federal Reserve regulations.



"We could well be placed in the unenviable position of either going back on our word to our customers or facing the Fed's wrath. And our word is our bond," said the top lending officer at a major money center bank. "We would not say in business long if we promised our customers credit, made them pay for their lines, then told them the funds were not there when they asked for them.

Critics who believe that big bankers—or for that matter, small bankers—played a significant role in the speculative boom that helped feed the current inflation don't mind seeing them squirm now. Government officials and others blame the banks for feeding speculation by supplying huge amounts of credit to finance corporate take-

overs, commodity speculation and excessive purchasing by consumers.

At the same time, however, bankers have the critical role of fulfilling legitimate borrowing needs of businesses. If credit is unavailable, or severely restricted in the coming months, the recession that was foreordained (although months late) will be much worse than it has to be, many bankers say.

Although loan demand declines during a recession, it usually increases—sometimes sharply-during the early stages as businesses are forced to finance inventories they no longer can sell. For example during the severe recession of the mid-1970s, it was not until the spring of 1975 that loan demands declined noticeably, although the recession took hold in the fall of 1974.

This year the strain that businesses could put on their bankers may have been greater than in 1974 and 1975. A chaotic bond market—record high interest rates have kept many companies borrowing short term from their banks rather than

selling long-term debt securities to the public.

According to a Chemical Bank survey of 135 major banks, loan commitment totaled \$379.6 billion at the end of January, while only \$138.5 billion of those credit lines had been tapped.

Between the end of January and early March, companies added to those lines at levels that can be measured in the tens of billions of dollars, according to Edward Palmer, chairman of Citibank's executive committee.

Chemical Bank said "there is a real possibly that massive and sudden increases in bank loans could occur," although that is not its most likely scenario for 1980.

But if the bond markets remain unsettled and the nation's corporations find themselves stuck with goods they cannot sell, then banks likely will find themselves besieged by businessmen who want to draw on their credit lines.

During the 1974-75 recession, businesses increased their use of credit commitments to 45.7 percent of their outstanding lines, according to Chemical Bank. At the end of January, businesses had drawn only 36.5 percent of their available lines. If businesses should behave as they did in 1974-75, even ignoring the large

increases in commitments that occurred in late February and early March, then business loans "could surge by some \$35.5 billion," the bank noted. That is equivalent to 20 percent of the outstanding loans.

Not all bankers are pessimistic. Many feel that they will be able to satisfy their customers' needs by tapping smaller banks whose credit demands aren't as strong as at major banks. But parceling out loans in small packages is a time-consuming and expensive way to do business.

Others say they hope that the recent stability in the bond market will convince some of their customers to sell debt securities rather than borrow from their banks, even though interest rates remain at near-record highs.

Nonetheless, most bankers feel itchy. The longer it takes the nation to slide into a

recession, the longer it will be before loan demand subsides.

At a time of high inflation—when it takes a bigger loan to finance the same physical amount of inventory than it did a year ago—a ceiling of between 6 percent and 9 percent on loans increases looms as a difficult, if not impossible, goal.

[From the Washington Post, Mar. 26, 1980]

SMALL FIRMS HERE HIT

(By Martha M. Hamilton)

The recession may not have arrived yet for the rest of the country, but for area small businesses the future is now-and bleak.

For them, the squeeze is already on, with high interest rates, unwilling lenders and a slump in the housing industry all adding more strain to the normally difficult task of surviving as a small business.

"The small entrepreneurs are out in the first trench," said Charles S. Caldwell, a partner in the Commodore Hotel corporation. "After the tanks roll over the first trench, they're going to hit all the rest of y'all."

Caldwell and his partner have been hit by rapidly rising interest rates on the money they borrowed to buy out other interests and to improve the hotel. "When I signed this note last June, it was 131/4 percent, or high enough, and now it's over 21.5 percent," said Caldwell.

The increase will cost Caldwell about \$100,000 more than he would have paid if the rates had remained what they were when he borrowed approximately \$1.3

million last summer.

"You can't find any long term money in this market, and I've been looking for it for nine months," he said. Like many other borrowers, Caldwell found the only loans available were loans with fixed rates that have floated sky-high, along with the increase in the prime rate to which they are pegged.

'I'm kind of fortunate to be hit with these escalating costs going into the best season of the year in April, but you're supposed to be putting your chestnuts away for the winter," said Caldwell. "I'm giving all my chestnuts to the bank."

"Borrowing money in the auto parts business is a thing of the past," said the owner-manager of a medium sized auto parts warehouse and distribution center in northern Virginia. "We are very nervous. We're not sure what we can do. We just can't borrow money. We have to cut the costs of operations and that amounts to real soul-searching," he said.

The dealer, who asked that his name not be used, borrowed money two years ago to expand and diversify his business. At the time he got the loan, which carriers a

variable interest rate, the interest rate was about 8 percent, he said.

Now he expects to pay 21.5 percent when he rolls over the loan-a rate equal to

the gross profits of the auto parts business.

"It puts you in a very tight squeeze," he said. The auto parts dealer has been able to adjust so far by not hiring replacements when workers leave, by reducing bonuses to himself and other executives and by delivering reduced services for more money.

The tighter things have gotten, the more time and attention he has had to devote to making ends meet. "All of a sudden, I'm out of the parts business and into money

management," he said.

For other businesses, money is not available at any price. "We're managing to keep just above water," said Mary Kovacs, whose family owns and manages the Port O' Kings Wine and Cheese shop on Braddock Road in Fairfax County.

The family took over the business in July. "So far we're managing to break even, but there's no profit being made. Every month it's a hassle to get the bills paid,"

"What we really need is money to expand the business and that's what's unobtainable," said Kovacs. Banks will not lend money for the expansion that the Kovacs family believes would increase business, because the business has no track record, she said.

"If we can hang on for a year and then go back to the bank, maybe we'll have better success," she said. "We're better off than some others because we can hang

on. But the money is going from the right hand to the left," she said.

In the meantime, she and her husband are working about 150 hours a week to

make the business survive, said Kovacs.

William C. Goode, president of Goode Refrigeration in Prince William County, said that the only loan he has sought lately was a vehicle loan for which he paid 13.5 percent. "That's a rate that would prohibit me from borrowing any more for vehicles," he said.

He has a line of credit tied to the prime rate, but he hasn't had to borrow on it. If he did, "it certainly would ouch," said Goode.

"Most people in my type of business and my size aren't even able to go in and ask a bank for money," said Goode. "Construction has fallen off to such a degree that I'm not sure a bank in its right mind, even at 20 percent, would lend money to a small business tied to construction," he said.

Goode supplies central heat and air conditioning systems for newly built homes, and services commercial heating and cooling plants. That service business, pared down operations and the lingering effects of a very good year will help carry him

through the current hard times, he said.

"If the interest rates stay what they are, I wouldn't be surprised to see some 30 percent of the small businesses go out of business," he said.

[From the New York Times, Mar. 21, 1980]

FARMERS FACE A CREDIT SQUEEZE

BORROWING COSTS ARE UP MORE THAN 50 PERCENT

(By William Robbins)

PALMER, NEBR.—This village in central Nebraska is only a dot on most maps, but it has a bank, several businesses and a population of about 400. Because it serves farmers who till level acres of good crop land stretching in all directions, it has

Some big worries.

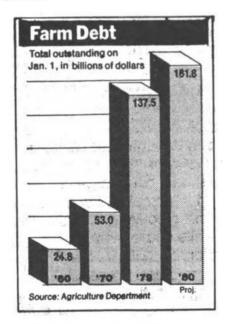
There is trouble in farm country, and it clouded the faces of Dale Friedrichson, John Forbes and Dennis Joseph recently as the denim-clad growers of corn, hogs and cattle dropped by the State Bank of Palmer. Like farmers around Aurora and Central City and elsewhere in the Middle West, their most troublesome immediate problem is credit and its costs.

The cost of the copious bank credit farmers need to operate has soared more than 50 percent in the last year. With crop prices down, many are unable to clear up last year's operating debts before seeking new funds for another planting season. And the increased cost of bank loans come atop soaring prices of other needs, especially fertilizer and fuel, which have risen 30 to 50 percent this spring compared with last

The resulting problem has strained the liquidity positions of many Middle Western banks reached in the last few days, and it has left bankers worried about

meeting all their farm clients' needs.

"It's like running into the wind with a funnel in your mouth—you're just sucking air." said John A. Dinsdale, vice president of the Palmer bank and a partner with his brother, Roy, in ownership of 13 other Nebraska banks, in describing the difficulties of farming clients.



Banks in Nebraska and elsewhere in the Middle West generally say they must charge farmers interest rates of 16 to 17 percent—less than the 19 percent prime rate in big cities but still a sharp increase of agricultural credit. Even so, they say they face a tight squeeze between the charges and their own money costs, and they see no prospect of immediate relief.

Nationally, total outstanding indebtedness of farmers, including mortgages on their land, reached \$137.5 billion on Jan. 1, 1979, according to the Agriculture Department. That figure included \$62.5 billion of loans not related to real estate, including \$5.2 billion of low-interest Government price-support loans on crops. Of

the total, real estate loans accounted for \$72.3 billion.

Refinanced mortgages

Preliminary figures as of Jan. 1, 1980, indicate that farmers' total indebtedness rose to \$161.8 billion, including \$4.5 billion of price-support crop loans. The Agriculture Department estimates that 53 percent of the total was real estate debt.

An increasing part of the real estate debt, Government economists say, is a result of farmers refinancing mortgages on their property—at prevailing interest rates—to provide funds to carry their rising operating costs. No estimate of the dollar amount

of refinancing being done was available.

"This could take me out of farming," said Mr. Friedrichson, a tall, broad-shouldered grower whose blond hair and ruddy skin looked weathered beyond his 42 years. "Another year like this and I'll be lining up my equipment for a farm sale." Like Mr. Forbes, Mr. Joseph and others, he said increased costs would wipe out the profit margin he squeezed from his farming last year.

"My dream is that one day I'll be able to retire with some dignity," he said. "Now I just don't know. Last year my fertilizer cost was \$37,000. They tell me that will be up over 30 percent this year. I paid \$40,000 in interest and that will be up 50 percent. Fuel costs also will be up 50 percent."

Mr. Forbes, a slender young farmer with more precise data, spoke with seething anger and frustration over a situation that he said was not of the farmers' making. He blamed mainly President Carter's curtailment of grain sales to the Soviet Union

and charged that not enough had been done to soften the impact.

"Last year I needed \$2.30 a bushel to break even," he said. "This year it will be \$2.42. And do you know what the price of corn is today?" A local grain elevator was

quoting \$2.18 a bushel.

Mr. Forbes pulled out a sheet of figures. "In 1976 repairs cost me \$5,250," he said. "In 1979 it was \$20,000. My interest cost was \$38,000 in 1976. In 1979 it was over \$100,000. God knows that it will be this year.

"In 1978, my fertilizer cost \$28,746 and it was \$48,068 in 1979. Now they tell us it will be up another 30 percent this year. My diesel fuel and gas bills were \$10,869 in 1976 and they were \$24,215 in 1979, and they'll be up another 50 percent in 1980." "Want to hear a real sob story?" Said Mr. Joseph. "I'm a hog producer." He fell

silent as if that were enough to say. Hogs were selling at about \$35 a hundredweight, sharply below last year's figures. A year ago, hogs brought about \$48 a hundredweight on the Omaha market. Most farmers also say today's prices are below the cost of production. Agriculture Department studies show that costs are

more than 40 cents a pound.

In nearby Central City, Wayne Thompson, a fertilizer dealer, was also talking with his banker, Terry L. Trueblood, president of the Farmers National Bank.

"I've never felt so pessimistic starting a season," said Mr. Thompson, who said he

was worried primarily about how farmers would pay for the fertilizer they will need this spring.

In Aurora, Dan J. Armbruster, president of the Farmers State Bank and Trust Company, pulled out a file and said: "Here's a farmer who could pay us off if he could get 25 cents more a bushel for the corn he's got in his bins. He'd like to wait for a better price, but we're going to have to insist that he sell his corn for what he can get now. That will leave him owing us \$5,000, but that way we can carry him for another year."

Mr. Armbruster, like most other bankers reached, said the bank's current loan-todeposit ratio was higher than he liked to see at this time of year. Most country bankers say they feel fairly comfortable with loans at 75 percent of deposits, but

some were citing current levels as high as 90 percent.

Mr. Armbruster's current level was 88 percent, down from 98 percent last year. A bank examiner said in a written report last October, from which Mr. Armbruster quoted, "The sole source of relief from this severely strained liquidity position seems to rest entirely with the successful marketing of farm products.

[From the Washington Star, Apr. 6, 1980]

IOWA FARMERS STAGGERED BY ECONOMIC BLOWS

GLOOMY FARMERS FEEL CAUGHT IN ECONOMIC BIND

The decline in the farm economy, with farmers caught in the middle of soaring production costs, lower prices and a credit crisis, is a significant development not widely reported to urban dwellers. The following article tells what's happening in one part of the nation's bread basket.



DES MOINES, IOWA.—The spring of 1980 has become an ominous time for Iowa farmers. Trouble is in the air, farmers say-perhaps the most trouble since the hard times of the 1930s.

"We're caught in a squeeze, and it's going to get worse," says Loren Klein, 33, who farms near Granville, in Sioux County. "I tell you, you don't sleep well these

nights."

Berkley Bedell, who represents northwest Iowa in Congress, agrees. "We're facing absolute disaster," he says. "We're going to have a large number of bankruptcies. There's never been anything like this since World War II in my area.'

Consider these specifics:

A year ago hogs were selling for \$48.20 a hundredweight; today they're bringing less than \$30.

Last spring a bushel of soybeans was worth \$7.06; today the market price is \$5.45.

Cattle sold for \$72.90 a hundredweight a year ago; now the price is \$65.

Corn prices are up from a year ago-\$2.10 compared to \$1.99 in central Iowa-but they're down from where they were before President Carter imposed the Russian grain embargo. They had risen above \$2.30 before the embargo, but even that price was below the cost of production—estimated at \$2.43 a bushel for 1979.

A year ago a gallon of diesel fuel cost 63 cents; today it costs about 92 cents, a 46

percent jump. The costs of fertilizer and farm chemicals are up, too.

Last year farmers were getting loans with interest rates of 11 percent; now interest rates are 14 to 18 percent.

Down in the mouth

"We've had times when there were low prices for a commodity or two," says an Iowa agricultural official. "But nothing like this. Almost everything a farmer raises or produces except milk is a losing proposition. You can't blame them (farmers) for

being down in the mouth about things.

One small sample of this troubled spring: Don Struthers of Collins recently got the shock of his pork-producing career when he couldn't even get a bid on his market ready pigs. Then when a buyer finally made a bid, it was a money-losing \$29 a hundred pounds. "I can't remember when I sold hogs that low," says the 36-yearold farmer.

People who have dealt with Iowa farmers for a long time say there is a sense of crisis. In coffee shops and traverns, listeners hear more than the habitual complaints. There is an element of alarm in the conversations, an uncommon alarm.

Iowa and the rest of the Midwest farm belt have been hit by a staggering series of

economic blows—many of them engineered by the Federal government.

They include the embargo on grain shipments to the Soviet Union imposed in January by President Carter, the administration's budget-cutting and tight-money, anti-inflation policies, the collapse of two key regional railroad systems and a decision by the administration to forgo any program to pay farmers to keep land out of grain productions—a policy aimed at providing consumers with cheaper food. Within this host of problems, tight credit has taken the spotlight recently. Inter-

est rates have soared as the government's money-tightening policies have taken

hold.

Reminiscent of depression

Iowa Secretary of Agriculture Robert Lounsberry says the current money situation in the state is "the worst credit crunch... during my 11 years in state government and (is) reminiscent of the Great Depression of the 1930s."

Lounsberry estimated that 20 percent of Iowa farmers are in "a crisis."

Some see the tight money policy as part of a cruel scheme to force farmers to

produce less

Michael Hall, a private agricultural consultant in Washington, D.C., puts it this way: "The people at the White House Office of Management and Budget and at the Council of Economic Advisers opposed all of the (Agriculture Department's) attempts to pay farmers to take some land out of production because they knew that these conditions which we're seeing today would accomplish the same thing and it wouldn't cost them anything. They've put farmers right up against the wall." Iowa Gov. Robert Ray offered similar thoughts when he criticized a USDA plan to

boost interest rates on loans to farmers from 9 percent to 13 or 14 percent.

"It appears that this is the federal government's way of getting a set aside

program," the Republican governor said.

Dewayne Bloem, manager of the Alden Cooperative, a grain elevator, said farmers are scrambling for money. Some, he said, are "borrowing" by not paying their property taxes; that means they will be assessed a penalty of 1 percent of the amount of their tax bill for each month that it goes unpaid.



"Where else can you borrow money for 12 percent?" Bloem asks.

Renters pulling out

One banker said he was not making any machinery loans.

Cash renters-farmers who pay a set figure to the landlord for the land they farm—are beginning to feel the squeeze.

There are rumors that some renters are telling landlords that they can't afford to pay the rent that was agreed upon last fall.

The squeeze is showing itself in other ways.

"We're starting to see some of our area farmers selling off some of their larger equipment and going back to a smaller operation," said a northern Iowa implement dealer. "They may be getting rid of all the rented land they have and are only going to farm the land they own."

Jim Leach, an Atlantic farmer, has reduced the number of cattle he's feeding from 300 head to 200 this year. When he bought his cattle last fall, with money borrowed at 11 percent interest, "you sort of had to grit your teeth when you took that, Leach said. Now, he says, interest rates are up around 16 percent. When his cattle are sold, he says, "I don't think I'll be back for more."

Leach also plant to cut corners this year by reducing the amount of fertilizer that

he uses. He figures that way he'll cut \$10,000 off the cost of planting 550 acres. Presumably, though, that could mean lower yields this fall.

"I'll get through this one," says Leach, "But I don't know about any more."

John Schnittker, a private agricultural consultant in Washington, said he believes the current economic Upper Midwest are the worst since the farm recession of the early 1950s that resulted in the loss of hundreds of thousands of small- and mediumsized farms.

"I've never seen people as despondent over a situation as they are about this," Said Harlan Hummel, owner of a lumber firm in Hawarden in northwest Iowa. "I'm just afraid we might be into something much deeper than we realize," said Robert Scroggs, president of Scroggs Feed and Grain in Hawarden. "What if we find land values start to go down next?

Bruce Berven of the Iowa Cattlemen's Association at Ames reported a lot of gloom at a recent meeting of his marketing advisory committee. "Everybody is down mentally, and very concerned about what's happening and what might happen, Berven said. "They're concerned about markets, prices and about how long they can exist in feeding or raising cattle.'

Berven reported that some cattlemen, trying to scrape up springtime funds, are

even sending pregnant cows to slaughter, within weeks of spring calving.

"It's hard to imagine time so tough that a cattleman sells off cows that should be producing a calf in 60 days or so, but that's what's happening, too," Berven said. U.S. Rep. Tom Harkin, D-Iowa, summed up the situation this way in a recent

weekly news column:
"There were 150 farmers who came to Washington last week. . . . They met with top administration and congressional policymakers . . . Their message simply stated was this: The farm economy is on the edge of disaster. Corn prices are down 30 cents a bushel due to the Soviet grain embargo . . . farmers face depressed prices when they need cash from last year's crop to pay off loans coming due and to put in this year's crop . . . A credit crisis and skyrocketing production costs combined with lower prices is driving many farmers out of business . . . When they go under, the rest of the nation's economy won't be far behind."

Congress has approved an additional \$2 billion in emergency farm cridit to be distributed by the Farmers Home Administration, a measure sponsored by Harkin. USDA officials said recently the money will be distributed quickly under a plan to be devised by high-level department officials, and they emphasized that areas which

have been hit hard by credit problems would receive special attention.

When President Carter cut off the sale of 17 million tons of grain to the Soviet Union on Jan. 4, there were promises of special measures to ease the burden on farmers.

Now there is a growing belief on Capitol Hill and among some private experts

that the Carter administration promises aren't being kept.
"Up to now, they have made only empty promises," said Schnittker, a former assistant agriculture secretary in the Johnson administration. "I couldn't be more critical of them. The handling of the embargo has been one of the most poorly carried out USDA actions I've ever seen."

"Their first mistake," Hall said of the administration, "was the embargo. Their second mistake was the repeated assurances to farmers. Then, they didn't deliver, and these interest rates are a result of their erratic trade and economic policies.'

USDA economist William Moats has promised that the department will begin buying both corn and wheat steadily and said the program would continue on a weekly basis until grain prices at the farm level begin to rise.

Another department economist acknowledged the USDA has not fully lived up to

the administration's pledges to farmers.

"Everybody here has made an honest-to-goodness noble effort, but in trying to execute, there probably have been some foul-ups," he said. "One of these foul-ups has been in purchasing grain. This business of taking six weeks to announce you're going to purchase grain, then asking for bids, them making a decision is far too long. The department has meant well, but we didn't quite get the job done."

Robert Delano, president of the American Farm Bureau Federation, recently

called for an end to the grain embargo, charging that it was ineffective and damag-

ing to farmers.

"Farmers are hardest hit among citizens making economic sacrifices at a time when soaring inflation and near impossible credit conditions have caused a cash flow crisis in rural America," he said.

Also, DeVon Woodland, president of the National Farmers Organization at Corning, has called for "unified efforts" by all major farm organizations to put profitability back into hog production.

Woodland said that with hogs below \$30, it was time for cooperative action to reduce breeding stock by up to 20 percent in order to reduce the supply of hogs and

help future prices for butchers.

Iowa Farm Bureau President Dean Kleckner called for farmers to continue "or-derly marketing" of hogs rather than take part in "panic selling" because prices have dropped.

[From the Wall Street Journal, Apr. 7, 1980]

CREDIT DROUGHT LEAVES FARMERS SHORT OF CASH FOR SPRING PLANTINGS-IT COMES JUST AS THEIR COSTS ARE WIPING OUT PROFITS; LOSING \$15 ON EACH HOG

(By Meg Cox)

LENOX, IOWA.—On a chilly spring afternoon, 35-year-old David Schweers is selling out of farming. Gathered around the auctioneer and the neat lines of farm equipment area 150 neighbors who have come not so much to buy anything as to judge for themselves how bad things are.

Much of the machinery sells for less than Mr. Schweers had hoped. His biggest John Deere tractor can't find a buyer at all, even after he offers to finance it

himself at 12 percent interest.

Mr. Schweers's neighbors have little incentive to buy here; there has been a sale of a farmer's machinery almost every day for several weeks in this are of southwestern Iowa, and often eight or nine on Saturdays. The reason for the auction-goers' stinginess is also a major cause of this deluge of sellouts: a severe farm credit crunch.

Some of those quitting farming were poor managers. And there are still plenty of land-rich farmers whose greatest pinch this year will be cutting back on buying new machinery. But other farmers are forced to sell out simply because they couldn't

borrow enough of a limited supply of money to put in a crop this year.

And some, like Mr. Schweers, just figure they are "getting out while the getting's sod." They could get money, but the interest cost has as much as doubled in a year, helping push the cost of producing many farm products above the selling price.

This is the worst

Credit is tight for everyone, as the government tries desperately to rein in inflation. But unlike consumers who can postpone a new car or stereo, farmers must have money at this time of year to plant—an average of \$50,000 or more for fuel, fertilizers and weed or insect killers. And most of them borrow it.

"I've got farmers and bankers from all over hollering at me about how they're out of money," says James Lee, an assistant administrator for the Farmers Home Administration for the Farmers Home Administration in Washington, D.C. "This is the worst credit crunch we've ever had. It's worse in some States than others, but I don't know of any where it isn't critical.

It certainly has been critical at the Farmers Home Administration, or FmHA. This so-called lender of last resort, where farmers turned away by banks can normally get loans if there is any chance at all they will pull through, recently ran out of money. It had to wait weeks for the government to approve an extra \$2

billion in emergency loan funds to last through fiscal 1981.

That money began trickling down to country offices last week. Farmers who couldn't wait, says an FmHA official near Lenox, "had farm sales." He adds that even some who were saved at the last moment "may just find the agony prolonged."

Old customers only

Visits to all sorts of agricultural lenders in this area show that the crunch is pervasive. Most rural banks won't take new farm customers, and others are restricting their service area. At Mr. Schweers's bank in Lenox, farmers who live more than about 10 miles away won't get a cent this year regardless of how credit-worthy they are.

Longtime farm customers at the Iowa State Savings Bank in nearby Creston find that money comes with some warnings this year: "Don't buy any new farm equipment or make any capital investments, even minor ones," says Joseph Knock, ment or make any capital investments, even minor ones," says Joseph Knock, president of the bank. The bank is even asking farmers to use less fertilizer this year, because it price up up 30 percent from last year. Doing that will cut yields, but Mr. Knock says the bank's money is tight and cuts must be made.

Because of the squeeze at rural banks, more farmers than ever are pouring into Production Credit Associations and Federal Land Banks. The two are part of a system of farmer-owned cooperatives and provide short-term and long-term loans, respectively. In a four-state area including Iowa, the Federal Land Bank alone saw a 60 percent surge in new money lent between February 1980 and a year ago, partly because of farmers' efforts to spread their mounting short-term debt over longer periods.

No more cushion for banks

Though credit costs vary, farmers are paying sharply higher rates in almost all cases. With a temporary removal of State usuary ceilings by the federal government, farmers are paying 15 percent to 18 percent for operating loans at their local banks, up generally from 9 percent to 10 percent a year ago. The Production Credit Associations raise money in the bond market, so their rate is up too; in Creston, the rate is 14.65 percent, up from 10.15 percent a year ago.

The jump in rates at rural banks wouldn't have been so brutal if the banks hadn't been cushioned from increases for years, says Marvin Duncan, economist at the Federal Reserve Bank of Kansas City. The banks found two things happening, Mr. Duncan says: Farmers' credit demands have soared in recent years, while rural savers got savvy, putting their money elsewhere for higher rates. For the first time, rural banks had to look outside for funds and complete aggressively for them, he

says, and they had to raise the rates on loans.

What's more, some sources of farm loans have dried up, including insurance companies. Prudential Insurance Co. of Chicago, for example, has \$2 billion in agricultural loans outstanding, mostly mortgages. But it hasn't issued a new farm loan for more than a month, and a spokesman says it won't until the "will interest markets" calm down.

Even with the leap in interest rates, the credit crunch wouldn't hurt farmers so much if they weren't already caught in a crunch of another sort, a cost-price squeeze. One farmer who sold out says, "Everything we have to buy went up and

everything we sell went down."

Net farm income is expected to drop about 25 percent this year from the nearrecord \$33 billion of 1979, the Department of Agriculture says, while farmers' net

costs are expected to rise 20 percent.

Grain prices, hit in January by embargo on exports to Russia, have been falling because of surluses and aren't expected to recover soon. Raymond Daniel, an economist with Chase Econometrics, predicts it will cost Midwest farmers an average of about \$2.34 a bushel to produce corn this year, while the price keeps sliding from the \$2.11 a bushel farmers in southwestern Iowa were getting the day Dave Schweers sold out. Mr. Daniel predicts that soybeans will cost farmers \$5.75 a bushel to grow this year but will sell in the fall at far below the current \$5.45 or so.

Hog growers are losing up to \$15 a pig because of an oversupply of pork. And all that cheap port has kept consumers shunning high-priced beef, so that many cattle feeders are in the red again. Market analysts say high interest rates are discourag-

ing farmers from buying more young cattle to fatten.

With almost every variety of farmer up against hard times, it's no wonder rising

interest rates and scarce money are the last straw for many.

Dave Schweer's situation illustrates that. "I haven't got enough money to cover last year's expense, and all my crop is sold," he explains. "The question I asked myself is: 'Do I borrow money for last year's expenses and more to put in this year's crops at 15% interest, when I'm looking at a loss in every bushel?' The answer I gave myself was 'No.'

Living on wife's earnings

Although he's a sensible, well-educated man, a Certified Public Accountant, and he didn't overextend himself by buying lots of fancy new equipment and buildings as some young farmers have, Mr. Schweers says that he "just got tired of making ends meet." If his wife hadn't worked also, as a teacher, he wouldn't have lasted this long, he says.

The gently rolling farmland of southwestern lows is far from the state's richest, and Mr. Schweers surmises that "if I had 400 acres in northern Iowa that was paid for, I'd probably stick this out." As it is, there are other passions to pursue; he will manage an almost-completed alcohol fuel plant that 40 local farmers have banded to together to build, and he is running for the state senate.

Among the throng of men sipping coffee and swapping horror stories at Dave Schweers's farm sale are lost of grim-faced farmers who don't have the choices he does. His own father, Art Schweers, aged 60 and the father of 11, is one of them.

"I've been farming since 1942," says his dad, "and I've never seen a year as bad as this one. The bankers thought I was broke three times over the years and I never believed them, but now they've got me scared. I've got \$650,000 in net worth and I can't get any money so far to put in a crop. Trouble is, we got no cash flow, meaning we can't get more money for our products than what they cost us. I don't know what we'll do yet."

Hog disease and hail

Although he is the same age as Dave Schweers, 35, William Parrish isn't blessed with the same broad educational background or good prospects. Mr. Parrish was forced out of farming by inability to borrow-his auction was about 10 days before Dave Schweer's-and he hasn't the slightest idea how he will make a living now.

He had been farming 10 years and, in the last one, Mr. Parrish was growing corn and soybeans on 740 acres. In hindsight, he might not have bought the last 300 acres, he says, had he known the setbacks nature had in store for him. First his 300 sows developed disease problems, so he sold them. Then last year, hail ruined much of his soybean crop just weeks before harvest.

Because of the meager crop, he couldn't repay last year's emergency loan to the FmHA, Mr. Parrish explains. "So when I went back this year for money to plant, they said 'No way.'

Mr. Parrish plans to go to town now and look for a job. But "I was born and raised on a farm," he says, "and I don't know anything else."

It will be some time before the dust clears and an accounting can be made of how many farmers went down in the great credit squeeze of 1980. At least in this area, most farmers seem to be hanging onto their land and just selling the equipment, hoping they can rent the land to another farmer and farm it themselves again some day.

Land fever cools

There's no way of telling how much land is changing hands, but it's clear the surging demand and price jumps of recent years have eased, and some farmers report land going for considerably less than its appraised value. The pattern of bigger farmers swallowing up the land of smaller ones apparently is continuing.

Agriculture analysts are quick to say that the future of farming remains bright. "The retrenchment in farm income this year isn't part of a trend," says Mr. Duncan at the Fed bank in Kansas City. "The longer-term outlook for farm prices is quite favorable.

But that's little solace to those caught in the current squeeze, some of whom are not only financially but also psychologically at the end of their rope. Kenneth Wernimont, a psychotherapist at a private clinic in Waterloo, Iowa, says he is seeing case after case this sping of "severe depression" among farmers, several of whom have been hospitalized.

His patients, Mr. Wernimont explains, "say they simply can't borrow enough money and at a rate that gives them a chance to make a profit. Even farmers with many years in the business don't know what's to become of them.

[From the Des Moines Sunday Register, Mar. 30, 1980]

A TROUBLED SPRING IN THE IOWA COUNTRYSIDE: SEEDS OF DISASTER

The spring of 1980 has become an ominous time for Iowa farmers. Trouble is in the air, farmers say-perhaps the most trouble since the hard times of the 1930s. "We're caught in a squeeze, and it's going to get worse," says Loren Klein, 33, who farms near Granville in Sioux County, "I tell you, you don't sleep well these

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Last year farmers were getting loans with interest rates of 11 percent; now

interest rates are 14 to 18 percent.

"We've had times when there were low prices for a commodity or two," says an Iowa agricultural official. "But nothing like this. Almost everything a farmer raises or produces except milk is a losing proposition. You can't blame them [farmers] for being down in the mouth about things.

One small sample of this troubled spring: Don Struthers of Collins last Thursday got the shock of his pork-producing career when he couldn't even get a bid on his market-ready pigs. Then when a buyer finally made a bid Friday, it was at a money-losing \$29 a hundred pounds. "I can't remember when I sold hogs that low," says the 36-year-old farmer.

Sense of crisis

People who have dealt with Iowa farmers for a long time say there is a sense of crisis. In coffee shops and taverns, listeners hear more than the habitual complaints. There is an element of alarm in the conversations, an uncommon alarm.

Iowa and the rest of the Midwest farm belt have been hit by a staggering series of

economic blows—many of them engineered by the federal government.

They include the embargo on grain shipments to the Soviet Union imposed in January by President Carter, the administration's budget-cutting and tight-money, anti-inflation policies, the collapse of two key regional railroad systems and a decision by the administration to forgo any program to pay farmers to keep land out

of grain productions—a policy aimed at providing consumers with cheaper food. Within this host of problems, tight credit has taken the spotlight recently. Interest rates have soared at the government's money-tightening policies have taken hold. Last spring, an Iowa farmer typically would have paid 11 percent interest on a loan from a rural bank to finance his spring fertilizer, seed and other planting expenses; this spring, he'd be lucky to get the loan at 16 percent.

Worst credit crunch

Iowa Secretary of Agriculture Robert Lounsberry says the current money situation in the state is "the worst credit crunch... during my 11 years in state government and [is] reminiscent of the Great Depression of the 1930s."

Loundsberry estimated that 20 percent of Iowa farmers are in "a crisis."

Some see the tight money policy as part of a cruel scheme to force farmers to

produce less

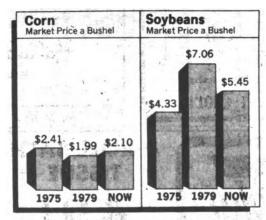
Michael Hall, a private agricultural consultant in Washington, D.C., puts it this way: "The people at the White House Office of Management and Budget and at the Council of Economic Advisers opposed all of the [Agriculture Department's] attempts to pay farmers to take some land out of production because they knew that these conditions which we're seeing today would accomplish the same thing and it wouldn't cost them anything. They've put farmers right up against the wall."

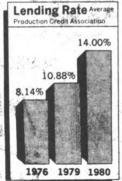
Iowa Gov. Robert Ray offered similar thoughts last week when he criticized a

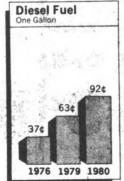
USDA plan to boost interest rates on loans to farmers from 9 percent to 13 or 14

percent.

"It appears that this is the federal government's way of getting a set-aside program," the Republican governor said.







Corn Production Costs: Estimated For lowa 1976-80 19761/ 19771/ 19781/ 19791/ 19002/ \$57.08 \$58.09 \$78.26 \$85,22 60.30 60.30 62.35 75.10 63.80 15.08 16.29 16.20 18.00 18.00 88.00 98.00 98.00 102.00 112.00 Total Cost/Acre \$223.96 \$242.68 \$252.76 \$267.57 \$303.49 \$ 2.04 \$ 2.21 \$ 2.30 \$ 2.43 \$ 2.64 1/ Estimated yield — 110 bushels per acre 2/ Estimated yield — 115 bushels per acre

Soybean Production Costs: Estimated For Iowa 1976-80

	19761	19771/	19781/	19791/	19002/
Growing and Horvesting	\$32.59	\$40.23	\$46.32	\$50.49	\$50.01
Seed, Chemical Fertilizer	32.80	32.50	34.10	36.65	44.10
Labor	14.16	15.51	15.51	17.90	17.90
Land	88.00	98.00	`98.00	102.00	112.00
Total Cost/Acre	\$167.55		\$193.93		
Per Bushel	\$ 4.79	\$ 5.32	\$ 5.54	\$ 5.92	\$ 6.47
		1/	Estimated yie Estimated yie	4d — 35 busi 4d — 36 busi	hels per acre hels per acre

Dewayne Bloem, manager of the Alden Cooperative, a grain elevator, said farmers are scrambling for money. Some, he said, are "borrowing" by not paying their property taxes; that means they will be assessed a penalty of 1 percent of the amount of their tax bill for each month that it goes unpaid.

"Where else can you borrow money for 12 percent?" Bloem asks.

One banker said he was not making any machinery loans. "Of course, if a customer blows up his tractor after he gets into the field we're going to help him, he said.

Cash renters—farmers who pay a set figure to the landlord for the land they

farm—are beginning to feel the squeeze.

There are rumors that some renters are telling landlords that they can't afford to

pay the rent that was agreed upon last fall.
"There are going to be a lot of places that could be up for rent this spring," said

Chuck Ehm, a Creston banker.

"If a farmer can't afford to farm a place at a set price then he would probably have to let it go," said Ehm.

'It is also getting a little late for some landlords to find someone else to farm the

land—at least at a high rent rate.

The squeeze is showing itself in other ways.
"We're starting to see some of our area farmers selling off some of their larger equipment and going back to a smaller operation," said a northern Iowa implement dealer. "They may be getting rid of all the rented land they have and are only going to farm the land they own.

Jim Leach, an Atlantic farmer, has reduced the number of cattle he's feeding from 300 head to 200 this year. When he bought his cattle last fall, with money borrowed at 11 percent interest, "you sort of had to grit your teeth when you took

that," Leach said.

Now, he says, interest rates are up around 16 percent. When his cattle are sold, he says, "I don't think I'll be back for more."

Leach also plans to cut corners this year by reducing the amount of fertilizer that he uses. He figures that way he'll cut \$10,000 off the cost of planting 550 acres. Presumably, though, that could mean lower yields this fall.

"I'll get through this one," says Leach, who has been farming since 1962, "but I

don't know about any more.

Hall, the agricultural consultant, said the administration's "economic policies, some of which have been made for political purposes, are going to haunt us late this summer." He said there are strong indications that hog and cattle production will be cut back—as in the case of farmer Leach—and that herds will be liquidated.

USDA economist William Moats said many rural banks depleted their locally generated funds much earlier this year than in previous years. This forced these banks, he said, to turn to correspondent banks in Chicago for money. And this money carried with it much higher interest rates than the country banks were

having to pay their own depositors.

Vance Haesemeyer, a banker from Stanwood, Ia., told a congressional subcommittee last Tuesday, "We can't charge more than about 18 percent interest, and our money is costing 17 percent. I don't like sitting across the desk and charging a farmer that much, especially when I know what he's getting for his products."

The Production Credit Association, a major source of short-term money for operating expenses of farmers, has been lending at 14 percent. Last year PCA charged

10.88 percent.

John Schnittker, another private agricultural consultant in Washington, said he believes the current economic problems among farmers in the Upper Midwest are the worst since the farm recession of the early 1950s that resulted in the loss of hundreds of thousands of small and medium-sized family farms.

"I've never seen people as despondent over a situation as they are about this," said Harlan Hummel, owner of a lumber firm in Hawarden in northwest Iowa.

"I'm just afraid we might be into something much deeper than we realize," said Robert Scroggs, president of Scroggs Feed and Grain in Hawarden. "What if we find land values start to go down next?

Bruce Berven of the Iowa Cattlemen's Association at Ames reported a lot of

gloominess at a recent meeting of his marketing advisory committee.

"Everybody is down mentally, and very concerned about what's happening, and what might happen," Berven said. "They're concerned about markets, prices and about how long they can exist in feeding or raising cattle.

"And they're worried about where they can get money [credit] because some bankers are saying they will give only short-term notes, and then renegotiate interest rates in 30, 60 or 120 days.

"How can a cattleman plan his business if he doesn't know for sure what his costs will be? That's what's happening out there today, and it has people feeling down.

Berven reported that some cattlemen, trying to scrape up springtime funds, are even sending pregnant cows to slaughter, within weeks of spring calving.

"It's hard to imagine times so tough that a cattleman sells-off cows that should be producing a calf in 60 days or so, but that's what's happening, too," Berven said. U.S. Representative Tom Harkin (Dem., Ia.) summed up the situation this way

last week in his weekly news column:

"There were 150 farmers who came to Washington last week * * * they met with top administration and congressional policy makers . . . their message simply stated was this: The farm economy is on the edge of disaster. Corn prices are down 30 cents a bushel due to the Soviet grain embargo * * * farmers face depressed prices when they need cash from last year's crop to pay off loans coming due and to put in this year's crop • • • a credit crisis and skyrocketing production costs combined with lower prices is driving many farmers out of business * * * when they go under, the rest of the nation's economy won't be far behind * * *"

Congress has approved an additional \$2 billion in emergency farm credit to be distributed by the Farmers Home Administration, a measure sponsored by Harkin. USDA officials said Friday the money will be distributed quickly under a plan to be devised by high-level department officials and they emphasized that areas which

have been hit hard by credit problems would receive special attention.

When President Carter cut off the sale of 17 million tons of grain to the Soviet Union on Jan. 4, there were promises of special measures to ease the burden on

Now, there is a growing belief on Capitol Hill and among some private experts

that the Carter administration has failed to live up to those promises.

"Up to now, they have made only empty promises," said Schnittker, the agricultural consultant, and a former assistant agriculture secretary in the Johnson administration. "I couldn't be more critical of them. The handling of the embargo has been one of the most poorly carried out USDA actions I've ever seen.

Following the embargo, the USDA announced a series of actions. The department raised price supports on corn and wheat slightly. It began to buy grain export contracts from the companies that had sold commodities to the Russians, and it announced it would buy \$4 million tons of wheat and up to about 9 million tons of corn in order to take supplies that would have gone to Russia off the domestic market

While the USDA has begun the process of relieving the grain companies of their financial obilgations involved in the Russian sales, it has yet to make major pur-

chases of corn.

"Their first mistake," Hall said of the administration, "was the embargo. Their second mistake was the repeated assurances to farmers. Then, they didn't deliver, and these interest rates are a result of their erratic trade and economic policies.

The USDA further infuriated many farmers this past week when it began to sell some 700,000 tons of soybeans it had acquired from grain companies following the

Russian embargo.

Representative Edward Madigan (Rep., III), referring to this action and to reports the USDA is seeking to sell other grain contracts it has bought from large exporting firms, said, "The farmers' own government, which at least ought to be an ally in these depressing times, turns against them and seeks to dump those stocks on the market to depress prices even further.

USDA economist Moats said the department will begin to buy both corn and wheat steadily beginning on Monday. He said the program would continue on a

weekly basis until grain prices at the farm level begin to rise.

Moats said farmers in the Upper Midwest were more seriously affected by the embargo because the sales cutoff involved so much corn.

One leading USDA economist acknowledged the USDA has not fully lived up to

the administration's pledges to farmers.

"Everybody here has made an honest-to-goodness noble effort, but in trying to execute, there probably have been some foul-ups," the economist said. "One of these foul-ups has been in purchasing grain. This business of taking 6 weeks to announce you're going to purchase grain, then asking for bids, then making a decision is far

too long. The department has meant well, but we didn't quite get the job done."
This economist said the USDA also could have significantly increased grain price supports, at least temporarily. The USDA, for example, increased the loan rate on corn from \$2 to \$2.10. Many officials strongly believed the rate should have been boosted to \$2.50 for 60 days to 90 days to provide needed cash for farmers to plant 1980 crops.

Late last week, Robert Delano, president of the American Farm Bureau Federation, issued a statement calling for an end to the Soviet grain embargo, charging that it was ineffective and damaging to farmers.

"Farmers are hardest hit among citizens making economic sacrifices at a time

when soaring inflation and near impossible credit conditions have caused a cash flow crisis in rural America," he said.

Also Friday, DeVon Woodland, president of the National Farmers Organization at Corning, called for "unified efforts" by all major farm organizations to put profitability back into hog production.

Woodland said that with hogs below \$30, it was time for co-operative action to reduce breeding stock by up to 20 percent in order to reduce the supply of hogs and

help future prices for butchers.

Iowa Farm Bureau President Dean Kleckner called for farmers to continue "orderly marketing" of hogs rather than take part in "panic selling" because prices have dropped \$3 to \$4 per hundredweight the past week.

[From the Washington Post, Mar. 28, 1980]

SMALL BANKS DISCOVER BIG CITY INTEREST RATES

(By James L. Rowe, Jr.)

HELENA, ARK.—Bart R. Lindsey gestured toward the sign displayed prominently near the tellers' cages in the First National Bank of Phillips County.

"Look at that sign," said the 35-year-old vice president of Helena's biggest bank.
"It tells our problem."

The sign reads simply: "Our Six-Month Money Market Certificate Pays You 14.956 percent." Similar signs sit in lobbies of banks-large and small-across the United States.

"It didn't used to be that we worried much about what went on in New York. Now we do," said Lindsey.

Unlike big banks-which "buy" most of the funds they lend to their customers on the open market and adjust their business lending rates in tune with those fundraising costs-small banks rely mainly on their own customers to supply the deposits from which they make loans to consumers, merchants, small businesses and

Bankers and their business customers are accustomed to fixed-rate loans—those based on the relatively stable cost of funds to the bank-not on the rates New York or Chicago banks must pay for their big certificates of deposit or commercial paper.

But with the advent of the consumer-size certificate of deposit-sold in minimum denominations of \$10,000 with rates tied to the interest the Treasury pays each Monday when it auctions bills on the open market—small rural banks have discovered New York.

When farmers begin to come in for loans to finance their spring plantings, they

will come face to face as well with New York interest rates.
"We had \$2.8 million of our deposits shift to money market certificates in one week in February alone," said William H. Brandon, Jr., president of the \$42-million-asset bank. All of that \$2.8 million came out of either passbook savings accounts which cost the bank 5.25 percent, or long-term certificates which depositors bought months or years ago at interest rates of about 6 percent or 7 percent. Brandon said that depositors are cashing in those certificates despite heavy interest penalties federal regulations require when a certificate is redeemed prior to maturity.

He said a year ago the bank had \$11 million in checking accounts (which pay no interest but cost the bank the equivalent of 4 percent), \$9.5 million in 5 percent passbook accounts, and \$12 million in certificates, which cost an average of about

6.5 percent.

Today, the checking accounts run about the same, but passbook savings deposits (which now pay 5.25 percent) have declined to \$7 million. About \$16.5 million is in "expensive, hot money," Brandon said, mainly the short-term consumer-sized certificates that have been yielding close to 15 percent in recent weeks.

The bank actually gained a temporary, if perverse, earnings boost last year because of the popularity of the new certificates. Brandon said that so many customers cashed in their old, low-interest certificates early and paid the interest penalty that the bank did not have to pay out thousands of dollars of interest as it had expected.

Of course this year "we'll be paying 15 percent on those funds compared to about

6½ percent last year," he said.



"Remember 10 years ago when everyone was talking about how smart corporate treasurers had become in taking advantage of the earning power of their money? Well, consumers in small towns are just as savvy today. They don't leave their money at 5.25 percent when they can earn 15 percent," Lindsey said.

Federal regulators dreamed up the money market certificates so that banks and savings and loan associations would be able to compete for their depositors' money during periods of high interest rates. In earlier high-interest-rate periods, consumers often withdrew their funds from bank accounts-where interest ceilings were set by law—and used the proceeds to buy investments such as Treasury bills.

During those periods (although the interest rates then pale by comparison), bigcity consumers were more prone to withdraw their funds, or disintermediate as the economists call it, than were their rural counterparts. But with the bank-offered money market certificates, depositors have to go no further than the nearest teller

to triple their interest yields.

As a result, however, First National of Phillips County has money to lend its customers, especially the farmers who will need loans soon to finance their spring

But that money is going to cost the farmers a lot more than it did last year.

But that money is going to cost the farmers a lot more than it did last year. John King, who farms about 4,000 acres in the county, found out last week that he will have to pay at least 16 percent for the \$200,000 he thinks he will need to borrow between now and next fall's harvest. Last year he paid 10 percent.

"I'm happy to have the money. Price matters, but I've got to have the money," the 47-year-old farmer said. "There is no way a farmer can go without borrowing

unless he goes out of business."

But King said he is being squeezed: All his cost are rising at the same time that the price he expects to get for his soybeans is down 25 percent because of the president's embargo on further grain shipments to the Soviet Union. Interest is not an inconsequential cost to King, reportedly one of the most successful independent farmers in this old Mississippi River town, about 65 miles southwest of Memphis.

Last year he paid an interest rate of about 8 percent, and this ate up 10 percent

of the \$700,000 he grossed, King said.

Although King will get the money he needs to finance his current harvest, bank officials told him he can just about forget borrowing any money if he wants to buy more land. King has been adding to his land holdings steadily for the last 25 years, but is resigned to buying no more in 1980.

If current customers cannot expect to have any new ventures financed by First National—there might be some limited exceptions to the general policy, Lindsey said-new customers might as well forget it, especially those who need to borrow

small amounts of money.

Arkansas bankers face more strictures on the amount they can charge customers than do their counterparts in other states. The 100-year-old state constitution sets a usury ceiling of 10 percent that cannot be corrected by an act of the legislature as it has been in other states.

Nationally chartered banks such as First National use a loophole in the National Banking Act to charge one percentage point more than the Federal Reserve discount rate (now 13 percent). But state-chartered banks such as Farmers and Mer-

chants here cannot use that loophole for loans of less than \$25,000. "We're turning down a lot of their customers," said Lindsey.

All Arkansas banks can charge up to 5 percentage points more than the discount rate on loans of more than \$25,000 because Congress passed a special law to

override the Arkansas constitution. That law expires at the end of the year.

"We'll have the money for our regular customers," said Brandon, who is bracing now for the big seasonal upsurge in farm lending. He expects farm loans to balloon from about \$3.7 million to \$8 million in the summer.

"Right now, we've got a loan-to-deposit ratio of 61 percent. We'll go close to 80 percent this summer. But we'll fight loans as much as we can. We're going to shoot for liquidity. We're a little scared," Brandon said.

That is just what the Federal Reserve wants the banking system as a whole to do: lend less money in order to restrain spending and fight inflation. But bankers such as Brandon say that rural banks do not make the speculative types of loans that

Instead, he said, the loans his banks make go mainly from local depositors to local borrowers (usually the same people) who use the money to grow crops, but necessi-

ties and finance inventories.

Indeed, Phillips County is fighting for its economic life. Agriculture, the backbone of its economy, has mechanized over the years, throwing thousands on the unemployment and welfare rolls and convincing many to leave for good. The county's population has shrunk in half in the last 30 years. More than 30 percent of its 35,000 citizens are on welfare, and its unemployment rate runs close to 13 percent, according to John Gatling, head of the newly organized Economic Development Council.

One victim of high interest rates and scarce money in Phillips County is Al Willinger, who heads a new barge building companay that so far has put 50 Phillips County residents to work. Willinger needs \$500,000 to finance steel and salaries for the \$2.4 million worth of barges he has on order. His life is further complicated because Brandon is on this board of directors and First National could not make him a loan even if it were possible otherwise because of the interlock in directors.

[From the Washington Post, Apr. 10, 1980]

EMERGENCY MEETING YIELDS NO NEW HELP FOR FARM BORROWERS

(By Art Pine and Martha M. Hamilton)

The White House, concerned about a sudden dearth of farm credit that threatens spring planting, called an emergency meeting yesterday to review the situation, but apparently decided there was little more that Washington could do.

In an hour-long meeting called by Vice President Mondale, top presidential economic and agricultural advisers heard status reports on various loan programs the

government has recently put into effect.

However, sources said later there were no new proposals on how the administration might further ease the squeeze on farmer's borrowings and none is considered likely. Officials indicated only that they would continue to monitor the situation.

Portions of Minnesota, Nebraska, North Dakota, South Dakota and northeastern Iowa are affected by the credit squeeze. In many areas, farmers cannot obtain loans for seed and fertilizer.

The crunch has occurred despite pleas from the Federal Reserve Board for banks to keep lines of credit open to other financial institutions and small businesses, even in the face of government credit-tightening.

Administration officials say the government has taken some steps that are likely to ease the situation. A week ago, President Carter signed a bill providing for \$1 billion in federal farm loans. And the United States has purchased wheat and corn from farmers.

Carter is also expected to sign a bill now before Congress that would allow farmers who missed out on earlier corn reserve programs to participate now.

Yesterday, Fed officials met with leaders of 15 national and regional farm organizations to talk over the credit drought, but they apparently reached no agreement.

Reuben Johnson, Washington lobbyist for the National Farmers Union, said later that Fed Chairman Paul A. Volcker declined to use authority in a 1969 credit

"From my vantage point, I didn't see any ray of hope or any kind of change coming out of the Fed that is going to solve our problem," Johnson said. "When Volcker [dismissed] the credit control act * * * I got up and walked out."

Farm economists say the credit squeeze stems from a variety of factors, including

high loan-to-deposit ratios in the rural banks, depressed commodity prices, and losses stemming from transportation tie-ups last autumn.

[From the New York Times, Apr. 12, 1980]

BUSINESS LOANS SOAR \$1.36 BILLION

NEW YORK BANKS RESPONSIBLE FOR MOST OF INCREASE

(By Robert A. Bennett)

Business loans soared by \$1.36 billion at the nation's large banks in the financial week that ended April 2, the Federal Reserve Bank of New York reported yesterday. Almost three-quarters of the surge took place among the 10 largest New York banks, where business borrowings rose by \$993 million.

The increase, which was the largest since the \$1.45 billion rise that occurred last

Dec. 19, runs counter to the Administration's current policy, which requires banks

to restrain the growth in their loans.

The Federal Reserve's figures also showed that banks were being increasingly squeezed by the credit-restraint program. Penalties on certain types of borrowings



by banks came into effect in the week ended Wednesday. These penalties, or "marginal reserves," quadrupled to an average \$2 billion a day from \$469 billion the previous week.

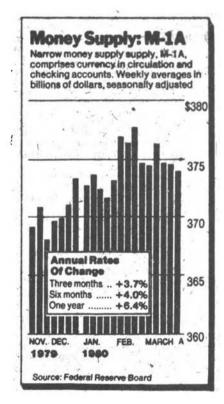
Reserves are funds that banks must keep in nonearning accounts at the Federal Reserve. The marginal reserve requirements are imposed on funds that banks "buy" from corporations and other banks.

Higher reserve requirement

As part of its latest credit-restraint program, the Federal Reserve on March 14 raised the marginal reserve requirement, the amount of reserves that must be held against any increase in their purchased funds, to 10 percent from 8 percent. The change became effective in the week ended Wednesday. Also effective that week, the Federal Reserve lowered the level of purchased funds that banks can keep free from the marginal reserve requirement."

The greater their marginal reserves, the more costly it is for banks. The Fed instituted the marginal reserves to discourage banks from obtaining money for relending.

Reserves are deposits that banks must keep in noninterest-bearing accounts at the Federal Reserve.



Bank economists were surprised by the sharp upswing in business borrowings. "I can't fully explain it," said Frederick W. Deming, senior vice president and economist of the Chemical Bank.

"One week a trend doth not necessarily make," cautioned Jay N. Woodworth, vice president and economist of the Bankers Trust Company.

Different basic assumptions

Mr. Woodworth and Mr. Deming start from different basic assumptions about business-loan trends. Mr. Woodworth believes that the rate of increase in business borrowing has been on the decline, while Mr. Deming believes that borrowing has continued relatively strong.

Mr. Woodworth stresses that during March business loans at the New York banks declined at a seasonally adjusted annual rate of 5 percent. From his perspective, the latest week's rise brought the annual rate of increase since the beginning of the year to the level that prevailed at the end of February.

Mr. Deming, however, contends that analysts must look beyond merely lending by the major New York banks and to credit extension by banks outside New York and borrowings in the commercial paper market, through which large corporations lend among themselves. On this basis, Mr. Deming says, business loan demand has been strong all along.

The latest commercial-paper figures can be used for support by either Mr. Woodworth or Mr. Deming. Total borrowings, by both financial and non-financial companies, declined by \$128 million in the week ended April 4, the Fed reported. But borrowings by business from the commercial-paper market rose by \$519 million.

To Mr. Woodworth, convinced that the recession is under way, the latest increase in borrowings from the major New York banks appears either to be a fluke or an indication that a sharp drop in sales has reduced corporate cash flows and sent

treasurers scurrying to the banks.

To Mr. Deming, the increase is viewed as a collision between ebbing inflationary forces, in which rising prices and continuing relatively strong demand for goods and services are causing some companies to increase their borrowings, and rising recessionary forces, in which declines in sales are causing other companies also to increase their borrowings.

Neither of the economists, however, says he is certain as to the cause of the surge

in business borrowings during the latest week.

[From the New York Times, Apr. 13, 1980]

CORPORATE LENDING: A TIME TO START SAYING NO.

(By Steve Lohr)

At 23 Wall Street stands a sober gray edifice, which houses an immense purse for corporate America known as The Morgan Bank. It is geared to serving institutional clients, both domestically and abroad, and first among them are the 200 largest corporations in the United States.

Peter B. Smith is a 45-year-old executive vice president of the Morgan Guaranty Trust Company of New York, the nation's fifth-largest bank. He is in charge of the bank's corporate lending in this country and these days, he says, corporate lending

is in a state of ferment.

the result of many factors. turbulence is Some of them—the internationalization of financial systems, the development of the commercial paper and Eurodollar markets, and other structural shifts-have been gathering force for years. More recently, the overriding feature of the financial markets has been the startling run-up in interest rates; the rate at which banks lend to their most creditworthy corporate customers, the so-called prime rate, reached an unprecedented 20 percent a little more than a week ago. Inevitably, the more companies pay for the money they need for current operations and new facilities, the more consumers must eventually pay for their products.

The soaring interest rates during the last 18 months, when combined with the structural changes in financial markets, have altered not only the methods but also the very character of corporate lending—the give-and-take between the bank lending officers and the top financial executives at companies. Long-standing relationships between corporations and their traditional banks have frequently been cast aside, as corporate financial managers, scrambling for the cheapest interest rates,

shopped around the globe.

The rules of the gentlemen's club gave way to the best deal the corporate treasurer could find. And the corporate executives were in command because, until recently, it had been a buyer's market for loans; funds were plentiful since 1976, even if the interest rates were high. Bank lending officers were the supplicants, knocking on the doors of executive suites trying to entice corporations to borrow or sign up for some of the banks' expanding array of advisory and other services.

But now, because of the Federal Reserve's credit-tightening program announced last month, yet another new element has been added to the fabric of corporate lending. Under the Fed's guidelines, loan growth this year must be held in a range of 6 to 9 percent. In contrast, industrial and commercial loans increased about 13 percent last year, while during the first quarter of 1980 this lending has risen an estimated 20 percent.

By restricting credit growth, the Government hopes to reduce the amount of money available to both consumers and corporations, thus slowing the economy and cutting inflation. Interest rates, too, should then eventually recede, since there is less demand for money in a slower-moving economy.

In the Fed's credit-curbing strategy, the banking system plays a key role. In a sense, it is the police force for the Government program, the mechanism through which credit growth will be controlled, especially corporate credit. As one banker put it, "We've been called into the Fed's posse."

Mr. Smith of Morgan Guaranty is one of the top deputies. His office is just off Morgan's main banking room, a cavernous expanse of wood and marble, set off in sedate browns, grays and greens. It looks, in the common phrase, like it's supposed to—as though J. Pierpont Morgan himself had designed it, which he did. Over the years, while its major rivals have pursued the consumer market with abandon, the venerable Morgan Bank has not, sticking largely to its blue-chip corporate clients.

Mr. Smith, a Yale graduate, has been with Morgan Guaranty for 22 years. He is a tall, lean man whose dark brown hair is flecked with gray. His speech is temperate

and measured.

It is somewhat premature, he says, to judge the precise extent and effects of the Fed's new program. "But clearly," he said, "we're entering a period when we're going to have to start saying 'no.' And to the extent that we have to restrict or ration credit, we will do it on the basis of our long-term relationships with corporate

clients-the ones that have been maintained.

Maintaining a relationship, in bankers' parlance, generally means that the client keeps some of its reserve funds on deposit with a bank. Corporate customers often "pay" a bank by placing money in such noninterest-bearing accounts. The bank, in turn, makes money be investing these deposits elsewhere. A corporation may use such an arrangement to pay for specific loan commitments or services. But it is also sort of mutually understood that this financial tie goes along with such hard-tomeasure benefits as being able to call a bank's chief economist at any time for advice, and other such amenities.

With credit tightening, these friendly relations are starting to look quite valuable indeed. As Mr. Smith noted, "We will become arbiters of who gets money and who

doesn't."

Concerned that borrowed funds will soon become scare, many corporations are rushing to change their "lines" of credit with banks to "committed facilities. Simply put, a line is an agreement between a bank and a corporation that if the company needs a certain amount of money, the bank will be ready with a loan.

A commitment is a legal obligation by the bank to lend money to the company, if asked. And corporations pay more for a commitment, usually about one-half of 1

percent of the sum committed.

In St. Louis, the Ralston Purina Company two weeks ago arranged a sizable committed facility with a group of 10 banks, according to Kenneth N. Kermes, senior vice president and chief financial officer. Morgan Guaranty is one of Ralston Purina's three main banks, along with the Bank of America and the Continental Illinois National Bank and Trust Company of Chicago.

These arrangements are seen primarily as precautionary measures by the corporations, who want to be sure that they are not squeezed out of the borrowing markets altogether by the Fed's controls. Some analysts have expressed concern that if a substantial portion of commitments outstanding were demanded, it might play havoc with the Fed's loan-growth guidelines. And if the commitments were not honored by the banks, that could prompt a rash of law suits from the corporations seeking funds. However, traditionally less than half of these commitments are used.

The commitments may well not be used simply because the Government's program is expected to slow the economy, thus diminishing the corporate need for funds. "What you have now is a lot of people like me trying to lessen the demand on Morgan and the other banks," said Mr. Kermes.

Partly because of the anticipated recession and partly because of the continuing rise in interest rates, Ralston Purina is trimming its capital budget. This year, according to Mr. Kermes, the big corporation, whose lines include animal feeds, pet foods and restaurants, plans to spend about \$215 million. "Just three months ago," he said, "we were talking about \$240 million to \$250 million."

These cuts will result from reducing maintenance and upgrading programs on facilities and equipment throughout the company. "What we lose is some of the

ability to make productivity gains," said Mr. Kermes.

Mr. Smith of Morgan was asked about the long-term effect of the continuing high rates of interest. "I think we're now getting to the point where these rates are going to bite, and some projects will be put off," he said. "But for the most part, I think companies will go ahead with their plans and the higher interest rates will simply

be built into the price of their products.'

"Paying a high prime rate for a year or two is not going to kill a project for us," said Will M. Storey, executive vice president and chief financial offier of the Boise Cascade Corporation, a producer of forest products.

This is a familiar refrain among executives of companies in capital-intensive industries, as is Boise Cascade. Many of their projects have payback schedules of 20 years or more, so a year or two of extraordinarily high rates is not a grave concern

Typically, these companies fund big projects by issuing long-term bonds, which carry maturities of up to 30 years. With interest rates so high, many corporate issuers are shunning the bond market to avoid having to pay high interest for decades.

Instead, they arrange short-term loans, hoping to move into long-term bonds when rates decline. This, too, adds to loan demand at banks, as they try to accom-

modate the corporate dropouts from the bond market.

"The real question for us," said Mr. Storey, "is when things settle down, what will

the long-term rate by?"

Still, he admits that because of the higher inflation and interest rates, Boise Cascade recently raised by "a percentage point or two" its so-called hurdle rates the anticipated rate of return needed to justify a new project.

Like Ralston, Boise has Morgan Guaranty as one of its three leading banks. It, too, recently decided to expand its total of committed bank credit lines to "some-

what more than \$400 million."

"The banks," he said, "certainly weren't beating on our doors telling us to borrow more money, but they also told us not to worry. But for companies who have not been paying commitment fees all along it may be another story. They may be in for a rude awakening when they go to their banks."

(From the Washington Star. Mar. 19, 1980)

MOST FIRMS MOVING AHEAD WITH SPENDING PROGRAMS

Businessmen, like consumers, are proving hard to rein in.

With banks charging their best corporate borrowers 19 percent, the bond market in disarray and a recession widely forecast, corporations might be expected to slash purchases of equipment and to defer plans to build factories, offices and warehouses. Some are. But most are continuing a fairly ambitious capital expenditure program for 1980—and their plans aren't likely to be changed much by President Carter's new anti-inflation program. Some evidence from people in a position to observe the action:

Frank T. Cary, chief executive officer of International Business Machines Corp., says, "I don't know of any other time in the history of IBM when . . . demand for our products has been greater.'

Machine-tool executives say orders are booming.

General Electric Co's big Industrial Products Group "hasn't seen any customers deferring programs or canceling orders because of the interest rate and bond-market

situation," a spokesman says.

Plant construction "prospects are extremely encouraging" says Charles A. Shirk, president of Austin Co., an international engineering and construction concern. "Some of the smaller outfits aren't proceeding with some of their projects," he adds, but he says big companies, which do most of the nation's capital spending, are going right ahead.

And despite the new Carter program, Mead Corp. "will stick with our (capital-spending) plan for the near term," says James W. McSwiney, chairman and chief executive officer of the forest-products company. "If we're wrong, we'll have a corrective period. We'll eat bread and water for 12 months."

The random comments are backed up by the Commerce Department's recent

statistics. The agency reported that U.S. companies plan to spend \$196.78 billion for plant and equipment this year, up 11 percent from the 1979 total. A department survey conducted in January and February showed manufacturers planned a 14 percent rise in 1980 outlays and non-manufacturing concerns an 8.6 percent increase. Similarly, a Conference Board survey of the 1,000 largest manufacturing companies projected a 13 percent rise in spending this year. The business-research organizations says capital appropriations for future projects rose 8.5 percent in the 1979 fourth quarter from the third period.

Discounted for inflation, however, these spending plans look much less ebullient: "Real" additions to plant and equipment this year would edge up a slim 1 or 2 percent, following a 5 percent increase last year. So the 1980 projections hardly

presage an investment boom.

In any event, capital spending this year seems to be stronger than might have been expected last fall, when a recession generally was believed to be imminent, or now, amid lowering interest rates. However the absence of any sudden cutback may be explained partly by the relatively modest increases in such spending in recent years. In addition, changes in capital spending totals normally lag behind changes in overall economic activity. Investment programs often require months of planning and then years of construction work; and once projects are embarked upon, companies are highly reluctant to abandon them half-finished.

Thus the 1980 projections don't prove that high interest rates and economic uncertainty aren't affecting capital spending. They undoubtedly are—but much of

the effect won't be felt until late this year or in 1981.

Moreover, high interest rates don't affect all companies equally. Many small concerns are delaying projects ranging from buying factory equipment to building restaurants. Electric utilities are announcing deferrals or cancellations of new generating plants with alarming regularity—a harbinger, perhaps, of power shortages after 1985. Railroads are slowing freightcar ordering. And companies ranging from American Greetings Inc., a card and gift concern, to Lamsom & Sessions Co., which makes such basic items as nuts and bolts and railroad-car parts are deferring some minor outlays to reduce borrowing.

Also, some builders of shopping centers, apartment houses and other commercial structures say they won't start new projects now. "You can't go ahead with a new shopping center if you have to finance it at 16 percent or 17 percent interest rates," says Samuel H. Miller, vice chairman and treasurer of Forest City Enterprises, a Cleveland real-estate developer and builder. "That's a one-way road to the poor-

house."

On the other hand, many big companies say they don't expect to cut back at all. Some have already accumulated the cash for 1980 programs, and lendable funds, although very costly, are still readily available. Most companies are reluctant to let what they regard as a short-term surge in interest rates interrupt their long-term plans. And—probably most important—concern about worsening inflation began

late last year to override concern about a possible recession.

The damn-the-torpedoes approach is illustrated by American Telephone & Telegraph Co. The Bell Systems has budgeted 1980 capital spending at about \$16.7 billion, up 5.7 percent from 1979. That figure, "has been scrubbed to the bare bones already," a spokesman says, adding that any reductions would impair future service. And H.S. Cody Jr., assistant treasurer, says that "we haven't set a limit" on the interest rates that Bell will pay. "We believe our customers expect us to pay whatever the market requires to provide them with good service."

At many companies, two possible development could alter the present investment

philosophy.

One would be a credit crunch so severe that companies wouldn't get money at any interest cost. To ward off that danger, some companies are resorting to borrowing in advance of needs and, fearing a federal program of credit controls, more companies have been firming up credit lines with banks.

The other development would be a severe recession which would slash companies' cash flow and change their expectations about the need for added capacity. Already, electric utilities and tire makers are in such a slump and are curtailing spending.

In fact, high interest rates are more likely to curtail capital spending by slowing

the economy than by directly discouraging borrowing.

Still another reason soaring interest rates haven't snuffed out more expansion programs is that many companies believe the high cost of money is only a temporary problem. They hope to refinance their loans later at lower interest rates. Besides, most are borrowing only a small part of their total outlays, and many average out money costs rather than measure each project against the highest loan rate that they pay.

Senator Culver. I have met numerous times during the past several months with bankers, small business people and farmers from my State. In Iowa, talk of recession has given way to real fears of depression, bank failures and farm foreclosures; and those fears are mounting with each passing day.

Many of the banks in the upper Midwest long ago ran out of loanable funds. Some of the best farmers in my State tell me they cannot afford to restock their cattle feeding operations as long as interest rates are above 20 percent. The Nation's cattle herd is already at its lowest level in a decade, yet Iowa cattlemen are now sending to slaughter cows that were 6 to 8 months pregnant.

And it is not agriculture alone that is suffering. Home building, as you know full well, and construction in Iowa, as across the Nation, have slowed dramatically. In some areas building has completely ground to a halt and many small builders face liquidation.

Young farmers, many of whom have been struggling to get themselves established, have found all their hard work is for naught. Caught in a squeeze between soaring costs and declining prices, this year's monetary actions dealt many of them a death blow.

I met twice last month with the Chairman of the Federal Reserve Board, Mr. Volcker. On one occasion, the meeting was attended by representatives from the Northwest Iowa Farm Business Coalition, who explained in painful detail what the Board's actions were doing to Iowa's farmers and business people. Mr. Volcker's response was that everyone was going to have to tighten his belt, an assertion that, in principle, is fine, but it does not coincide with the painful reality in Iowa where credit was tight even before the latest moves of the Federal Reserve Board.

And I noted in the morning paper where the largest banks in the Nation are now showing record profits and it looks like while everybody has got to take in their belt, some just buy a bigger belt and put it in the first notch.

The impact is not distributed with any semblance of equity or sound economics. Last week the New York Times reported that loans to businesses during the week ending April 2 were up dramatically. Almost three-quarters of the increase was accounted for by the 10 largest New York banks.

I feel confident that few of those loans went to farmers or small businesses in Iowa or anywhere else. If the large corporations are doing any belt tightening, it is certainly not apparent. What is clear is that the Federal Reserve's policies represent a noose around the necks of many of America's farmers and small businesses.

The Fortune 500 are borrowing at record rates and Iowa farmers

cannot get money to put their crops in the ground.

The needs and potential contributions of a vast army of workers, businessmen and farmers are being choked off by policies that presume to fight inflation, while undermining the productivity and jeopardizing the very survival of the most efficient, the most productive sectors of the economy.

It is not my intention today, Mr. Chairman, to present specific recommendations for monetary policy changes. I have already communicated to Chairman Volcker some of my thoughts on this subject and doubtless will have additional recommendations along that line in the future.

My purpose here is to present to this committee the desperate need for a new perspective which I feel should and indeed must be incorporated into the monetary policy deliberations of the Federal Reserve Board. The best way I know to accomplish that objective is to place on the Board someone who possesses that perspective, someone who understands and shares the high priority that farmers and small

business enterprizes have earned.

Lyle Gramley does not possess that perspective. I understand that yesterday, Mr. Chairman, Mr. Gramley provided the committee with an extensive biographical sketch of his agricultural experience. When the chairman posed this question to Mr. Gramley at his confirmation hearing for his present position in 1977, however, he responded, I think more candidly and I think perhaps more to the point. "I don't pretend to know much about the agricultural sector of our economy, and I would be leaning on the experts on the staff," said Mr. Gramley on the occasion of his confirmation hearing in response to a question from you, Mr. Chairman.

Mr. Gramley also mentioned his role in Federal Reserve surveys of small business credit needs during 1955, 1957, and again in 1959. During this period he was a financial economist at the Federal Reserve Bank of Kansas City and participated in these surveys. Apparently the 1959 survey was the last such study conducted and

is long out of date.

Following a brief excursion into academia from 1962 through 1964, Mr. Gramley returned to the Federal Reserve Board, this time to the staff of the Board of Governors. From 1969 to 1977, he successively held the positions of Associate Director, Deputy Director, and Director of the Board of Governors Division of Research and Statistics in that bureaucracy.

To my knowledge, during that period no survey of small business credit comparable to the 1959 survey was conducted under his

direction.

I would urge this committee to review the record of Mr. Gramley's testimony on October 23, 1979 before the Senate Small Business Committee. Senator Stewart, who of course is here today, chaired that October hearing. My reading of that record, in which several members of the Small Business Committee repeatedly questioned Mr. Gramley concerning the specific impact on small businesses of then current fiscal and monetary policies reveals no indication—reveals no indication of an understanding of or sensitivity to the possibility that the impact on small business might be different from that on large businesses.

To small business, that difference, Mr. Chairman, frequently is

the difference between life and death.

I agree with the chairman of this committee that a candidate for a seat on the Federal Reserve Board should possess extensive knowledge and experience in general economic and monetary policy. I am convinced that in a Nation of 220 million people they all don't come out of the Ivy League. They all don't come out of New York banks and large corporate board rooms or out of the bureaucracy of the Federal Government. I am convinced that a candidate can be found that possesses these qualities, yet also has a more intimate understanding of the impact of monetary policy on small businesses and farmers, which as I have pointed out constitutes over half of the national economy.

Mr. Chairman, the views I have presented to the committee are not mine alone. I would also like to submit for the record commu-

nications I have received from numerous organizations and associations endorsing this effort to broaden the makeup of the Federal Reserve Board.

The CHAIRMAN. We would be happy to incorporate those in the record.

[The information follows:]



National Association of Home Builders

15th and M Streets, N.W., Washington, D.C. 20005 Telex 89-2600 (202) 452-0400

Merrili Butler 1980 President

April 14, 1980

The Honorable William Proxmire Chairman Senate Committee on Banking Housing and Urban Affairs 5300 Dirksen Senate Office Building Washington, D.C. 20510

Dear Mr. Chairman:

On behalf of the more than 121,000 members of the National Association of Home Builders, I am writing to express our views concerning the nomination of Lyle Gramley as a member of the Federal Reserve Board.

It is with some reluctance that we urge that this Committee not recommend the confirmation of a nominee for any major Federal position, but we feel strongly that we have no other choice regarding the filling of this Vacancy on the Federal Reserve Board at this time.

As this Committee is well aware, the housing industry is in a state of crisis. And the almost exclusive use of the "tight money" policies of the Federal Reserve Board in an effort to combat inflation has resulted in a precipitous decline in housing starts and sales with its attendant loss of jobs and revenue to the Treasury. Traditionally, housing has been "at the end of the whip" of the FED's policies.

We believe that a nominee for the Federal Reserve Board should be keenly aware of the impact of high interest rates on the housing industry and on potential homebuyers as well as on small businesses and consumers in general. We do not find that Mr. Gramley has recognized the extent of the crisis in housing or the devastating impact of the high interest rate policy. This is not intended as any personal or professional critism of Mr. Gramley. We are certain that he is extremely competent in the area of monetary policy.

We would urge that this nomination be rejected and that serious consideration be given by the President to the nomination of a small businessman for this important position. Someone who has been "at the end of the whip" of the FED's policies could help bring a fresh and needed perspective to the deliberations of the Federal Reserve Board.

"Where Will Our Children Live?"

The National Association of Home Builders shares the concerns to be expressed by Senator John Culver in his testimony before the Committee regarding the nomination of Mr. Gramley.

We appreciate the opportunity to present our views and respectfully request that this letter be made a part of the Committee's hearing record.

Merrill Butter

Merrill Butler President - c o , d 2

NATIONAL LUMBER AND BUILDING



MATERIAL DEALERS ASSOCIATION

March 27, 1980

Honorable John Culver United States Senate Washington, D.C. 20510

Dear Senator Culver:

The National Lumber and Building Material Dealers Association, representing 15,000 small retail businesses throughout the Nation, on March 7, 1980, endorsed with our full support your letter of March 6, 1980, to President Carter proposing a small businessperson or a farmer for the vacancy on the Federal Reserve Board of Governors. The NLBMDA recorded our support of your proposal to President Carter and requested his consideration of a small business/farm appointment by mailgram on March 7, 1980.

Accordingly, it is our understanding that the President has placed the name of Lyle Gramley for the FRB Board of Governors position. We do not feel that this nomination meets with the intent and tone of your proposal. The NLBMDA does not want to record any personal bias towards Mr. Gramley, and while we recognize that he may be a monetary policy expert, we feel he lacks a certain sensitivity to the problems of supply economics and small business. Another concern about his confirmation involves his response to a question at a White House briefing on the President's Economic Policy which indicated that he does not understand the severity of the housing crisis. He summarily dismissed the subject with a remark that he did not feel things were as bad as he was being told.

The National Lumber and Building Material Dealers Association reaffirms our support of your position on the Board of Governors of the Federal Reserve and urge you to express our position during the confirmation hearings before the Senate Committee on Banking, Housing & Urban Affairs.

incerely yours,

JOHN M. MARTIN Executive Vice President

JMM/jh

1990 M Street, N.W., Suite 350

Washington, D. C. 20036

(202) 872-8860



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FARMERS ORGANIZATION

MATIONAL HEADQUARTERS - CORNENS, IONA 9881 - \$12,322,312 Weekington Office Suite 220 — 475 L'Extent Piece S.W. WASHINGTON, D.C. 20024 OPPICERS

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Stateland, Stateland
Stateland, Stateland

April 14, 1980

The Hon. John Culver United States Senate Washington, D. C. 20510

Dear Senator Culver:

We appreciate your concern regarding the current high interest rates and lack of adequate credit for farmers, ranchers and small businessmen in rural communities. Consequently, we support your efforts to secure appointment of a member of the Federal Reserve Board who possesses real experience in rural banking and a commitment toward adequate credit policies for rural producers.

With best regards,

Sincerely

Director, Washington Office

Collective Bargaining FOR AGRICULTURE THROUGH NFO | LEGAL PROPERTY



Office of the President

April 10, 1980

The Honorable John C. Culver United States Senate 344 Russell Senate Office Bldg. Washington, D.C. 20510

Dear Senator Culver:

National Farmers Union is pleased to join you in calling on the President of the United States to appoint to the Federal Reserve Board of Governors an individual who is knowledgable of the financial requirements of agriculture and small business.

The delegates to the most recent National Farmers Union convention meeting in Denver, Colorado, March 2-6, 1980 adopted the following statement relative to the Federal Reserve Board:

"The Federal Reserve Board should be compelled to conform its policies to the goals of the 'Full Employment and Balanced Growth Act of 1978'. The Federal Reserve statutes should be amended to require representation on the Board of agriculture, small business and labor."

I am attaching for your information excerpts from the 1980 policy statement of the National Farmers Union dealing with Economic Policy.

The Nation's farming and small business sector are facing economic catastrophe. We believe it imperative that a member be appointed to the Board of Governors that can represent those interests that have been so long denied a voice in setting our national monetary policy.

Sincerely

Lary W Stone
George W. Stone

GWS:qp

Attachment



12025 East 45th Avenue • Denver, Colorado 80251 • Phone (303) 371-1760 600 Continental Bldg. • 1012 - 14th Street, N. W. • Washington, D. C. 20005 • Phone (202) 628-9774



515-233-3270

April 9, 1980

The Honorable John Culver 344 Russell Senate Office Building Washington, D.C. 20510

Dear Senator Culver:

The Iowa Cattlemen's Association would urge the U.S. Senate not to ratify the appointment of Mr. Gramley to the Federal Reserve Board. We feel that someone from outside the system with an understanding of the financial needs of agriculture and small businesses is needed. Mr. Gramley does not have the background to provide us with this much needed approach to the monetary matters of this nation.

The current policies of the Federal Reserve Board are devastating to cattle producers and farmers in general. Increased production costs, primarily from increased interest costs, at the same time that American consumers are concerned about the economy and have cut back on their beef purchases have put producers in a precarious situation. We are already seeing production cutbacks and continuation of existing policies will be even more counterproductive.

Your assistance in this matter will be greatly appreciated.

Sincerely,

Rob anderson

Robert G. Anderson, President

RGA/bsc

HOWA CATTLEMEN'S ASSOCIATION



The National Small Business Association Building 1604 K Street, N.W. Washington, D.C. 20006 Telephone (202) 296-7400

April 11, 1980

The Honorable John C. Culver United States Senate 344 Russell Senate Office Building Washington, D.C. 20510

Dear Senator Culver:

The Small Business Legislative Council applauds your announcement concerning the need for small business representation on the Board of Governors of the Federal Reserve System.

Current trends in our economy necessitate representation at the topmost levels on all national economic policy boards and agencies of the federal government. We will be working toward this goal and we support the efforts of those who share the same belief.

The lives and future economic status of 14 million small businesses and their 59 million employees are dependent upon the decisions of these governmental bodies. This is too great a segment of our society to be ignored, especially since small business suffers disproportionately from downturn in our economy.

Recent reports of "jawboning" for small business credit needs, attributed to the chairman of the Federal Reserve Board, indicate an awareness of small business credit problems, but such "jawboning" is simply not enough. It is obvious that we need more than a mere "awareness" among the Governors of the Federal Reserve System. Small business needs action.

Senator Culver, to the extent that your remarks today and your efforts in the Senate next week are aimed at getting the President to nominate, and the Senate to confirm, a qualified individual to represent small business interests, to fill the vacancy on the Board of Governors of the Federal Reserve System, your effort has the support of the Small Business Legislative Council, whose 76 member associations, with their affiliates, represent more than four million small businesses.

Sincerely, Hutat Sukmen Herbert Liebenson

Executive [

Attachment: SBLC Membership List

*Of the National Small Business Association



The National Small Business Association Building 1604 K Street, N W Washington, D C 20006 Telephone (202) 296-7400

MEMBERS OF THE SMALL BUSINESS LEGISLATIVE COUNCIL

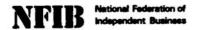
American Association of Nurserymen American Metal Stamping Association American Textile Machinery Association American Trucking Associations, Inc. Association of Diesel Specialists Association of Independent Corrugated Converters Association of Physical Fitness Centers Association of Steel Distributors, Inc. Automotive Affiliated Representatives, Inc. Automotive Warehouse Distributors Association, Inc. Building Service Contractors Association International Business Advertising Council Christian Booksellers Association Direct Selling Association Eastern Manufacturers and Importers Exhibit, Inc. Electronic Representatives Association Forging Industry Association Furniture Rental Association of America Independent Bakers Association Independent Business Association of Michigan Independent Business Association of Washington Independent Sewing Machine Dealers of America, Inc. Institute of Certified Business Counselors International Franchise Association Local and Short Haul Carriers National Conference Machinery Dealers National Association Manufacturers Agents National Association Marking Device Association Menswear Retailers of America Minnesota Association of Commerce and Industry Small Business Council Narrow Fabrics Institute, Inc.
National Association for Child Development & Education National Association of Brick Distributors National Association of Catalog Showroom Merchandisers National Association of Floor Covering Distributors National Association of Home Builders National Association of Plastic Fabricators

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*Of the National final Business Assituation

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National Association of Plastics Distributors, Inc. National Association of Plumbing-Heating-Cooling Contractors National Association of Realtors® National Association of Retail Druggists National Association of Trade and Technical Schools National Beer Wholesalers' Association of America, Inc. National Building Material Distributors Association National Burglar & Fire Alarm Association National Candy Wholesalers Association, Inc. National Coffee Service Association National Concrete Masonry Association National Electrical Contractors Association, Inc. National Family Business Council National Fastener Distributors Association National Home Furnishings Association National Home Improvement Council National Independent Dairies Association National Insulation Contractors Association National Meat Association National Office Machine Dealers Association, Inc. National Office Products Association National Paper Box Association National Paper Trade Association, Inc. National Parking Association National Patent Council, Inc. National Pest Control Association National Precast Concrete Association National Shoe Retailers Association National Small Business Association National Society of Public Accountants National Tire Dealers & Retreaders Association, Inc. National Tooling and Machining Association National Tour Brokers Association National Wine Distributors Association Power and Communication Contractors Association Printing Industries of America, Inc.
Sheet Metal & Air Conditioning Contractors' National Association The Roller Skating Rink Operators Association Web Sling Association, Inc. Wine & Spirits Wholesalers of America



April 14, 1980

Mr. Stuart E. Eizenstat Assistant to the President for Domestic Affairs and Policy The White House Washington, D. C. 20500

Dear Stu:

NFIB, on behalf of its 600,000 small and independent business members, urges you to nominate to the Federal Reserve Board a person with a clear understanding of the situation that small business occupies in our national economy. The Federal Reserve Board's responsibilities over credit and monetary matters have a direct impact on small business. As an aggregate, small business occupies an extraordinarily important role in the national economy. But as individual participants in that system, small businesses are usually the first to feel economic pressures and the least able to respond to those pressures.

Small business' confidence in the ability of the Federal Reserve to chart practical and effective economic policy would be enhanced by the appointment of a Federal Reserve Governor with an understanding of small business. Business and financial experts frequently have practical experience with large corporate, academic or financial institutions. While the perspectives from such vantage points are not necessarily contrary to the perspectives of smaller business, NFIB strongly feels the Federal Reserve Board would benefit by additional exposure to small business considerations. Appointment of a Board Governor qualified by knowledge or experience with small business will achieve more informed and effective Federal Reserve Board policies.

Thank you for considering the views of small business. With best wishes.

James D. Mike" McKevitt Director of Federal Legislation

JDM:scw

Federal Legislative Office 490 L'Enfant Plaza East, S.W. Suite 3206, Washington, D.C. 20024 Telephone (202) 554-9000 "Home Office. San Mateo, California

ARTICLE VI 1 ECONOMIC POLICY AND THE FAMILY FARM 2 3 A. National Economic Policy 4 Farmers cannot isolate themselves from what is happening in the 5 rest of the national economy. The demand for our farm products is 6 severely reduced by economic stagnation and high unemployment. The 7 costs which farmers must pay to produce and live are imflamed by energy prices, inflation, and low productivity in industry. 8 The severe depression in our agricultural economy is a special 9 problem requiring urgent attention to avert a worldwide food crisis 10 as dangerous to world stability as the energy crisis. Current prices 11 received by American farmers are the lowest of any country in the 12 world, and the lowest in purchasing power of any time in history 13 except the years 1931 and 1932. Positive measures to raise farm 14 prices into balance with returns in other sectors on labor, invest-15 ment, management, and risk must be initiated at once. 16 Our government must take vigorous steps to reach full employment, 17 to dampen inflation rates, and to encourage higher productivity. 18 This is basic to the attainment of a balanced federal budget, the 19 strengthening of the dollar, and to a healthy national economic 20 21 recovery. Because current monetary and fiscal policies are neither curb-22 ing inflation nor spurring sufficient employment growth, better 23 strategies must be developed and implemented. Tough decisions and 24 hard choices must be made. We recommend a brief freeze on prices, 25

1	wages, interest, and profits, with provision for adjustments to
2	enable farmers and others whose returns are currently below those
3	prevailing generally in the economy to "catch up", followed by
4	selective price and wage controls where needed.
5	The provisions of the Federal Reserve Act of 1913 are the root
6	cause of the inflation, both in our national economy and in inter-
7	national influence such as the escalating oil, silver, and gold
8	prices.
9	We, therefore, call upon Farmers Union leadership to become
LO	informed as to the provisions of the Federal Reserve Act and the
11	workings of the Federal Reserve System, the Federal Reserve Board,
12	and the Open Market Committee, with the intent to offer leadership
13	to Congress to lead the way out of our economic dilemma.
14	
1.5	B. Farmers and Inflation
16	Farming costs are currently 14 percent above a year ago and
17	43 percent above the level just three years ago. Obviously, high
18	costs and inflation are reducing total United States net farm incom
19	by several billion dollars a year.
20	Inflation has a particularly pumishing effect upon farmers.
21	Although it may add somewhat to the level of prices received by
22	farmers, it has a more pronounced effect on the cost side and, with
23	prices a third below parity, it is not possible for farmers to
24	pass on the burden to others in the economy.

Farmers, therefore, have perhaps a greater stake than most

25

others in the economy in success in reducing inflationary pressure to manageable levels.

3

- 4 C. Money and Credit Policy
- 5 Farmers are drastically injured by the current high interest
- 6 rates being employed, without success, to dampen inflation.
- 7 As of January 1, 1980, farmers had outstanding debts of \$157
- 8 billion and it is predicted that debt will grow by \$25 billion dur-
- 9 ing the year.
- 10 Interest outlays by farmers, which were \$11.9 billion in 1979,
- 11 are expected to reach \$14 billion in 1980. This would be a doubling
- in four years and a ten-fold increase since 1960.
- 13 At the same time, interest payments on the federal debt in fis-
- 14 cal year 1981 are now projected at \$80 billion, a major cause of the
- 15 difficulty in balancing the federal budget.
- 16 A better remedy is available in the form of the emergency powers
- 17 conferred on the President by the Emergency Credit Control Act of
- 18 1969, under which the President may limit credit use, may prescribe
- 19 interest rates and credit terms and, if needed, allocate credit to
- 20 productive uses. Severe as such actions would be, they are prefer-
- 21 able to continuing the present totally ineffective policies.
- The Federal Reserve Banking Board should be compelled to conform
- 23 its policies to the goals of the "Full Employment and Balanced Growth
- 24 Act of 1978". The Federal Reserve statutes should be amended to
- 25 require representation on the Board of Agriculture, small business, and labor.

[Mailgram]

APRIL 15.

Hon. JOHN CULVER, Russell Senate Office Building, U.S. Senate, Washington, D.C.

Regarding nominee for Board of Governors of the Federal Reserve System. National Cattlemen's Association urges nomination of person who has working knowledge of agriculture and small business and is conversant with credit needs of these segments of economy.

B. H. (BILL) JONES, Vice President.

[Mailgram]

NATIONAL LUMBER AND BUILDING MATERIAL DEALERS ASSOCIATION, Washington, D.C., March 7.

President CARTER,

White House, Washington, D.C.:

This mailgram is a confirmation copy of the following message: National Lumber and Building Material Dealers Association, representing 15,000 small retail businesses throughout nation, endorses and supports Senator John Culver's letter of March 6, 1980, to you proposing small businessman or farmer for vacancy on Federal Reserve Board of Governors, your consideration appreciated.

JOSEPH W. HOBSON, Staff Vice President.

[Mailgram]

IOWA CATTLEMEN'S ASSOCIATION.

President JIMMY CARTER, White House, Washington, D.C.:

The Iowa Cattlemen's Association strongly supports Iowa Senator John Culver's recommendation that a person knowledgeable of the credit needs of farmers and small businessmen be appointed to the Federal Reserve Board. The availability and cost of working capital is having a depressing effect on agricultural production today.

ROBERT G. ANDERSON, President.

Senator Culver. These organizations include the National Farmers Union; the National Farmers Organization; the Iowa Cattlemen's Association; the Small Business Legislative Council, a consortium of 76 associations representing more than 4 million small businesses; the National Federation of Independent Business; the National Lumber and Building Materials Dealers Association; the National Association of Home Builders; and the National Cattlemen's Association; and I respectfully ask the members of this committee to listen to the voices of these organizations in the immediate weeks ahead.

Their members for too long have been the silent victims of policies designed by and for the corporate board rooms of America.

Thank you very much, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Culver. I very, very much welcome this kind of challenge. We don't have enough of it. We automatically approve nominations in this body and I think it's a mistake. We have the authority to advise and consent and we rarely use that authority as we should. You and I and Senator Garn and Senator Stewart have opposed nominations in the past, but it's rare that we have a Senator come and actually appear and challenge a nominee and do it on the basis of very, very careful research which you obviously have done. You know a lot about Mr. Gramley. I dare say you know more about him than members of



this committee knew although he appeared before us, as you say, for the Council of Economic Advisers and we went into some detail on that.

So I think this is a very healthy challenge on your part and I welcome it.

I think we ought to, however, put Mr. Gramley's nomination into perspective and I'm delighted to see a Harvard man tell a Yale man who's chairman of this committee that the Ivy League has too much representation.

There are all kinds of ways we can criticize the Senate and the Federal Reserve Board and others. My own view, however, is that what we need on the Federal Reserve Board is, above all, somebody

who understands monetary policy. That's what their job is.

I think you can make the argument that we ought to have farmers on the Board. We ought to have businessmen on the Board. In fact, you can go to the legislation and you can establish that we need that, and you say very wisely that we need somebody who has both. But it seems to me that's hard to find.

Isn't it true that with all the limitations that Mr. Gramley has, he's had at least some farm experience? He worked on a farm in a

limited way, but he's worked on a farm.

Senator Culver. Mr. Chairman, you yourself asked him the question on the occasion of his 1977 confirmation hearing. I read that with considerable interest, but you specifically asked him what—in obviously searching for this kind of representation and broad background—

The CHAIRMAN. You're right. You quoted accurately, and he did

admit as you say---

Senator CULVER. I think that's a far more honest and candid acknowledgement. He knew in anticipation of my appearance here today—I'll just read it. I think it's very useful. "The Chairman. How about in the farm area?"—in terms of searching his background—"How about in the farm area?" "Mr. Gramley. Again, I'm not an agricultural economist. I don't pretend to know much about the agricultural sector of our economy." There isn't a better witness than he is on his own qualifications, and "I would be leaning on the experts on the staff just as I have leaned on the staff of the Federal Reserve Board."

Now he came in here yesterday and he said he would have been brought up on a farm but they went broke so he missed that opportunity. Well, unfortunately, a lot of them are experiencing that opportunity today in my State.

The second thing is he had a relative that he thought still had farms, one of them even in Iowa, which was a convenient recollec-

tion. And the other thing he said is he could milk a cow.

Well, with all due respect, Mr. Chairman, I think that hardly qualifies for bringing to bear on the policies of the Federal Reserve Board any standing to speak to agricultural and small business economic matters.

I must say, Mr. Chairman, I wasn't looking for cheap demagogic points when I said we've got a Board here—and you know it yourself—you have seen what Chairman Reuss has done in the House—this is the most incestuous historical background and record imaginable. It's the height of elitism to say that out of a

Nation of 225 million, the only way you know anything about the Federal Reserve Board is to be born and bred in the high priest-hood of the Federal Reserve Board itself. As I said, if it's any more incestuous, they are all going to have a single eye in their fore-head—the consequences of that inbreeding will be policies which have no real application and have dangerous consequences to the

people that are really out there making it go around.

The Chairman. Now, Senator Culver, I'm simply saying that he is a man who has worked on a farm. As you say, he's not an agricultural economist, but he's worked on a farm. He did have an experience that I think would be very valuable to him of having his father go broke on a farm and he has some experience with what that is. It means something. It would be better than if he had never worked on a farm or never had come from a farm background.

Furthermore, he did make a study—and you said it is dated—it was finished in 1959 and it's more than 20 years old, but it's still the definitive study of the credit needs of small business. It's about time we had another one, but that was a study which is highly respected and indicates that as a monetary expert, a man with good training, a man who has worked in the Federal Reserve for years, that he had the responsibility of studying small business.

Senator Stewart. Would the Chairman yield? The Chairman. I will yield in just a minute.

Furthermore, he was the author of what is the most comprehensive study of housing. I argued with him on housing. I didn't like his housing policy. I disagreed with the gentleman that he succeeds on the Federal Reserve Board because I didn't like his monetary policy. But I cannot argue with a man who's appointed to a position for which he's qualified, even though I disagree with his ideology and disagree with his position. He understands housing. He has a different view, but he studied it thoroughly and came up with what is one of the most comprehensive studies the Federal Reserve Board has ever made of housing.

So in the small business area and in the housing area, both of which are tremendously affected, as we all know, right now by monetary policy, he's a man who's established a strong back-

ground.

If you went through my questioning of Mr. Gramley before you could also tell I was very critical of him as an appointee to the Council of Economic Advisers. Frankly, he had been under the tutelage and jurisdiction of Dr. Arthur Burns, a man for whom I have the greatest respect but with whom I disagree very strongly with respect to monetary policy; but I think he's also a man who is qualified for this particular job.

And you make a very strong case against the Federal Reserve Board. I disagree with it, but it's a strong case. If you look at the members of the Board, however, of all the members, this man probably has more background, limited as you think it is in the small business area and particularly in the housing area, of any

member of the Board.

So for those reasons, I would hope that we don't take the position that a man may be qualified but he's not been an agricultural economist. He may be qualified, but he hasn't actually operated a small business and therefore he shouldn't be appointed to the Federal Reserve Board.

Senator Culver. Well, Mr. Chairman, my only point would be when we speak of qualifications, is that's exactly what I'm trying to address here today—the qualification which, in my judgment, are so desperately lacking on the present board and in the board's history, and as a consequence the formulation of policy that is not properly sensitive to the distinctions that are so critically important in the nature of this economy. The fact that this one individual can lay some tenuous claim to some relative competence which relatively might be more than some others on the Board, in my judgment, is just a tragic and woeful reinforcement of my point.

I emphasized at the outset this is in no way addressed the personal character of the nominee or the qualifications in a highly technical sense, given the traditional background of this nominee. What I'm saying is that the present policies of this administration are economic disasters and I'm totally convinced that, after numerous efforts and repeated urgings on this administration in 1978 and again now, this is the only way to get representation on the Board that is more compatible and congenial with the real needs of the people I represent—which happen to be right across the river from people, with all due respect, which you represent—and that is more responsive to their concerns because these policies are bringing about economic recession and depression and I think unnecessarily so.

When we speak of qualifications, I must say, with all due respect, I don't see why those qualifications should be limited to somebody who spent a lifetime in the bureaucracy of the Federal Reserve Board itself or who compounds the traditional skewing of the representative character which I understand from the legislative history of the Board is supposed to exist.

So, I think when we speak of qualifications, that's exactly what we're addressing here, is qualifications to do the job. And whether or not we are going to use this opportunity to broaden and make more reflective of the economy of this country and its needs than what we are getting as a result of policies that come out of the academic libraries.

The Chairman. Senator Culver, I'm going to have to leave. I will come back because it looks as if there's enough Senators here so you will be questioned for 15 minutes or so. I will come back as soon as I give my speech on the floor. I'm going to ask Senator Morgan to chair the meeting while I'm gone. I will be back.

Senator GARN. We'll take care of that this year.

The CHAIRMAN. I'm sure you will.

Senator GARN. What I'm referring to is when Senator Proxmire and I change seats, John, and he becomes the ranking minority member.

Senator Culver. I might help you do it. You'd better be nice to me.

Senator GARN. I have always been nice to you. John, I'm pleased that you are here to testify today and I don't have any particular questions. I do have some remarks that I would like to make, actually a repetition of yesterday.

First of all, you may be interested to note that I had the testimony from 1977 placed in the record in its entirety because I felt, in addition to the question that you brought up today, that his testimony in many other aspects was noteworthy to today's hearings. So the entire hearing record from that 1977 confirmation was placed in the record yesterday in addition to what you mentioned.

Second, I'm concerned about this appointment, not as an individual—I think what the chairman says is correct—Mr. Gramley is well qualified by all of our traditional methods of looking at somebody's background—Ph. D. in economics and all that—but I happened to mention yesterday and I will do so again today that as I have watched the Federal Reserve Board appointments over the 5 years I have served on this committee, they are all tending in one direction. And this is not a reflection on any individual member of the Board, but if you look at the recent appointments with one exception, Mr. Schultze, a Florida businessman, Mr. Volcker came from the Fed, from the New York Fed. Mr. Partee was an economist at the Federal Reserve Board, another inside appointment. Nancy Teeters came from the Congressional Budget Office. Mr. Rice came from the Washington, D.C. bank. Mr. Wallich, a Yale professor, formerly with the New York Fed.

So you look at all of them and they are all basically coming from the same geographical area, from the same general sort of back-

ground.

Mr. Gramley is another one of those. Again, I want to stress it isn't personal disagreement with any one of them individually or their qualifications, but I think we are seeing the Fed stacked with a particular line of thought and background and we have also found out that they get around the geographic requirement of not having more than one appointee from each Federal Reserve District by picking any sort of thing, like if they were born or they went to school or whatever—any tie with an area, they can say, well, 30 years ago they lived here, therefore we can appoint them from that geographical area.

Now I think that qualification was put in for a very specific reason, to give some diversity of thought geographically around this country. It would seem to me it ought to be somebody who had been living, working in that geographical area to have a feel for that. I'm sure in your years here in Congress you've found out that people think differently in Iowa than they do here on the Potomac. They certainly do in my State and I think that diversity of thought comes from geographical distribution which has been ignored not only by this President but many others. It's not peculiar to this

particular administration.

One thing that I have always, the entire time I have been on this committee in 5 years, fought for is the independence of the Fed. Whether I agree with them or not is not nearly so important as that their decisions be independent of this body, meaning the Congress, and the administration. Whether I agree with them or not, I don't want them to be politically influenced. Again, I'm not insinuating at all that Mr. Gramley would be called by the President or by the chairman of this committee or Henry Reuss and do exactly what they ask him to do. I doubt that very much. Nevertheless, he's coming from the President's Council of Economic Advisers.

Yesterday, in questioning, he said that he fully agreed with the economic policies that were going on right now from the administration, from the Fed. That disturbs me alone, that he's so satisfied with the—well, it isn't fair to say he's satisfied with the economy right now—certainly he would not be the condition it's in, but satisfied at least at this point with the proposed solutions to those problems. I'm one who is not. I'm one who is concerned, like you are, that certain segments of the economy, particularly farmers, homebuilders, and automobile dealers are being hit rather inordinately hard compared to other sectors of the economy in almost a total disregard, as we have had testimony from many people before this committee—"Well, so be it, we have to take our lumps and we've got to get this thing over with. We might as well take them now."

Well, I have a hard time feeling that a deliberate recession is the best answer to inflation. So Mr. Gramley's satisfaction with the present economic policies disturbs me somewhat too, but the major thing that I'm concerned about is the overall picture of looking at

these past appointments and where we are heading.

So your remarks on that I would certainly agree with. I have not yet made up my mind whether or not to vote for Mr. Gramley for this position, but at this point I'm certainly leaning against it. Again, not as an individual rebuke to him, but a pattern that I see developing on the Federal Reserve Board that I think could potentially affect their independence, but certainly getting an inbreeding of thought that I think goes too far in one direction and does not give the diversity of economic thought or certainly the diversity of background and the various areas of the economy and certainly not into geographical dispersal of thought around this country.

So if I do end up voting against Mr. Gramley, it will be for those general principles and I hope to send the message that we would like a broader representation on the Federal Reserve Board than

we have been getting.

Thank you very much for coming today. Senator Culver. Thank you, Senator Garn. Senator Stevenson. I have no questions.

Senator Morgan. Just let me say this, Senator Culver; that I have read your statement that appeared yesterday and I appreciate your position. You raise an issue that I have raised in almost every confirmation hearing that's been before this committee with regard to the Federal Reserve and to the President's Council of Economic Advisers. It just seems to me somewhere along the line we need some people—some people—maybe not all of them—in these posi-

tions that are in contact with the real world.

As I said yesterday, you can't really understand the plight of the farmer today in America unless you have been out into the countryside itself. I went home during the Easter recess and rented my own farm. Since we got all our ethics rules I can't farm it myself any more. And every year up to this year there's been a waiting list posted at the county ASE office of people who wanted to rent farms. This year I had to scour the countryside to find somebody who was willing to take it at a 25-percent reduction less than what I was able to rent them for last year, and one of the main concerns was farm planting financing. Here it was planting



time and they didn't know whether they were going to be able to

finance their crops.

So you raise some real questions and I won't belabor the point, but I appreciate your bringing it to the attention of the committee because it's something I feel like in government we need some

people who have been out in the world.

Senator Stewart. Mr. Chairman and members of the committee, I want to commend—I don't know which one is chairman—I want to commend Senator Culver on your very fine statement that you made and I want to say to you that I join with you in opposition to the nominee. I do so for a number of reasons, the general reason as you state, but also because I disagree with his positions that he's taken as a member of the Council of Economic Advisers to the President, and I don't mean any disrespect to the gentleman at all, but his insensitivity that he's expressed in public meetings and private meetings with me on the Small Business Committee.

I've got some questions I want to ask you, but you raised a point that I think the committee needs to be made more aware of than perhaps some of them may be. I know I wasn't until I read an article that appeared in the New York Times Sunday edition of

their newspaper.

You indicated that farmers in Iowa were having difficulty borrowing money to plant their crops this year. In Alabama, they are too. This article talked about corporate lending that was going on at this time in this country despite the fact that the small business concerns, the homebuilder, the farmer, was having difficulty. Boise Cascade just in the last week or so had gotten a line of credit committed to them of some \$400 million. In addition to that, the Ralston Purina—and I'm not picking any companies out—I'm sure this is true generally—had arranged with 10 large size banks a large size commitment for loans.

Now when Chairman Volcker was here before the Banking Committee we asked him about the allocation of credit and he said that he would pay particular attention to the interest of small business, to the interest of the farmer, to the homebuilders, and recognize their plight, and that they would question severely the activities of the larger banking institutions in their granting of loans to the

large size concerns in this country.

Obviously that's not being done and I think that's something that needs to be addressed by the Fed and by this administration

and I don't see the sensitivity to that situation.

I welcome joining with you in opposition. I'm going to say to the members of the committee that I hope we reject this nomination and if we don't, I hope it's rejected on the floor, and I plan to go to the floor and fight it because if I don't, this type of—not that he's not an expert in the field—I don't think this type of thought ought to be governing monetary policy.

If the Senate rejects the nomination of Lyle Gramley and the Board vacancy is actually filled with a person with views more sympathetic to the plight of small businesses, farmers, and homebuilders, the question will be raised, John, that you will have other

special interests clamoring for representation on the Board.

How do you respond to that question? What do you say in response to that?

Senator CULVER. First of all, I don't believe in any way what I'm advocating here is special interest in nature. I think in the 16 years I have been in the Congress I have voted consistently for the strong independence of the Federal Reserve Board. What I'm talking about here is a representative character in terms of the general qualifications on the Board that is more consistent and compatible with the original intent of Congress, as I understand it, and one that guarantees that that remarkable and unique independence that you're according it will be used in ways that are compatible and in the best interest of the population of the full Nation and its needs.

Small business and agriculture represent every industry in this economy and 60 percent of the Nation's labor force. I'm advocating broader representation on the Board and, frankly, there may be other groups such as consumers and labor who could legitimately charge insensitivity on the part of the Federal Reserve Board. In my view, the Federal Reserve Board should be composed of members with a broad range of experience and expertise. Not all of the Nation's monetary policy experts lie in the Northeast. They don't all lie in Government. They don't all lie in academia. They don't all lie in the big banks and big corporations of this country, and they don't all lie within the Federal Reserve System itself

I think that in a Nation of 220 million people this idea that this is such a highly esoteric specialized science, that we don't have people with agribusiness or small business backgrounds that can bring to bear that kind of talent and qualification to make that Board perform better I think is just elitist and absurd on its face.

Senator Stewart. It may be the fact that it has become a small group of people from whom you can pick to serve on the Board has lent itself to the insensitivity that some of us now find there.

What difference will it really make, though, for the Board to have this kind of representation? You're talking about one member with one term. How do you respond to that, because I'm quite sure

that's going to be raised?

Senator CULVER. First of all, I don't think anybody is under any illusions that one member of the Board of Governors is going to in and of themselves revolutionize monetary policy. The Federal Reserve Board of Governors, of course, as we know, is made up of seven members who make joint decisions.

In addition, there's an Open Market Committee and the directors of the 12 district banks, all of whom are involved in various aspects

of both setting as well as carrying out policy decisions.

In my judgment, the Board of Governors role in national monetary policy is, however, the most pivotal and the most crucial. Board members themselves make their own final decisions on votes as well as recommendations to other economic policy boards with whom they interact in our Government. A person who understood the implications, for example, for farm and small business operators of an increase in interest rates this winter, for example, could have at least pointed out to that Board in its deliberations the fact that the planting season was coming up right at the time when interest rates would peak, and that in many rural areas the economic life of entire communities revolves around agriculture. Such a person I think could have also pointed out that in the wake of

the embargo decision by this administration farm prices were depressed. Costs have gone up 20 percent. Farm income is to go down 25 percent next year. Therefore, in the wake of those actions, the economy in Iowa, the economy in Minnesota and Nebraska and the Dakotas, were all dangerously affected. Farm prices were depressed and additional interest costs could not be passed on and had to be borne. These interest costs represent a substantial portion of total costs in the cattle industry, of course. Cattle producers can't expand their herds. The inflationary implications of this has to be understood at the Federal Reserve. It has to be understood that this will lead to liquidations of these herds and much higher beef prices. If this is understood by the Board of Governors, it seems to me they could tailor and modify their own policies to adjust to the crucially productive sides of our rural economy at the same time they're trying to turn off the more speculative activities.

Senator STEWART. Do you have a particular person in mind for

this position?

Senator Culver. No; I don't have a particular nominee in mind. I don't really see that that's our responsibility. I think that's the President's responsibility to make those nominations, and it's our responsibility to advise and consent on those recommendations. I have listed a number of national organizations who support my opposition to this nomination and they, in turn, have suggested names to me. I don't think in this great Nation of ours, we would be at all hard-pressed to come up with a distinguished candidate for nomination who embodies the kind of background, training and

expertise of the general description that I'm referring to.

Senator STEWART. Thanks, Senator Culver. My time is up, but I do want to say again that I will join with you in opposing the nomination and the acceptance of Mr. Gramley as a member of the Federal Reserve Board. I would hope that other members of the committee would join with me. That's based, again, not necessarily on his qualifications but on the general feeling that the Board ought to be broader and more diversified, but also on the difficulties that the people that I represent are having as a result of the Fed's monetary policies and this administration's fiscal policies and if we can send any message at all downtown, I hope it's one that should say there should be more sensitivity to the needs of the farmers, the homebuilders, the small business interests in my State, many of whom are near depression state as far as their economic situation is concerned.

Senator Garn. I have no more questions. Senator Stevenson. Very well. Thank you, Senator Culver.

Senator Culver. Thank you, Mr. Chairman.

Senator Stevenson. The committee is adjourned.

[Whereupon, at 10:25 a.m., the hearing was adjourned.]

[The following resolution was ordered inserted in the record:]

96TH CONGRESS 2D SESSION

S. RES. 434

Expressing the sense of the Senate that nominations to the Board of Governors of the Federal Reserve System should reflect careful consideration of the requirements for regional and economic interest representation contained in the Federal Reserve Act.

IN THE SENATE OF THE UNITED STATES

MAY 15 (legislative day, JANUARY 3), 1980

Mr. Culver (for himself, Mr. Stewart, Mr. Bumpers, Mr. Durkin, Mr. Metzenbaum, Mr. Sasser, Mr. McGovern, Mr. Hollings, Mr. Baucus, Mr. Eagleton, Mr. Exon, Mr. Dole, Mr. Jepsen, Mr. Thurmond, Mr. Magnuson, Mr. Nelson, Mr. Morgan, and Mr. Bentsen) submitted the following resolution; which was considered and agreed to

RESOLUTION

- Expressing the sense of the Senate that nominations to the Board of Governors of the Federal Reserve System should reflect careful consideration of the requirements for regional and economic interest representation contained in the Federal Reserve Act.
- Whereas the Board of Governors of the Federal Reserve System has responsibility for the conduct of monetary policy and control of rates of growth of the monetary and credit aggregates which affect the economic well-being of the Nation;
- Whereas the Federal Reserve Act requires that not more than one Governor shall be selected from any one Federal Re-

2

serve District, and that due regard be given to a fair representation of financial, agricultural, industrial, and commercial interests and geographical divisions of the country; and

Whereas recent nominations to the Board have been made primarily from the eastern part of the Nation or without genuine representation of financial, agricultural, industrial, and commercial interests: Now, therefore, be it

- Resolved, That continued insensitivity to the require-
- 2 ments of the Federal Reserve Act in selecting nominees to
- 3 the Federal Reserve Board shall not be overlooked by the
- 4 Senate Committee on Banking, Housing, and Urban Affairs,
- 5 or by the United States Senate.