

FEDERAL RESERVE MONETARY POLICIES

HEARING BEFORE A SUBCOMMITTEE OF THE COMMITTEE ON BANKING AND CURRENCY UNITED STATES SENATE

EIGHTY-FIFTH CONGRESS

SECOND SESSION

TO DISCUSS THE MONETARY POLICIES AND ACTIONS OF
THE FEDERAL RESERVE BOARD WITH REFERENCE TO
THEIR IMPACT ON THE NATIONAL ECONOMY

FEBRUARY 19, 1958

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WEDNESDAY, FEBRUARY 19, 1958

UNITED STATES SENATE,
COMMITTEE ON BANKING AND CURRENCY,
SUBCOMMITTEES ON THE FEDERAL RESERVE,
Washington, D. C.

The subcommittee met, pursuant to call, at 10:10 a. m., in room 301, Senate Office Building, Senator J. Allen Frear, Jr., (chairman of the subcommittee) presiding.

Present: Senators Frear, Robertson, Douglas, Proxmire, Bricker, and Bennett.

Also present: Senators Fulbright, Clark, Bush, and Case.

Senator FREAR. The subcommittee will come to order.

For several years the Senate Banking and Currency Committee has called upon the staff of the Federal Reserve Board to furnish the committee with an up-to-date economic briefing at the beginning of each new session of Congress. This we have found helpful and necessary because of the vital role played by Congress, and especially this committee, in the formulation of policies which have great impact on the national economy.

We are told that the briefing which the Board's staff has given us is essentially the same presentation it gives every month to the Federal Reserve Board's Open Market Committee. It consists of a comprehensive report of the latest Economic Indicators in the major sectors of the American economy and the status of the business picture in the other major countries of the world.

These briefings have been professionally competent and a considerable help to us as we consider the legislative measures which fall within our jurisdiction.

During our last briefing session with the Board's staff, which was held on January 24, several members of the committee expressed a desire to discuss the policy aspects of the economic picture as well as the factual data which the staff presented. Obviously, the Board's staff could not discuss policy issues, with sufficient responsibility, as members of this committee desired. Therefore, we have requested the Chairman of the Board of Governors of the Federal Reserve System, the Honorable William McChesney Martin, Jr., to appear before us to discuss these matters, and he has kindly consented.

Chairman Martin, we are very pleased to have you with us this morning. I assume that you have a statement prepared to give us. And then there will certainly be some questions from the members of the committee.

Mr. MARTIN. That will be fine, Mr. Chairman. May I proceed?

Senator FREAR. You may.

STATEMENT OF WILLIAM McCHESNEY MARTIN, JR., CHAIRMAN,
BOARD OF GOVERNORS, ACCOMPANIED BY RALPH A. YOUNG,
DIRECTOR, DIVISION OF RESEARCH AND STATISTICS, FEDERAL
RESERVE SYSTEM

Mr. MARTIN. The year 1957 was a difficult one for those of us charged with appraising financial and economic events and formulating appropriate monetary policy. From its opening and on during much of the year, inflationary pressures were dominant in this country and abroad.

In commodity markets, industrial prices were continuing to advance despite generally downward reaction in prices of some internationally traded basic materials following the Suez crisis. In consumer markets, prices of goods and services were advancing at a very rapid pace for a nonwar period.

Prices of common stocks, which had tended down from mid-1956 to early 1957, rose sharply to new highs in midsummer under the influence of creeping inflation doctrine and of widening confidence that the large capital expansion in which business was engaging would be adequately supported by the demands of a rapidly growing population for a rising standard of living.

The strength of inflationary pressures was exemplified by the marked advances being recorded in the gross national product measured in current dollars as compared with the relatively modest gains that were being obtained in the physical volume of total output.

In spite of Federal Reserve actions taken to resist inflationary trends—including six increases of Federal Reserve bank discount rates in 1955 and 1956 and the pursuance of a restrictive credit policy—money lost its value at a rate that was a matter of great concern to all. Inflationary excesses had clearly gotten ahead of us, and the economy stood in danger of an inflation crisis. The adjustment problems that the economy is confronting today are the aftermath of those excesses.

As a nation, we were trying to do too much too fast, and heavy pressure was exerted against the available supply of savings.

In retrospect, we underestimated the speed and force of the inflationary boom and the widespread growth in speculative attitudes and commitments.

Consumer installment credit rose substantially in 1955 when terms were sharply relaxed, and consumers used credit more freely than ever before in the purchase of record numbers of new automobiles. Businesses greatly increased their expenditures for plant and equipment. The rise from 1955 to 1956 amounted to more than one-fifth for business as a whole, and this advanced level was further exceeded in 1957. Stock investors were too optimistic in capitalizing the income and dividends which this investment might yield. Bankers and other lenders greatly expanded their commitments to lend in these years.

Furthermore, liquidity positions of banks and businesses were being reduced as their short-term liabilities were increasing faster than their holdings of cash and Government securities. Labor unions sought wage increases—and commitments for future increases—that pressed against or exceeded gains in productivity. State and local

governments borrowed record amounts through the capital markets in an effort to meet the needs of their citizens for community facilities and services.

Inflationary trends continued through the summer months of last year. There was an alarming spread of the belief, not only in this country but also abroad, that creeping inflation under modern economic conditions was a chronic and, indeed, an inevitable condition. Reflecting this view, common stocks, the most popular hedge against inflation, rose sharply in price in July to a level where for the first time in two decades their yields fell below the yields on high-grade bonds.

Also, credit demands generally continued to show great strength, and interest rates were rising. Large city banks on August 7 raised their lending rate to prime business borrowers from 4 to 4½ percent. In this situation, Federal Reserve bank discount rates, which were below market rates by a widening margin, were raised in mid-August from 3 to 3½ percent, thus increasing costs to member banks which were operating on the basis of borrowed reserves.

In late summer and early autumn, developing uncertainties here and abroad began to affect the short-term economic outlook. In European exchange markets, widespread expectations of changes in exchange rates fostered large speculative movements of funds between European centers. These expectations in part reflected further accentuation of inflationary developments in some key countries, despite actions to tighten credit that were taken in various countries during the summer.

It was not until late September, after the Bank of England established a 7-percent discount rate, that it became clear that key foreign currency values would be maintained and that inflation would be strongly resisted.

In this country, the unexpected curtailment in defense payments and changes in procurement policies that were inaugurated during the summer, partly to avoid breaking through the debt ceiling, had an unsettling effect on business.

In September, nonagricultural employment, which had been at a record level in August, began to show signs of slackening. The Board's index of industrial production declined slightly. Reflecting these and other developments, common stock prices in late September broke through the trading range that had prevailed during the past 2 years.

With changing attitudes toward the economic outlook, production and other adjustments that had been occurring for some months in various lines of activity, including some capital goods lines, came to be reappraised by businessmen, investors, and the public generally. In contrast to earlier indications of strong credit demands, bank loans to business during early autumn decreased contrary to usual seasonal tendencies.

The pace of business was maintained for a time in spite of these uncertainties. By late October, the composite of most recent economic information suggested that inflationary pressures were abating, and open-market operations were modified to lessen restraint on bank credit and monetary expansion. By mid-November, information becoming available, incomplete though it was, indicated that a general downward adjustment was setting in.

In response to this change in basic economic conditions, Federal Reserve bank discount rates were reduced from $3\frac{1}{2}$ to 3 percent.

Since that time, the use of open-market and discount policies has been complementary. Open-market operations have provided sufficient reserves to permit member banks not only to repay a substantial portion of their indebtedness to the Reserve banks, but also to accumulate some addition to reserves available for bank credit expansion. Discount rates were lowered again in mid-January, from 3 to $2\frac{3}{4}$ percent.

At the end of 1957, stock-market credit to customers of brokers and banks for purchasing and carrying listed securities was less than at midyear and back to the level of early 1955. Thus, the need for using the higher level of margin requirements, established in early 1955, to prevent an excessive expansion of stock-market credit had abated. The Board of Governors in mid-January reduced margin requirements for purchasing or carrying listed securities from 70 to 50 percent.

System actions have contributed to a marked easing in the credit and capital markets. This is illustrated dramatically by the very sharp drop in market rates of interest, the sharpest drop for any comparable period of which I have knowledge. Yields on Treasury 90-day bills dropped nearly 2 percentage points—from over $3\frac{1}{2}$ to a recent low of $1\frac{1}{2}$ percent.

This adjustment in credit and capital markets is helping to facilitate and cushion other adjustments in the economy as well as to strengthen demands in important areas dependent on credit financing. It is thus, along with other Government programs, helping to set the stage for recovery in activity and employment.

We all share the hope that recession will be moderate and short lived, but it is not possible to be completely certain about the future course of economic activity. There is a range of views currently held regarding the duration and extent of this recession and of the timing and vigor of the ensuing recovery.

In my own view, the underlying strengths of the economy are many. The inflationary trends seem to have halted before creating maladjustments of such severity as to lead to a protracted period of liquidation and structural realignment in the economy. After not too long a period of readjustment, healthy revival should set in, progressing to new records of economic performance and new high levels of national well-being. A great deal depends upon the speed with which needed readjustments are made.

We are all, of course, well aware that reasoning by analogy may be misleading and that history does not repeat itself. Nevertheless, it may be noted that the downward movement from the third quarter 1957 peak has been reminiscent in many ways of the declines that occurred in 1948-49 and in 1953-54. In these two postwar recessions, lows in activity were reached in less than a year from the cyclical peak, and recovery to new high levels of output, demands, and employment was rapid and substantial. In both recessions, the industrial production decline was limited to about 10 percent from high to low. With the exception of the catastrophic depression of the early 1930's, the downward phase of every cycle since World War I has been over or virtually over in the course of about a year.

There are many basic forces in the present situation favorable to hopes for recovery. These include:

(1) Credit and capital market conditions have already responded to relaxed monetary policy and are much easier than they were a few months ago. Other important financial adjustments have already been made or started. Stock yields, for example, have adjusted to a more normal relationship with highgrade bond yields. By borrowing from the capital market, moreover, business firms have been repaying bank debt, thus rebuilding the liquidity positions of both financing institutions and business enterprises.

(2) Consumer incentives to achieve still higher standards of living are strong, and research continues to provide new products of wide consumer appeal. As a group, businessmen and consumers continue to have confidence in the long-term growth prospects for our economy. Total retail sales advanced both in December and January and were at levels well above those a year earlier despite lower sales of new automobiles.

(3) Population increase has been maintained at a rapid pace—the rise of 1.8 percent in 1957 compares with a postwar average of 1.7 percent, and hence the market is expanding steadily.

(4) Consumer incomes have shown some cyclical decline recently, but the decline has been small and moderated by unemployment compensation benefits. Consumer demands are supported by a record volume of financial assets, the ownership of which is widely distributed. Growth in such assets was rapid in 1956 and 1957, while growth in consumer instalment and mortgage debt, though not small, was at a much slower rate than in 1955. The availability and terms of mortgage credit have recently become more favorable to borrowers. New housing starts increased in January and were moderately above their low in the spring of 1957.

(5) At the State and local government level, community demands for schools and teachers, for roads, public buildings, and other community facilities are continuing large and insistent. Bond issues of State and local government authorities have advanced to record levels.

(6) For the Federal Government, postwar budgets have been dominated by the need to cope with critical international stresses and tensions and to provide adequate defense under conditions of major scientific advance and rapid technological change. National security and related problems continue to be urgent.

(7) Insofar as international economic developments are concerned, Western Europe still shows strength. Industrial activity, while no longer expanding, has generally been maintained at or close to record levels. In general, balance of payments positions have improved although in several countries reserves of gold and foreign exchange are not as large as might be desired. Outside Europe, however, raw materials-producing countries are facing difficulties because of declines in volume and prices of their exports.

A primary uncertainty with respect to the timing of economic revival and renewed growth relates to the course of business outlays for new plant and equipment. Some observers view the business capital goods boom of the past three years as having provided a margin of industrial capacity over prospective demands greater than can

be absorbed quickly. These observers tend to expect a more protracted period of adjustment than took place in the two preceding cycles.

This concern may turn out to have been well-founded, but it may be noted that capacity never appears more excessive than in the midst of receding activity. Recovery, in due course, can certainly be expected to be accompanied by effective and profitable use of the economy's capacity to produce and by still further additions to capacity. The important factors working to expand business capital investment in the period ahead should not be minimized. The advance in the technology of production, in part the result of the huge investment in research of recent years, has been rapid and can be expected to continue. Incentives to reduce costs, to meet competition, and to sustain or improve profitability are strong.

History shows that our market economy has cyclical characteristics, and the consequences of this irregularity in terms of hardship and unemployment are of deep concern to everyone. When downward readjustment becomes unavoidable, it is incumbent on business enterprises, financial institutions and labor organizations, as well as Government generally, to adjust policies and programs to foster recovery.

We have been concerned, for example, about the decline in output and employment while prices generally have been maintained and some prices even have risen further. Currently, it may be noted, consumer prices reached a new high in November and remained at about that high in December and January.

How soon recession is checked and recovery is resumed will be influenced by the rapidity with which economic corrections and adaptations are made in factors beyond the province of monetary policy—that is to say, in business-pricing policies, selling practices, and productive efficiency; in wage bargaining; in various financing arrangements; and in the incentives to consumers to buy.

In the past, price reductions during periods of contraction served to stimulate increased buying and output and thus to contribute to general recovery and expansion. Undoubtedly, lower prices now would prove to have expansive benefits for economic activity generally.

If needed adjustments are promptly made, the current recession may be moderate and short lived. Furthermore, there will be the possibility that revival may develop without renewed inflationary tendencies. Under such circumstances, the task of monetary policy would be to foster such revival and to encourage the resumption of orderly growth.

If revival in overall economic activity becomes exuberant, however, there will be an accompanying danger of resurgence of inflationary pressures. Our postwar experience has demonstrated that, in a period of expanding demand, upward pressures on prices and costs can develop very quickly. Once under way, inflationary movements tend to spread themselves throughout the economy, not only because of normal market reactions, but also because of a variety of institutional arrangements.

When contractive tendencies in economic activity set in, there is always the hazard that recession may be deeper and more protracted

than many anticipate, with a greater degree of underutilization of manpower and industrial resources and with manifest deflationary tendencies. In such an eventuality further monetary action would need to be considered, both to increase the liquidity of the economy and to encourage expansion of spending financed by credit.

Monetary policy by itself, however, cannot assure resumption of high-level employment and sustainable economic growth, although ready availability of credit at reasonable cost is certainly an essential ingredient for recovery.

Those of us charged with responsibility for national economic policies must at all times reckon with the dangers both of inflation and of deflation. The central policy problem, in one sense, is to prevent either inflationary trends or deflationary trends from becoming dominant. Public policies for one objective or another can have effects that go far beyond those that are intended. Both fiscal and monetary policies must be carefully formulated to exert enough pressure or ease but not too much. That is certainly a difficult task. It is one that you and I both must live with every day and do the very best we can to reach the judgments and come to the decisions which in the long run will prove to have been wise.

As I have said on many occasions, anti-inflationary policies and antideflationary policies are inseparably linked. Excesses on the up side must be avoided in order to avoid the heavy costs and personal hardships that unfortunately develop during the ensuing contraction. Now that we are in the contractive phase, we must take whatever actions are needed to minimize the hardships and to foster vigorous recovery. But in so doing we also must recognize that excessive stimulus during recession can sow seeds of inflation that can grow to jeopardize our long-run stability and our economic strength at a time when as a Nation we are confronted with a special urgency to maintain all the productive strength we can muster on a sustainable basis.

That covers my prepared statement.

Senator FREAR. Thank you.

Mr. Chairman, as has been stated before in your appearances before this subcommittee and the full committee, I believe it might again be worth noting that on any questions that may be asked of you by our members, that would tend to have an improper stimulus or adverse action in any manner, you might reserve your comments for an executive session.

Mr. Chairman, do you think an economic upturn will occur in March?

Mr. MARTIN. I have to answer that by saying I do not know.

Senator FREAR. There has been a great deal of publicity regarding March as the month of upturn.

Mr. MARTIN. Well, I have tried to keep out of the prediction business.

Senator FREAR. The Federal Reserve Board has been given various tools which it can employ to promote economic stability. Perhaps it would be helpful, Mr. Chairman, if you would briefly outline what your main tools are, along with, if you care to, your opinion as to the relative value of these tools and under what circumstances they can be most helpful.

Mr. MARTIN. Well, I think the three tools that we have are well known to you.

The discount rate is the rate that we charge the member banks that borrow reserves from us.

Our open market operations by the purchase or sale of Government securities supply or absorb reserves in the market.

With respect to reserve requirements, we are given authority in the Federal Reserve Act to vary reserve requirements by classes of banks. There are central Reserve city banks, Reserve city banks, and country banks designated under the act, and the reserves for each of those are 13, 10, and 7 in the act. And we can double that. In other words, we have a range between 13, 10, and 7 up to 26, 20, and 14.

At the present time they stand at 20, 18, and 12.

With regard to time deposits, the rate set in the act is 3 percent, and we can double that to 6 percent. At the present time the requirement against time deposits is 5 percent.

Concerning the use of these instruments, I think you have to evaluate the position that its economy is in at a given time. We have felt that the reserve requirements is probably the bluntest of our instruments. There has been quite a bit of discussion during the restrictive monetary policy of, "Why didn't you raise reserve requirements?"

Reserve requirements, in my judgment, got too high for the type of monetary policy we are now trying to operate, during the period when we had a pegged market. They were being asked to do things that were not contemplated.

Fundamentally, reserve requirements are the fulcrum around which monetary policy becomes effective.

In looking back at the reserve requirement changes during the 1953-54 period, we reduced reserve requirements twice. We did it each time when we wanted to inject massive reserves into the market with a minimum of disturbance to the money market. And both of those steps were, I think, helpful and useful.

I want to make it clear, Mr. Chairman, that I am not forecasting what the Federal Reserve will or will not do tomorrow or the next day when I discuss this, but I say that a change in reserve requirements, blunt or not blunt, is one of the instruments that we have not utilized recently, but we are studying this instrument every day.

Certainly the press would make up our minds for us if we would let them. At the moment they are discussing the subject freely, and I am discussing it equally freely with you. It is one of the instruments that we have at our disposal. But, like all others, its use has to be appropriately timed.

Senator FREAR. What is its relative importance to the others, in your opinion?

Mr. MARTIN. The way I would put it is this: We would probably be better off if we made only major adjustments in reserve requirements. But first, we need to arrive at some better system of reserve requirements than we have at the present time. That has been a most difficult thing for us to achieve because of the disagreements between bankers, which represent, I am sure, honest differences of view.

I think the geographic classification is largely outmoded today. But I do not think it is totally outmoded. What I would like to see is an ultimate reserve requirement that would be based on size of bank, velocity or turnover, and the nature of the business, in preference to mere geographic distinctions.

But in the act today we have these three geographic classifications.

Now, as a fulcrum, we have tried to have an overall reserve of about 16½ percent. I am pulling all of these ratios together in an average here. I think it would be desirable if we had a little different system of reserve requirements. But, since we do not have a different system of reserve requirements, I think we have to be careful and not favor one class of banks against another competitively just because at that particular point it looks like you would reasonably inject more reserves into the money market. We should not favor one group or another group, but try to look at the national policy as a whole.

The reserve requirement instrument is one that we have labored with about as strenuously as we possibly can, but we still have differences of opinion in our own Board and among our presidents as to the exact way in which it should be used.

Senator FREAR. That is stimulating also. The differences of opinion are stimulating.

Mr. MARTIN. That is indeed. I am very glad to say we have differences in the Federal Reserve.

Senator FREAR. Do you think Federal Reserve actions can be as helpful in stimulating investment during a recession as they are in retarding investment during a period of inflation?

Mr. MARTIN. I do not think they can be quite as helpful because of the human factor.

Let me put it this way: They may be equally as effective in either direction, but it is harder to put people under restraint, even though it may be desirable in an expanding economy, and it is easier to get people to ease money in a declining economy.

If you operated without those human factors, I would think that you would be much more effective in restraining than you are in stimulating. But I think that those human factors have a tendency to even up the effectiveness.

Senator FREAR. How do you account for the 1956-57 inflation despite the Federal Reserve's strict credit policies?

Mr. MARTIN. Well, I account for it by the fact that all of us underestimated the strength of the boom, and I think that we went on a spending spree and an expanding spree. Where I think Federal Reserve policy is vulnerable is that we should have been tighter—not that we were too tight in the policy. And I think that we should have had more support from a larger budget surplus and from other restraining factors in the economy, including the management of the Federal debt.

I think we tended to be slow in our start, and then the momentum gathered up on us, and then, at the tail end of it, it was perfectly obvious to a lot of us that it was being overdone.

When you lose more than \$10 billion of your gross national product in a markup in prices without any additional goods and services, you know something has gone wrong.

The cost of living index was going up every month on us. It just got away from us. And, I think as the result, we are now suffering from the inevitable aftermath.

Senator FREAR. I have several questions that I would like to put that you have given me the idea to ask, but I think it is unfair to the other members of the committee for the chairman of the subcommittee to monopolize the questioning of the Chairman of the Federal Reserve while he is here.

My final question, Mr. Chairman, is: Do you think the Federal Reserve Board has all the authority it needs to promote stability, or are there other powers you would like to have Congress give you?

Just a short while ago you mentioned something that you may want to elaborate on now on powers you might want Congress to give you.

Mr. MARTIN. Well, outside of the possibility of our coming up with a request for legislation on reserve requirements, which is fundamentally a change in the nature of the requirements, I think we have the authority that is required. I hope we have the wisdom to exercise that authority properly.

Senator FREAR. Do you have an idea that you may bring up within this session of Congress a request for a change in reserve requirements?

Mr. MARTIN. I think we may come up with legislation suggesting a change in reserve requirements before this session of Congress is over.

Senator FREAR. Thank you.

Chairman Fulbright?

Senator FULBRIGHT. Mr. Chairman, I have 1 or 2 questions.

I would like to pursue a bit your last observation that you did not act soon enough or fast enough and your only criticism of your policy was you were not tough enough.

You recall this committee had a hearing in the spring of 1955, did it not, on this subject?

Mr. MARTIN. You did.

Senator FULBRIGHT. Did the committee not try to urge you and others to take note of the inflationary tendencies in our economy?

Mr. MARTIN. I think that hearing was very helpful, and we did take some action subsequently. We did not take as—

Senator FULBRIGHT. You took some, but did any other agencies in the Government? Did the Treasury take any note of it or do anything in respect to their policies?

Mr. MARTIN. Well, they did not do enough. Let's put it that way.

Senator FULBRIGHT. Would you not say that the tax bill of 1954 contributed to the overexpansion of the productive capacity?

Mr. MARTIN. As things developed; yes.

Senator FULBRIGHT. It was quite clear in 1955 that that would be the effect, was it not? That is what this committee—certain members at least—alleged; was it not?

Mr. MARTIN. Well, I am inclined to agree with you, but it is a matter of judgment there.

Senator FULBRIGHT. But it is not a matter of judgment now. The facts bore out the views of the committee at that time; did they not?

Mr. MARTIN. I think subsequent events did.

Senator FULBRIGHT. Is that not the proof that they were correct at the time?

Mr. MARTIN. Well, for that period; yes.

Senator FULBRIGHT. That hearing did not amount to shouting "Fire" in a crowded theater and did not cause an undermining of the economy of the country; did it?

Mr. MARTIN. No.

Senator FULBRIGHT. You recall the committee was accused of doing that; do you not? You remember that; do you not?

Mr. MARTIN. I remember it very well.

Senator FULBRIGHT. Recently Mr. Burns, who was, as you know, formerly Chairman of the President's Council of Economic Advisers, was reported to have said in the New York Times on Sunday, February 16, and I quote for the record:

Professor Burns believes that the recession which began after the peak in July and August 1957 will continue "at least for some weeks or months." The contraction will not be ended by a revival of business investment, of export demand, or any other economic development but only by "massive" Government intervention.

Do you agree with that statement?

Mr. MARTIN. No; I do not think I do.

Senator FULBRIGHT. I wish you would comment on it. I would like to see your difference of view about it.

Mr. MARTIN. Well, I have some question about massive Government intervention. To me, I have no question about the strength and vitality of this American economy. And I think that recovery is assured.

As I have stated recently, I look on it as a patient—to put it in those terms—who has overexerted himself. You want to do all you can to help that patient. You do not want to punish him on account of the fact that he has overexerted himself; you want to give him all the solace and comfort and whatever medication you can give him.

But you have got to be very careful that you do not rush in with a hypodermic that will temporarily create stimulus that will cause him to get up and run a 100-yard dash and then fall back in a worse state than he was before.

Now, I think that that is where you have to watch massive Government intervention. And I think what is required here is that our recovery is assured on a sustainable basis—provided we do not engage in too much foolishness about it and we just go about it in an orderly, sensible, intelligent way.

Senator FULBRIGHT. Are you recommending one way or the other about a tax reduction at this time?

Mr. MARTIN. I am not recommending one way or another because I think that that would have to await the unfolding scene. But if a tax cut should come, it should be carefully weighed as to the deficit that would be created as against the time element of recovery and all the factors that are involved in that.

There might come a period here where you would have to consider fiscal policy as one of the legitimate things to do. But if you are going to have an offsetting deficit created by that, and deficit financing, you have got to weigh that very carefully.

Senator FULBRIGHT. Let me put it this way: As of today you do not see the need for a substantial tax cut?

Mr. MARTIN. I do not as of today.

Senator FULBRIGHT. How about substantial expansion of Government expenditures on public works?

Mr. MARTIN. I do not see that as of today.

Senator FULBRIGHT. As between those two, would you have any preference if you had to make a choice today? Would you have any preference between one or the other procedure?

Mr. MARTIN. No; I would not think either one of them would be—I think that public works expenditures would be preferable to a tax cut.

Senator FULBRIGHT. That is what I mean.

Mr. MARTIN. Yes.

Senator FULBRIGHT. Supposing you had to make a choice.

Mr. MARTIN. If I had to take one——

Senator FULBRIGHT. You would take public works over taxes?

Mr. MARTIN. Right.

Senator FULBRIGHT. In fairness to Mr. Burns, I believe his whole statement suggests this would be a temporary tax cut or temporary expenditures that he felt might be resorted to, if I recall correctly.

Mr. MARTIN. I want to say I have not read his whole statement either.

Senator FULBRIGHT. I did not care to read it all into the record.

Senator BRICKER. Let's put it in the record.

Senator FULBRIGHT. I would be glad to.

Senator FREAR. Without objection, it may be made part of the record.

Senator FULBRIGHT. The whole statement will be in the record.

(The statement referred to follows:)

[From the New York Times, Sunday, February 16, 1958]

BURNS FORESEES LAG IN BUSINESS—PRESIDENT'S FORECAST OF RISE IN MARCH IS DOUBTED BY EX-ADVISER AT COLUMBIA

(By Will Lissner)

President Eisenhower's former chief economic adviser said yesterday that the President's recent forecast of a business pickup beginning next month was not backed by compelling evidence.

The economist is Prof. Arthur F. Burns, of Columbia University, one of the world's authorities on the business cycle. He declared that as yet there was insufficient evidence to justify any prediction of an early end to the current business recession.

Dr. Burns spoke at Columbia College on the Morningside Heights campus at the annual dean's day fete. About 1,000 of his fellow alumni and members of their families attended lectures by 17 faculty members and a reception for Dean Lawrence H. Chamberlain at the academic homecoming.

Dr. Burns, Chairman of the President's Council of Economic Advisers during Mr. Eisenhower's first term, is president of the National Bureau of Economic Research, a center of business-cycle study. He spoke, however, as a Columbia economics professor and not as an officer of the research agency.

PRESENT CHAIRMAN

The present council chairman, Dr. Raymond J. Saulnier, is on leave from the bureau and its facilities have been available to the council. The bureau does not publish short-term forecasts.

Professor Burns believes that the recession, which began after the peak in July and August 1957, will continue "at least for some weeks or months." The contraction will not be ended by a revival of business investment, of export demand, or any other economic development, but only by "massive" Government intervention, he declared.

The Communist world, he held, would reap vast benefits and international political advantage from a prolonged and severe slump here. Because of that, he predicted, the Government will intervene "on a large scale before very long." He said he was "very confident that this intervention would end the decline and restore full employment."

The professor refused to speculate about the counterdepression measures the administration probably would invoke. But in defending Government intervention against the charge that it was necessarily inflationary, he indicated that at least two courses of action were uppermost in his thinking.

TAX CUT AND SPENDING

"There is no doubt that a temporary tax cut of \$4 billion to \$5 billion for consumers and businesses would revivify the economy," Dr. Burns said, adding: "That doesn't mean that today is necessarily the time to do that." The timing and the selective basis of tax reduction would determine its substantial effect, he explained.

Expanded Government spending on public-works projects that will be completed in 6 or 9 months, rather than on water-resource projects that would run for 5 to 15 years, would also help to revive the economy while holding the risk of reviving inflation to a minimum, the economist said.

Dr. Burns contended that political spokesmen had exaggerated the extent of the decline. Statistics show that steel output has fallen 45 percent, automobiles between 20 and 25 percent, and industrial production as a whole 9½ percent. But the professor estimated that overall output had declined so far between 2 and 2½ percent.

His estimate would mean that gross national output of goods and services, which amounted to about \$435 billion in 1957, would be about \$426 billion in 1958 if economic activity got no better or no worse in the remainder of the year. Allowing for recent inflation, that would put 1958 on a par with 1955 and a little behind 1956 as well as 1957.

UNEMPLOYMENT FIGURES

Unemployment figures also have been misinterpreted, Dr. Burns held. Currently the jobless figure is between 4.5 million and 5 million, he said. However, December, January, and February are the months of highest seasonal unemployment. Allowing for the normal seasonal increase in unemployment, the economist estimated that the loss of jobs due to the current business contraction between 1,250,000 and 1,500,000.

Professor Burns said a study of slumps going back to World War I showed that the current decline was rather mild or moderate. He explained that it resembled far more closely the recession of 1953-54 and 1948-49, which were very mild, than those of 1920-21 and 1937-38, "to say nothing of that of 1929-33."

From another tack, the economist said, comparison of the changes in activity from July through December 1957, with those of the first 6 months of every previous contraction, showed that the last period resembled the minor contractions of the past rather than the ones that were more severe.

Dean Courtney C. Brown of the Columbia Graduate School of Business told the alumni and guests that the United States faced long-range problems that were not unlike those that handicapped underdeveloped countries.

He said growth of bureaucracy and redtape—not only in Government but in private sectors—emergence of a caste system and declining initiative and scope for individual development were among the problems with which the country must deal.

Senator FULBRIGHT. One last thing. I thought it would be helpful to the committee if in addition to your discussion of reserve requirements you could say a little about your open-market operations. They go hand in hand, do they not, as to their effect?

Mr. MARTIN. Yes. Well, with our open-market operations, as indicated in the paper, we began to lessen pressure in that way in mid-October. Then after the cut in the discount rate—

Senator FULBRIGHT. You began to buy bonds, did you?

Mr. MARTIN. That is correct.

Senator FULBRIGHT. What happened? Would you describe it a little?

Mr. MARTIN. We had a minus reserve, net borrowed reserve, of about \$500 million that we were running in late October and early November, and today we have free reserves. This has been done over a gradual period of time by purchases of bonds in the market. We have free reserves of \$200 million, approximately. So that is about a \$700 million swing in a period of about less than 3 months.

Senator FULBRIGHT. What has been the effect on prices of Governments?

Mr. MARTIN. It has been a very sharp decline in rates generally.

Senator FULBRIGHT. Putting it in other words, an increase in the price of Governments on the market?

Mr. MARTIN. That is right.

Senator FULBRIGHT. About what percentage? Could you say? Just to indicate the magnitude of it for the record?

Mr. MARTIN. Well, percentagewise I am not good at figuring those, but they have gone up to 104 and 105—some that were down at 94 and 95. And all across the board there has been a strong recovery.

The Treasury recently sold a long-term 32-year bond for 3½ percent—sold \$1,700 million—which is the first substantial lengthening of the debt that has taken place, and in the short end of the market, which is the real payoff here. You have had your bill rate drop from about 3½ percent to 1½ percent. It is now a little bit higher than that.

Senator FULBRIGHT. I will conclude by saying that within your jurisdiction, the Federal Reserve, I think you all have done a very good job, with the exception that you were a little slow in 1955, as you have already stated, in taking hold.

Mr. MARTIN. We have not been perfect by any means.

Senator FULBRIGHT. Otherwise I have not had any reason to quarrel with you, as you know.

That is all, Mr. Chairman.

Senator FREAR. Senator Bricker?

Senator BRICKER. Nothing, except I would like to ask one question. What do you estimate the capital expenditures will be for this year by industry?

Mr. MARTIN. By industry? I might ask Mr. Young. Would you comment on what you think capital expenditures would be, Mr. Young? They are running about 15 percent less than—

Mr. YOUNG. Not 15 percent. About 5 percent down for the first quarter, it is estimated, from a rate, an annual rate, of around \$37.5 billion, I believe, toward the end of the year. Then what they will do in the rest of the year we do not know, except that we have the McGraw-Hill survey of the fall which estimated a decline for the year of around 11 percent. But I do not—

Senator BRICKER. From the 37½?

Mr. YOUNG. From the 37½.

Senator BRICKER. That is billions?

Mr. YOUNG. Yes.

Senator FREAR. Senator Robertson?

Senator ROBERTSON. Governor, since you are an independent agency responsible only to the Congress and you do not have to run for any

office this year or any other year, I think the statement you have given us this morning will be well received by the public generally. They know that you know about the conditions that you have described here, and they will appreciate the rather temperate position you have taken with respect to methods of easing what you have clearly defined as a temporary recession.

Of course, you did not blink at the fact that we have a recession from the high of 1956 and the spring of 1957.

I understand that when some people have high blood pressure they will have a stroke, and if the blood gets back to the brain cells within 24 or 48 hours they will say it is a slight stroke and they recover. If the blood does not get back to a certain portion of the brain in 2 or 3 days, that brain cell dies, and there is permanent injury to whatever that brain cell controlled.

You say that the high blood pressure caused by excessive borrowing for plant expansion, for home building, and the purchase of automobiles did not cause a dislocation, when the recession came, involving permanent injury?

Mr. MARTIN. That is correct.

Senator ROBERTSON. Therefore, you said the pattern of this recession should follow all of our other recessions—except the big one of the thirties when it was worldwide—lasting not over a year.

Then you give us seven encouraging things on the side of a recovery, without saying whether it is going to be March, April, May, June, or July. You say there is going to be recovery, and here are the reasons you think so:

There is an ample supply of credit.

There is a population increase.

Consumer incomes have held up mighty well.

There will be large Federal and local spending.

There will be a big defense budget.

And there is no depression in Western Europe.

Those things are on the favorable side—at least you think—and there will be a recovery.

Then you wind up with a statement leaving us, of course, to make the application, as pointed out by Senator Fulbright. You say that we must take whatever actions are needed to minimize the hardships but avoid excessive stimulation.

I heard a story once about a good old Methodist sister who complained that her preacher smoked a pipe, and she said:

“Now, Doctor, don’t you think that is wrong?”

He said, “No, Sister, not unless he smokes to excess.”

“Well,” said the sister, “what would you call excess?”

He said, “Smoking two pipes at once.”

I understand that for the time being the 7 pipes that you have lit on the recovery side are all that you think are needed, and that if we were to light, for example, big deficit spending or a tax cut, which certainly would go first to consumer spending such as a \$100 increase in personal exemptions, that would be smoking 2 pipes at once? It would be excessive at the present time?

Mr. MARTIN. At the moment I think so; yes, sir.

Senator ROBERTSON. Is that the proper application of your philosophy?

Mr. MARTIN. Yes. I do not have any—

Senator ROBERTSON. You did say recovery would be stimulated by a reduction in prices. The last presentation of the economic picture by your experts was that there had been no cut, no appreciable cut, in wholesale prices although there was considerable unemployment. There had been a reduction in production, yet wholesale prices held up.

How are we going to get any reduction in prices if the manufacturers do not cut, if the wholesale houses do not cut? You cannot expect the retailer to take it all, can you?

Mr. MARTIN. Well, that is the market process. I think the pressure will force some reductions. And, of course, you are on unpopular ground with anybody when you suggest he cut prices if he has got a stock that he hopes to be bailed out of either by waiting until the recovery gets a little bit further ahead or some other stimulus will come in and save him.

Senator ROBERTSON. Some of my banker friends tell me that a cut in the reserve rate would be more stimulating to them than a cut in the rediscount rate. Have you had many requests from member banks that you cut reserve rates?

Mr. MARTIN. Yes; we have heard that. We have had the story on both sides. If you took our mail, we have a good many people who think we should not have cut the rediscount rate. There is a smaller number as time goes on, but you have some. There are some who think the way to have handled it would have been to reduce reserve requirements.

Senator ROBERTSON. In other words, do you think that credit at the present time is sufficiently easing to take care of creditworthy risks that are applying for capital?

Mr. MARTIN. I think that the availability of credit has been steadily improving, Senator.

Now, I do not say that it has been totally adequate. I think that is something you have to measure from day to day and week to week. And that is one of our major concerns right now. If we had a sudden resurgence of activity, a real boom, we would consider reversing monetary policy in the direction of putting the discount rate back up. But if, on the other hand, the decline continues, we have got to look at the situation as it is and be certain that there is availability of credit.

There is no question that the availability of credit has improved. You can see it in the mortgage market. It has been steadily improving there.

Now, it is not running out everyone's ears yet, but I think you have got to be very careful that you do not force credit. This is borrowed money.

Senator ROBERTSON. According to the records of the State unemployment offices, we have over 4 million unemployed at the present time, and for them this is a real depression. They are suffering hardships, but, as you pointed out, we have a better system of unemployment compensation than we had in any previous real depression and that is helping to tide us over. But there are some hardships.

And you say that we should take action to minimize the hardships. But you said an immediate tax cut is not one of them. Pump

priming is not one of them. You said reducing prices would be one of them, but that is something we cannot in Congress control.

What would you specifically recommend?

Mr. MARTIN. Well, I have no recommendation at the moment, Senator. I think we have got to watch the situation. I think that the patient, to get back to that, needs convalescence. I do not know that my medical knowledge is very good, but I think a certain period of convalescence is required, and you have to gage the patient on the basis of that.

Now, I think that in terms of minimizing hardships through credit and monetary policy—

Senator ROBERTSON. This language that "we must take whatever actions are needed to minimize the hardships" largely indicates a sympathetic attitude on your part, but you do not have anything particularly in mind?

Mr. MARTIN. The Federal Reserve Board is very distressed at any unemployment. We want to do everything within our power to be helpful.

Senator ROBERTSON. But you say that monetary policy alone will not either put it up or bring it down but that you can do a better job in keeping it from going too high than you can bringing it up again.

The question I raise is this: I pointed out that some bankers think money is not yet easy enough and that if you did not tie up as much of their reserves as you do at the present time they would feel a little easier on making greater loans.

Mr. MARTIN. That is a matter of judgment that we have to weigh very carefully in the System; and if we come to the conclusion that that is correct, you can be sure that we will act.

Senator ROBERTSON. You would not hold back, if that would be a remedy, until we get forced into a tax bill, would you?

Mr. MARTIN. I would not hold back 1 minute. The minute the Board is convinced—and we are studying this every day—that that would be helpful and would do something for the economy, we are going to do it.

Senator ROBERTSON. I agree with Chairman Fulbright. I think you have been doing a good job.

Thank you, Mr. Chairman.

Senator FREAR. Senator Bennett?

Senator BENNETT. I would like to go back, Mr. Martin, to the sentence on page 9 which Senator Robertson mentioned and refer to the comment about the maintenance of prices.

All last summer and fall the Finance Committee, of which three members of this committee are also members, was engaged in a hearing on what was then the current economic situation—a situation of inflation. It was obvious to me as a member of the committee that there is a philosophy in this country which suggests that the way to cure inflation is to raise wages—on the theory that then the wage earner will be able to buy more merchandise and that will prime the pump.

There is some evidence that within the next 2 or 3 weeks we are going to be visited here in Congress as a part of an organized campaign to support that theory that the minimum wage should be raised

to \$1.25 and current collective-bargaining programs should produce massive wage increases. Do you believe that that is sound policy in a situation where we have unemployment and prices are still rising?

Mr. MARTIN. Well, as I pointed out in this statement, Senator, wage rates were pressing against productivity and exceeding productivity in some instances, and that was one of the reasons for the inflation getting ahead of us. And I think that is one of the factors that has to be considered at the present time.

I do not think that you can justify wage increases beyond productivity and—

Senator BENNETT. Can you do that at any time?

Mr. MARTIN. I do not think you can at any time. And I do not think you can spend yourself prosperous. I just do not agree with that theory.

Senator BENNETT. Sitting in on those hearings, it was obvious to me that there is a line of thinking in this country which says that the way to cure inflation is more inflation, that in periods of inflation the policy of the Federal Reserve Board should be to ease money, thus producing more purchasing power, which presumably would fill up the gap produced by the current underuse of productive facilities.

Is it not logical, to follow that same reasoning, to assume that in a period of recession like this the correct policy should be a tight monetary policy? And would you believe that in your position as Governor of the Federal Reserve System you would recommend tight monetary policies in time of recession?

Mr. MARTIN. I certainly would not.

Senator BENNETT. Then you believe you really were following the correct program during the inflationary period, and that by releasing more capital or more reserves now that business has fallen off a little you are also following the correct policy?

Mr. MARTIN. I do.

Senator BENNETT. I think the record would not be injured too much if I asked you if you ever heard the story of the man and the lions? You have not so I will proceed to tell it to you.

The story is that there was a man in an automobile going through the main thoroughfare of a busy town, and about every half block he threw out half a newspaper. Finally the traffic policeman caught up with him and said, "Here, what are you doing? You can't do that. That's against the law."

He said, "I'm protecting this community against wild lions."

The policeman said, "There aren't any wild lions around here."

The man said, "See. My program works."

I wonder if this theory that in periods of inflation we should have more inflation is not based a little bit on that same kind of reasoning?

Mr. MARTIN. Well, I think it is an incorrect theory.

Senator BENNETT. I was very interested in your earlier comment in response to questions by Senator Fulbright that there is a possibility that you might come to this committee with proposals for basic alteration in the pattern of reserve requirements. Do you think this committee should take some initiative to hasten the time when that should be considered, or do you feel that you are not quite ready yet?

Mr. MARTIN. I do not think we are quite ready yet, Senator. But we are working on that. We have been working on it for months, as some of you know. And I am hopeful we will come up with something before too long now.

Senator BENNETT. Would an indication of interest by this committee hasten the day when some of the differences among your members might be resolved?

Mr. MARTIN. I do not think it would do any harm, but I do not really think it would advance things very much at the moment, because we are making progress at the moment.

Senator BENNETT. That is all.

Senator BRICKER. Along what line?

Mr. MARTIN. Along the lines of a proposal.

Senator BRICKER. I know, but do you know now what the nature of the proposal might be in the readjustment of your reserve requirements?

Mr. MARTIN. I would not want to discuss that today, Senator, because I have not got agreement on it yet with our own people. But we have been, as I discussed earlier, considering this thing from the level, the overall level, of reserve requirements.

Senator BRICKER. Doing away with the geographical limitations?

Mr. MARTIN. And doing away with the geographical. But not so much worrying about that as worrying about how we make the transition to a sounder reserve level for the long-range growth and development of the country that we think is going to be with us in the not too distant future. Certainly in the 1960's we are going to have a terrific need for financing. If the current growth occurs, you are going to have need for substantially more reserves than we presently have. We want that financed on the right basis.

We know that part of our problem today is that a lot of the people who were very generous and going all out on supplying credit when things were very good get equally tight when things get bad.

Senator BRICKER. Yet the geographical expansion of the country has not been limited to any one area.

Mr. MARTIN. That is correct.

Senator BRICKER. So the tendency would be, you think, to apply certain reserve requirements across the country rather than by geographical limitations?

Mr. MARTIN. Well, I am certain that intellectually it is not, in my judgment, possible to defend the geographic distinctions per se. But when it comes to writing a reserve requirement plan on the basis of velocity of deposits, you have administrative problems, and you also, I think, have a distinction between a very large bank and a very small bank. I think that the large bank ought to have higher reserve requirements than the very small bank.

I think you have got these distinctions that have got to be weighed.

In moving toward uniformity, you have got to have some uniformity that will stand up. And when it comes to defining it or administering it, it certainly is the most difficult problem the Reserve Board has ever had from the inception of the System.

You see, what happened is that up to 1935-36 we had virtually fixed reserve requirements. In 1936 you had the 13, 10, 7, and 3 area that is the minimum now. And then you had the big gold inflow, you

see, in the period of the 1930's. So in 1936 we gave the big upswing permitted in the Banking Act of 1935 for the increase, and we got the reserves up to 26 percent. Now we no longer have that gold swing, and you know all the ins and outs of gold policy since that time, including the devaluation of 1934. So that, in a sense, we are working with reserve requirements that are adapted to a different period and a different gold setup.

Senator FREAR. Does that finish your questions, Senator Bennett?

Senator BENNETT. Yes.

Senator FREAR. Senator Douglas?

Senator DOUGLAS. Mr. Martin, like you, I believe in a flexible monetary and credit policy. In a period of undue boom there should be some dampening down on the creation of bank credit—particularly use of commercial credit for investment purposes. Also in a period of recession or depression there should be a loosening of credit.

But it is highly important for those who apply this policy to know what period they are in when they apply it. Namely, you should not follow a restrictive policy when you are on the downgrade.

And I would like to ask you whether, looking at things in retrospect—and I want to accord you full honesty of your judgment—you think you should have increased the rediscount rate in August from 3 to 3½ percent?

Mr. MARTIN. Senator, I do not think we had any alternative, because that was a technical problem in the money market. You will recall that the prime rate at the banks was raised on August 7 to 4½ percent. Now, the demand for credit was still very strong. We had some apprehensions in February. We also had difficult Treasury financing over quite a period of time there or we might have moved the discount rate up as early as December of 1956.

Senator DOUGLAS. As a matter of fact, however, all the statistical indexes indicate that the present recession began in August. In other words, things started to slip in precisely the month that you increased the rediscount rate. The situation became even more obvious long before you lowered the rate in November.

Mr. MARTIN. Well, I just cannot agree with you on that. You, see—

Senator DOUGLAS. What about the index of production? The index was 145 in August and by November had fallen to 139. It was falling steadily during that period. Unemployment was rising.

Mr. MARTIN. Look at the preceding period, Senator—May, June, July. You have the index there in front of you, do you not?

Senator DOUGLAS. I have the indicators, yes. Which index? Production?

Mr. MARTIN. Our production index.

Senator DOUGLAS. Yes, I have one.

Mr. MARTIN. Well, you see May, June, July it held steady.

Senator DOUGLAS. That is right.

Mr. MARTIN. In August it went up.

Senator DOUGLAS. One point. But you did not get your August figures until September.

Mr. MARTIN. Oh, but we are in the making of them all the time. And then in September there was a slight decline. And we were watching clearly because we were thinking about a fall upturn.

Senator DOUGLAS. Is it not true that the recession really gathered weight in August and began to move down so that from August to November you had a higher rediscount rate in the face of falling production and falling employment?

Mr. YOUNG. You did not have falling employment in August. You had pretty close to the peak, Senator. I believe.

Senator DOUGLAS. I say from August to November.

Mr. YOUNG. It is on page 11.

Senator DOUGLAS. Would you give the Governor—

Mr. MARTIN. Have you got it, Mr. Young?

Mr. YOUNG. Total civilian employment, nonagricultural in August was 59,562,000, which was up.

Senator DOUGLAS. You mean there was no increase in unemployment during the fall? There was no decrease in employment during the fall?

Mr. YOUNG. Of course, this is a technical problem. You had the little bit of advance in the summer in industrial production from June to August. Retail sales had been showing up very strongly in that period, and employment had been rising moderately.

Senator DOUGLAS. Now, just a minute. If you look at these figures you have cited, nonagricultural civilian employment in August is listed at 59,562,000 and in November at 59,057,000, or a decrease of half a million. So that my earlier statement, which you questioned, was correct, namely, there was a fall in production and in employment during this period.

Mr. YOUNG. Oh, there was from August.

Senator DOUGLAS. That is right.

Mr. YOUNG. It was not declining in August. And in September there was some question.

Senator DOUGLAS. What I am asking is this: In retrospect—I am first going to ask in retrospect—is it not true that the rediscount rate was raised at the very time the economy began to slip?

Mr. MARTIN. In the first place, I think the discount rate was just a technical move. But I do not agree with you on that because there is hindsight and future there. There are at least a dozen times from 1955 to 1957, Senator, where you could have seen the same pattern developing.

And I think one of the things as to why our policy was less effective than it might have been was that we were scared off a number of times into not doing something that should have been done.

Senator DOUGLAS. What you are now uttering is really a plea in mitigation? You are saying, "Yes, perhaps we made a mistake, but we could not have told at the time"?

Mr. MARTIN. No, no. Well, I will answer you categorically I do not think it was a mistake.

Senator DOUGLAS. In other words, you think the increase in the rediscount rate was proper?

Mr. MARTIN. I do indeed.

Senator DOUGLAS. Despite the fact that you had a falling off in production and employment immediately after it was increased?

Mr. MARTIN. Which I insist no one could have been certain of until after it began.

Senator DOUGLAS. What you are saying now is we could not have foreseen it?

Mr. MARTIN. Certainly.

Senator DOUGLAS. Therefore, it was not your fault? But if you could have foreseen it, would you have increased it? If you could have foreseen the decrease in production, the falling off of employment that would have occurred, would you have raised the rediscount rate from 3 to 3½ percent in August?

Mr. MARTIN. I would have if the money market was in a situation where the prime rate at the banks could have stayed at 4½ percent with us having a discount rate of 3.

Senator DOUGLAS. Now, there is another question I want to ask. Namely, was it possible to foresee what was going to happen? You people spend your full time down there studying business conditions and are in touch with the situation very closely. You have a large group of economists. I take it that you were afraid of inflation during this period?

Mr. MARTIN. I certainly was.

Senator DOUGLAS. And, therefore, you increased the rediscount rate because you wanted to check inflation, and you were measuring inflation by the consumer's price index? Is that not true?

Mr. MARTIN. It was one of the measures.

Senator DOUGLAS. What was happening to spot prices in the daily quotations? You know the Bureau of Labor Statistics computes an index of daily spot prices of raw materials—copper, lead, zinc, iron, oil, wool, wheat, corn, and so forth. This is the most sensitive index of all. What was happening to that index in the period prior to August?

Mr. MARTIN. It was erratic with a slight tendency down.

Senator DOUGLAS. I have here the list of monthly indexes of these spot prices which I should like to read now which have been phoned up from the Bureau of Labor Statistics.

December 1956: 100.4.

January 1957: 97.8.

February: 94.7.

March: 94.4.

April: 93.5.

May: 92.7.

June: 93.3.

July: 92.7.

You undoubtedly were watching this closely.

August: 92.1, or a fall of 8.3 percent in the course of 7 months.

Here you have spot prices going down—generally. It is not merely an erratic movement, Mr. Martin. A downward slope. A rather steady downward slope at the rate of 1 percent a month.

Should this not have warned you that there might be trouble coming?

Mr. MARTIN. I did not have the slightest doubt in my mind, Senator, as I testified up here several times, that we were in trouble once the gross national product began to rise at the rate it did without any additional goods and services.

Senator DOUGLAS. But you thought the trouble was inflation, whereas, as a matter of fact, what was happening was a decrease in spot prices on raw materials?

Mr. MARTIN. No; I just do not agree with you. That is just a judgment. I am not—

Senator DOUGLAS. Do you disagree with the figures?

Mr. MARTIN. I am not quarreling with your figures. I studied those figures, too, just as—

Senator DOUGLAS. Do you think that you should not have paid any attention to them?

Mr. MARTIN. I think they were one of the factors to be concerned with, and we kept them in front of us all the time.

Senator DOUGLAS. May I ask what importance you would give to the decline in the balance of exports over imports? Would you give any importance to that?

Mr. MARTIN. Do you have the export figures?

Senator DOUGLAS. On page 22 of the indicators it gives excess of exports over imports excluding grant-in-aid shipments. And you will find that in December the excess of exports over imports was \$822 million. It declined in January to \$470 million. In February it was \$497 million. It went up in March to \$890 million. It went down in April to \$661 million. It went down in May to \$607 million. In June it was \$669 million. And in July it was \$358 million.

In other words, there was a steady decline in our exports. And this was partially due, as you know, to the fact that the countries producing raw materials, since their prices were falling, were unable to purchase goods in the same quantity from us. And this has been one of the factors in the recession.

It is true, as you say, Western Europe has held steady—steadier than we—but the countries outside of Western Europe, the tropical countries and the oriental countries, for example, have been experiencing a fall in prices of primary products and, therefore, increased inability on their part to purchase from us.

So here were at least two danger signals that were up: The fall in primary prices—very sharp, very precipitous. A decrease in exports, which would inevitably kick back on our production. And yet you went through the danger signals, went through the danger signals with the best intentions in the world, Mr. Martin.

Mr. MARTIN. Never have I claimed perfection for policy.

Senator DOUGLAS. No; but this—

Mr. MARTIN. I just would disagree with your analysis of those danger signals against the cost of living. I am not quarreling with your figures. I studied those figures all the time. But I would disagree with your analysis of it. In my judgment it was an inflationary trend. The cost of living was rising. There are always erratic price movements.

Senator DOUGLAS. But, Mr. Martin, you know perfectly well from your study of price movements that the cost of living always lags. It is more of a result of forces rather than a primary force. The first thing that happens is the movement of primary products. Then come movements of wholesale products, fabricated wool, fabricated cotton, and so on. Then, at the tail end, comes the movement of retail prices and the cost of living.

This is historically the movement of prices.

What you were taking was the end product, which took into account past increases and disregarded the fact that underneath the ground was shaky.

Senator FULBRIGHT. Will the Senator yield for a question for clarification?

Senator DOUGLAS. Certainly.

Senator FULBRIGHT. You picked out December 1956 to make your comparison.

Senator DOUGLAS. Yes.

Senator FULBRIGHT. Take October of 1956. It is 440. October of 1957 is 459. Actually, between those two there is an increase. For some reason which I do not understand, December is almost twice what November and October were.

Senator DOUGLAS. That is right.

Senator FULBRIGHT. It is that 1 month that stands out, indicating something unusual happening there. Actually, as between October and October there is an increase in exports. I do not understand myself why that should happen. It is just that 1 month that shows that most unusual change.

Mr. YOUNG. That was the Suez crisis, sir.

Senator FULBRIGHT. What was it?

Mr. YOUNG. The Suez crisis.

Senator FULBRIGHT. December?

Mr. YOUNG. Which gave us the bulge at the end of 1956.

Senator FULBRIGHT. Just that 1 month?

Mr. YOUNG. Yes. That was very heavily petroleum shipments.

Senator DOUGLAS. If you take the average of 1956 you find it was approximately \$400 million a month.

Senator FULBRIGHT. Actually, in 1957 you have month by month much higher than that—except for the 1 month of December. I do not know what the significance is.

It just occurred to me that that does not really reveal any substantial decrease except by comparison to the 1 month of December.

Mr. YOUNG. Well, we were watching the export figures very closely at that time. They were at a quite high level through the summer.

Now, you have to remember that our export figures lag in their receipt by us. We are getting figures now for December.

Senator DOUGLAS. Two months.

Mr. YOUNG. Two months' lag.

Senator DOUGLAS. Of course, there was also a downward movement, a slight downward movement, in the index of production, which was 147 for December, 144 for July, a slight rise to 145 in August. A slight dip in production. Certainly production was not increasing. A fall in primary prices, which I think is the most sensitive index. What was happening to new orders during this period?

Mr. MARTIN. New orders were sliding off.

Senator DOUGLAS. That is right. From January 1957 to August 1957.

Mr. MARTIN. Right.

Senator DOUGLAS. Did this make any impression on you?

Mr. MARTIN. It certainly did.

Senator DOUGLAS. Yet, in spite of this, you increased the rediscount rate?

Mr. MARTIN. Well, in my judgment, that increase in the rediscount rate was necessary for technical reasons.

Senator DOUGLAS. It was defended at the time not merely for technical reasons but to check inflation.

Mr. MARTIN. I do not know who defended it that way.

Senator DOUGLAS. I think you defended it and certainly Mr. Humphrey defended it in our hearings.

Mr. MARTIN. Any increase I suppose could be interpreted, let's say, in that direction.

Senator DOUGLAS. I think it was actually defended on that ground, not merely on technical grounds but as a part of policy.

Mr. MARTIN. When you have seven members of the Board, each one of them might have a different reason for voting for the increase in the discount rate. To me it was untenable to have a prime rate for the banks with a heavy credit demand at 4½ and a 3-percent discount rate.

Senator DOUGLAS. This is the whole point. I am not trying to put you in the hole. I agree with the principle of a flexible credit policy. But it is highly important that the pilot or the engineer read the signals. And if you restrict credit at a time when business is sliding, that is the wrong kind of a credit policy.

As I say, I am sure you moved honestly, but we only learn how to behave in the future, frequently, out of the mistakes that we make in the past. The sole burden of my song is this: Do you not think it would be wise in the future not to place so much reliance on the cost-of-living index?

Mr. MARTIN. Well, the cost-of-living index may not be the most accurate index that we have. And I question a lot of our indexes.

Senator DOUGLAS. As a matter of fact, the cost-of-living index was going up in November when you reduced the rediscount rate back again to 3 percent, so obviously you had been a little bit disillusioned with it by November, although you were in love with it in August.

Mr. MARTIN. I just do not—Well, let's put it this way: I would be the first one to admit a mistake if I thought I had made a mistake. But I do not think we made a mistake there.

Senator DOUGLAS. All I ask is that you read the questions and answers tomorrow morning and let them sink into the subconscious.

Mr. MARTIN. I will be very glad to do that. I will paste it on the mirror, Senator.

Senator DOUGLAS. There was one other question I should like to ask. Am I exceeding my time, Mr. Chairman?

Senator FREAR. You have plenty of time.

Senator DOUGLAS. I will be very glad to stop if I am exceeding my time.

Senator FREAR. No, continue.

Senator DOUGLAS. You mentioned at the end of your statement, on page 10, that monetary policy by itself cannot assure resumption of high-level employment and sustainable economic growth. In other words, there is a place for fiscal policy too?

Mr. MARTIN. Yes, under certain conditions.

Senator DOUGLAS. What would those conditions be? You say now is not the time, but there might be a future time. What criteria do you have for determining when you should add fiscal policy to monetary policy? Fiscal policy could consist either of an increase in expenditures or a reduction in tax receipts.

Mr. MARTIN. Well, I think it would have to be dependent primarily on whether you think the decline is spiraling and coming in—

Senator DOUGLAS. What indexes would you use to determine whether the decline was spiraling?

Mr. MARTIN. I would not use any one index. I would——

Senator DOUGLAS. What group, what family of indexes would you use?

Mr. MARTIN. Well, I think we would have to cover the whole waterfront on that.

Senator DOUGLAS. Let's get to some of the docks on the waterfront. Production?

Mr. MARTIN. Production index.

Senator DOUGLAS. Employment?

Mr. MARTIN. Employment.

Senator DOUGLAS. Unemployment?

Mr. MARTIN. Unemployment.

Senator DOUGLAS. What else?

Mr. MARTIN. Mr. Young, what would you——

Mr. YOUNG. I think you would go across the board—on new orders——

Senator DOUGLAS. What?

Mr. YOUNG. You would go across the board on new orders and inventories——

Senator DOUGLAS. If you go across the board, what would you look at?

Mr. MARTIN. New orders, inventories——

Mr. YOUNG. What is happening in the securities markets?

Senator DOUGLAS. What is happening to production? It was 145 in August.

Mr. MARTIN. January, 133.

Senator DOUGLAS. A fall of 12 points. What is that?

Mr. YOUNG. Around 8 percent.

Mr. MARTIN. Seven to eight percent.

Senator DOUGLAS. If it should go down below 10 percent would you regard that as significant?

Mr. YOUNG. I think you would want to look at the movement against typical patterns in the past also.

Senator DOUGLAS. You say in past recessions the fall in production has not exceeded 10 percent?

Mr. YOUNG. For a moderate recession it is something like 10 percent.

Senator DOUGLAS. All right. Now, then, suppose it exceeds 10 percent. What I am trying to get at is that you are the doctor, one of the doctors, sitting by the bedside of the patient. And that is your own analogy; that is not mine. I did not say the patient was sick; you said the patient was sick.

Now, you feel his pulse. You find out what his temperature is. An M. D. has certain standards. If the temperature rises to, say, 103, something is wrong. He does not worry very much at 99½.

Do you have anything in the back of your mind as to where you might have a critical point? Would you say a fall of 10 percent in production should begin to——

Mr. MARTIN. I would not want to be pinned to a level. I think that you have got to——

Senator DOUGLAS. Suppose you had a fall of 15 percent. Would you worry?

Mr. MARTIN. The further the fall——

Senator DOUGLAS. You do not think fiscal policy should come in if production fell 15 percent?

Mr. MARTIN. I would not—just could not answer that on a specific basis.

Senator DOUGLAS. Suppose it fell 20 percent?

Mr. MARTIN. I am not—

Senator DOUGLAS. Twenty-five percent? You would not be concerned with 25 percent?

Mr. MARTIN. Senator, I am sorry but I just cannot say that I—

Senator DOUGLAS. You see, you are the doctor. You say, "Have faith in me."

Mr. MARTIN. No; I—

Senator DOUGLAS. We want to find out what you are having faith in, what indexes you are watching.

Mr. MARTIN. I am not saying, "Have faith in me."

Senator DOUGLAS. Let's turn to unemployment. The census says we have 4½ million unemployed. If you add the part-time workers to this you get an equivalent of 1.2 million more or 5.7 million. The total working force is a little less than 67 million. That is 8.5 percent. But this 67 million includes the self-employed, 9 million self-employed plus a million more wives and elder sons or elder daughters, self-employed. So you really have to deduct them in getting an index of unemployment. And when you come to the number of wage and salary workers in the country, a little less than 57 million, then you have 5.7 million equivalent unemployed. That is a 10-percent unemployment ratio. Do you think that is significant?

Mr. MARTIN. I certainly do. I think that—

Senator DOUGLAS. But you say it is not yet time for fiscal action. By how much would it have to increase before you think it would be time?

Mr. MARTIN. Well, I cannot answer that categorically, but I want to say that these unemployment figures ought to be studied awfully carefully too. You have questioned the Consumer Price Index. I think all of these indexes have got to be put in the context of what is the truth about it.

Senator DOUGLAS. You see, here is the point. You will say, "I am moving because the Consumer Price Index is this way." Then you will shift. The pea will be under another thimble, and so on. You chase these around. What I am trying to do is assemble these various indexes and try to see when you would believe that fiscal policy should be carried out.

Mr. MARTIN. Well, I cannot tell you precisely.

Senator DOUGLAS. You are not in control of fiscal policy. We are in control of fiscal policy. Presumably we have to make up our minds. We are coming to you for advice.

Mr. MARTIN. Well, I am not trying to be presumptuous in what I am saying now, but I am saying that I think you, in studying your problem, just as we in studying our problem, should look at the whole picture and not just at one index or the trend in a few indexes.

Senator DOUGLAS. Oh, that is my whole quarrel with you—that you looked at only one index, the Consumer Price Index, and ignored export figures, ignored the spot price figures, and ignored the employment figures. I think we should look at employment and production as well as the Consumer Price Index.

Mr. MARTIN. Well, I do not want to belabor it, but I did not look at just one price index.

Senator DOUGLAS. You made up your decision on the basis of the Consumer Price Index.

Mr. MARTIN. No; I would not say that. I made it on the basis of overall inflation.

Senator DOUGLAS. There was no inflation in primary products.

Mr. MARTIN. There was a——

Senator DOUGLAS. On the contrary, there was deflation in primary products.

Mr. MARTIN. Now, go back to 1955.

Senator DOUGLAS. No; I prefer to take 1957.

Mr. MARTIN. Well, I think it started in 1955. We had price instability from the middle of 1955 on. And one of the reasons we had it was that farm products had stability for the last half of 1955 but we had it at the expense of the farmer during that period, and all of those factors have to be taken into account. I do not think we had price stability from the middle of 1955 till the end.

Senator DOUGLAS. I quite agree with you. The farmer was taking it on the chin. Industrial prices were going up.

Mr. MARTIN. At the present time——

Senator DOUGLAS. As a matter of fact, I made your friend Mr. Humphrey very angry by pointing out in his testimony that it was not really industrial price stability at all.

Mr. Chairman, I think I have taken up more than my quota of time.

Senator FREAR. It has been interesting.

Senator DOUGLAS. I apologize to the chairman for talking so long.

Senator FREAR. The chairman of the subcommittee has attempted to follow our usual subcommittee line of procedure, except extending the courtesy to the chairman of the full committee, in calling on the Senators, I hope that any Senator who has higher seniority in the full committee will forgive me for following the procedure of going down the subcommittee.

Senator PROXMIRE.

Senator PROXMIRE. Did I understand you, Mr. Martin, to say that we have a situation now in which there is adequate credit available so that banks can make sound loans generally throughout the economy? You did not make that statement precisely but is that a fair interpretation of your position?

Mr. MARTIN. I would say up to today the Federal Reserve Board has not felt that it would be wise to move any further in the policy of easing credit than we have.

Senator PROXMIRE. Well, that is——

Mr. MARTIN. I do not want to be held beyond today, now.

Senator PROXMIRE. I understand your answer, but what I asked is: Do you feel that generally throughout the economy banks are in the position to make whatever sound loans are available?

Mr. MARTIN. I do. Let me——

Senator PROXMIRE. In the light of that, let me ask what is there further that the Federal Reserve Board can do except slightly reduce the interest rate, which you already have reduced substantially, if the banks are in a position to make whatever loans are available. Is not the monetary situation, as far as you can control it, such that it is about as easy as it can get?

Mr. MARTIN. Except this is a process, Senator. One of the most striking things at the time of the reversal of credit policy was the decline in the demand for loans that began in October. Over a period of 5 weeks, at a time when the loan demand would normally be rising, there was a sharp contraction. There was a swing of about a billion dollars there, compared with the previous year, in the contraction of loans.

Now, the loan demand at the present time may pick up very quickly. If you are talking about it this week or next week you may say that the availability of credit has been steadily improving. Just yesterday we asked a group of bankers if they knew of any area of the country—this was a group from all over the country—where there was in the aggregate, not an individual bank but in the aggregate, nonavailability of funds. They said they did not know in the aggregate but they knew of a good many individual banks.

You may want this to get down to the level at some point so there would not be individual banks holding back on making loans because of shortage of credit facilities. That would be the ultimate, you see, that we are moving toward.

Senator PROXMIRE. I understand.

Now, there are some banks then which cannot make sound loans at the present time because their reserves are inadequate and they are not in position to make them, but they are very few?

Mr. MARTIN. They are relatively few.

Senator PROXMIRE. Relatively a small proportion of the economy?

Mr. MARTIN. That is right. And without criticizing our banker friends, some of them are those who were the most aggressive at the peak, you see.

Senator PROXMIRE. I see.

Mr. MARTIN. And so they have to go through a process of digestion before they—

Senator PROXMIRE. The reason I am asking these questions is that it seems to me, in view of that answer, that we have reached about as far as we can go in stimulating the economy through monetary policy.

Mr. MARTIN. I would not say entirely.

Senator PROXMIRE. It may be in the future that more loans can be made if the economy for some other reason starts moving upward. But at the present time through monetary policy, through making more reserves available, and so forth, there is not very much that the Federal Reserve Board can do; is that not correct?

Mr. MARTIN. There is very little additional that the Federal Reserve can do at the moment.

Senator PROXMIRE. So if something is going to be done to stimulate the economy, we cannot rely on monetary policy at this point. We have to go ahead with fiscal policy, if we are convinced something should be done?

Mr. MARTIN. Well, I would not go quite that far, because I think monetary policy takes some time to work. I am not quarreling with your major thesis, but I am trying to point out that this process is one where first you have a decline of the demand for credit. Then as this process goes on you have the banks taking a new look at the picture and you have credit reassessment taking place around the picture.

And there may be another opportunity when we could be helpful in the picture without endangering banking equilibrium.

Monetary and credit policy has already made some contribution, but its major contribution will come probably in the course of the next few months because of the timelag.

Senator PROXMIRE. I see. The contribution may develop later from the steps that have been taken already?

Mr. MARTIN. That is right. I would not say every step that could be taken.

Senator PROXMIRE. I understand.

Mr. MARTIN. I do not want to—

Senator PROXMIRE. You made the statement that because of the big increase in the gross national product we had a situation in which the economy was perhaps racing ahead too fast and monetary restraints were necessary in order to keep it in balance. You did not say that, but that is roughly a paraphrase of your position.

Mr. MARTIN. That is correct.

Senator PROXMIRE. And the reason was because it was increasing much faster than the actual physical production of goods and services?

Mr. MARTIN. The dollar volume of the GNP was going up but the physical volume was not.

Senator PROXMIRE. I am going to ask a question that I am deeply concerned about and I have not heard any real answers to, but I think it is a fundamental question in our economy. That is, how can we develop a more ambitious standard in view of the challenge we are up against with the Soviet economy which has been advancing not at a rate of 2 or 4 percent in the physical production of their goods but 8, 10, or 12 percent according to the most reliable estimates we can get?

Now, is it your judgment that if we are going to have a free economy this is something we just have not solved? Do you feel we cannot do this without excessive inflationary pains?

Mr. MARTIN. No; I would not say you cannot. I think that what you are trying to build is strength that can be sustained. Now, when you look at the Soviet economy, you must not think that they do not suffer from the same problems we do. Take this matter of losses.

Senator PROXMIRE. I am sure they suffer a great deal more than we do.

Mr. MARTIN. I think so too. But take the problem of losses, which I find the most difficult to deal with. We have a profit and a loss economy. Now, when losses come, the difference between the Soviet economy and ours is that they socialize their losses and we do not. But now when you talk about the rate of growth over there, I spent several months in Russia in 1943 and I went down to Magnitogorsk and looked at the steel mills and was very much impressed with their progress at that time. I know it must have been colossal since then.

Unquestionably, if you are talking about the overall standard of living—and here I do not know what I am talking about in terms of Russia—I think they are faced with the same problems that we have. You saw the breakdown of their farm program probably a year ago in a broad sense.

So that I question a little bit whether you can say—on individual lines they have run 8 or 10 percent ahead of us. Maybe in steel, you see, compared to our expansion there. But if you take the overall economy, I just question it.

We are talking about our technology and development. We may have to emphasize more some things in this country that we have not been emphasizing. We may have to have less of some popularly advertised products that people like and more basic research and make some sacrifices in current luxuries, you see, in order to get the long-range development and technological progress that the Russians with the mailed fist have been able to do without too much trouble. But, in a free society, we have possibly gone somewhat soft.

Senator PROXMIRE. You do not feel that in the last few years our rate of productivity development has slowed down?

Mr. MARTIN. No, I do not; at least no more than temporarily.

Senator PROXMIRE. Historically it is all right? It is just in comparison with a totalitarian country which has this capacity to depress its people and keep its standard of living down and then enormously increase its productive plant?

Mr. MARTIN. And the figures that we get from them emphasize certain things like steel, for example, or armament production, to the exclusion of the general—

Senator PROXMIRE. Their whole productive plant. For instance, the most startling increase I have seen is in cement, which they have increased thirteenfold since 1945. They have had an enormous increase as compared to ours in electric power, in coal production, in almost everything you can mention as far as their productive plant is concerned.

Let me get into something a little more related to your testimony. You talked about the fact that we had a price rise in the face of a stationary output recently, or relatively stationary, and I wonder if we can expect in your judgment to prevent this without adopting some kind of policies we do not have now.

What I am concerned about is the fact the studies I have seen by Gardiner Means and others indicate a great deal of our inflation has been in the so-called administered price section of our economy, sections in which a few companies dominate an industry and in which they have not had a price reduction for over 25 years.

In view of the fact of life that these units are going to exist in our American economy and make a great contribution, do you see that there is any way that we can prevent this sort of administered inflation by the kind of policies that we have now, or do we have to adopt something new, take a different look at it?

Mr. MARTIN. Well, I do not know. The tail end of any boom period has people struggling to hold on to price levels—the reason for it being the expectation of higher prices that frequently galvanized them into additional activity to beat their competitors. So that the profit squeeze gets rougher and rougher for them. And nobody likes to take a loss. You get back to this loss operation.

The unfortunate thing about private enterprise—and I happen to believe in private enterprise—is that many people who practice private enterprise are not willing to take losses when the going gets tough. They come running down to the Government or the Federal Reserve Board or someone else to make the adjustments for them, or they hope against hope that they can borrow enough money so that they can stave off the adjustment that would move their inventory and create new demand.

Now, I happen to be one who believes that you can interfere with the laws of supply and demand for limited periods of time, but only for limited periods of time, and that in the long run they catch up with you.

Of course, it would be nice if we had some mechanism where these adjustments could be more delicate.

Senator PROXMIRE. We have been interfering with the laws of supply and demand, and we are going to for a long, long time, as long as we have an industry like the steel industry where they keep increasing their prices whether the demand is going up or down and have consistently.

Mr. MARTIN. Well, I do not know enough about—

Senator PROXMIRE. And many other industries with which you are familiar.

Mr. MARTIN. Well, I do not think they can do it indefinitely, though, any more than any of us. The laws of supply and demand in the long run will have their impact with all of us. You can hold it for a certain length of time, and then it gets too big for you. That has been the past history.

And I think it certainly occurs in the Soviet Union as well as here. It just means that the loss when it comes has to be absorbed in some other way than by private companies.

Senator PROXMIRE. At any rate, another weapon in combating inflation along with monetary and fiscal policy could be an antitrust policy which would attempt to create conditions that would be more amenable to the effect of supply and demand.

Mr. MARTIN. The maintenance of sound competitive enterprise as an antitrust policy is certainly a vital part of our system.

Senator PROXMIRE. Thank you, Mr. Chairman.

Senator FREAR. Senator Case?

Senator CASE. Mr. Martin, I have just one question on the matter of dealing with combating the recession. May I say, of course, I recognize that we are asking—and I am here asking—something outside of your particular responsibility.

But you do have a cautionary note—I think it is proper to have the caution—that we should not take action which might very well lead to aggravating an inflation which might get under way as a result of our activities.

Is it not possible, however, to take massive action to turn the tide and still have that action temporary so it would not have the dangers of adding cumulative effect to an inflationary spiral that is always a danger when you get things going up again? As far as we have a responsibility, or any sector of the Government has a responsibility, should it not be for that sort of thing that we are looking?

A big tax cut if you like, but for a temporary period? Or public works that can be immediately put into effect but accomplished within a rather quick period pending a decision as to whether they should be renewed or what not?

Would not much of your objection to Government action be dissipated if the actions we took were of that nature?

Mr. MARTIN. Oh, yes indeed, I think so. But I think even there you have to emphasize the size of the action in terms of my illustration, which may not be a good one, in taking a hypodermic. There is a

period perhaps where the patient can take a little bit of drug. "Drug" is a poor simile, but I am sure you follow me. And if you do too much, it may become self-defeating.

Now, the problem, of course, on the temporary action is judging the timing of it, and that is a very difficult thing. I am just talking about the Federal Reserve Board. I find one of the problems in the Federal Reserve System is that we like to maintain the status quo. We say, "Well, we will be flexible," you see, and so we finally debate something for a long period of time and we come out with a decision and we say, "Well, now we will be flexible." But then, having done it, we sit by for weeks and think just a little bit more time should pass.

And I think that is the problem you have with fiscal policy or anything else.

But I agree with you on the temporary nature of it.

Senator CASE. But again, at the risk of appearing not to understand it—I think generally I do—why can we not have massive action that will have temporary effect? There will always be some danger that a boom once started will get out of hand. But why can we not have it without having the effect of that complicate the ordinary problem which always exists in any period of even reasonably full employment, not necessarily an inflation, but inflationary tendencies, price rises that continue?

For my own self I have been persuaded at least theoretically that it should be possible to devise actions of this kind and, subject to institutional difficulties and human frailties and all the rest, which of course come into the picture, and political difficulties too, that we ought to be able, if we could surmount those, to find the technical remedy for a situation like that which we are in now.

Mr. MARTIN. Well, I think it would be fine if you could. But you have got the problem of psychology. I do not know any other word to use for it. You have this problem in massive action.

It is like anything you take. I have got a cold at the moment, for example. My doctor gave me some acromycin. Well, he told me, "You can take that for a certain period of time. It knocks the cold on the head. But if you take it too long it is self-defeating."

Well, now, I think in your timing of this or your use of massive action it has got to be related to something of that sort. And I think that is very difficult to gage.

I think at the present time, to get back to my thinking at the moment about the economy, the patient needs a little period of convalescence here, irrespective of what happens. There are some points that you get into where I think you need a little rest cure, and there is no other thing that you can get for it. You need to contemplate your situation and think about it.

Now, I think we made some bad mistakes. We let inflation get so far ahead of us that now when we try to unravel the knots it is a painful process. And I do not know any pain killer we have that will completely absolve the necessity of unraveling those knots.

Senator CASE. Well, let me then, if I may, just for a couple of minutes—is it all right to go ahead?

Senator FREAR. Yes. The Senate is in session. I do not want to limit anybody, however, Senator.

Senator CASE. To get to the side of restraint of inflationary tendencies, I think it is true, is it not, that the area within which the Board can effectively operate has been considerably narrowed over the last 25 years?

Mr. MARTIN. Yes indeed.

Senator CASE. For a number of reasons, such as, well, the fact that the private sector of the economy on which you operate is a smaller part of the whole economy, maybe almost a hundred per cent smaller.

Mr. MARTIN. That is right.

Senator CASE. The fact that other than commercial banks have assumed a larger part of transferring people's savings into productive activity. The fact that corporations themselves out of their own resources—depreciation reserves and what not—do a great deal larger part of their own financing than they used to in relation to the part from borrowing from the public and through various institutions.

In view of this, is there any desirability in your judgment and that of your colleagues of enlarging your area of control to make more effective the kinds of indirect restraints which you have the instruments to apply?

This is a subject that I know you have been thinking about. You cannot answer it in 2 minutes, or anything of that sort, but in general is that not a problem that it would be useful for us to get your considered advice on—and continuously?

Mr. MARTIN. Well, this is a real problem and it is why I have welcomed all these efforts to have a real review, a long, careful review, of our monetary and credit problem.

But in the final analysis, where I come out on parts of it is that you say the private sector is influenced, you see, as against the public sector. Now, part of my problem comes in helping finance the Government, and we must help finance the Government, so that if you were to transfer to the Board—we have plenty of headaches as it is now—authority that would help us control the appropriations outcome of the Congress, for example, we just could not operate because—

Senator CASE. I do not really think I had that in mind.

Mr. MARTIN. Yes.

Senator CASE. There are private sectors of monetary operations where your influence is only indirect, and—

Mr. MARTIN. It is indirect; that is right. And we have had long discussions about selective controls, you see. I do not think we have had the final answer on that by any means.

Senator CASE. Just a couple of other questions. There is increasing concern, of course, and discussion about whether monetary policy and fiscal policy too can adequately do the job of preventing creeping inflation. Many suggestions have been made.

One of them recently was that we will have to come to direct controls. A particular suggestion of that sort recently came to my attention that in substance, as I understand it, we should not control each specific price but that we should at least in certain times or under general authority, which could be exercised perhaps by the Federal Reserve or some other agency, fix limits beyond which prices or wages would not be permitted to ride. Presumably ceilings.

Have you any general comment on the possibility of a ceiling-floor operation as opposed to a fixing of specific prices? Does that sugges-

tion offer any possibility of consideration beyond those which would be involved in direct and complete, precise price controls?

Mr. MARTIN. Well, I think the administrative enforcement problem in a free country is almost insuperable.

Senator CASE. My question specifically is: Do the same difficulties apply to a system in which ceilings on prices and floors—

Mr. MARTIN. I think so. I think so.

Senator CASE. So that there is no particular light cast by that suggestion as far as you are concerned?

Mr. MARTIN. That would be my personal thinking.

Senator CASE. Just one other point. On this question of prices, and wages too, it has been suggested that, while they are sticky, certainly insofar as money terms are concerned, a very substantial price reduction in effect is given by an increase in quality and an increase in service, at periods such as those we are in now. Also increased productivity on the part of the wage earner.

Mr. MARTIN. Yes.

Senator CASE. Is this, first of all, significant in your judgment?

Mr. MARTIN. Yes, I think it is.

Senator CASE. As an adjustment not appearing on the indexes, but actual. Does it have a significant value as far as controlling the economy is concerned?

Mr. MARTIN. Yes, I think so, but it is very difficult to measure.

Senator CASE. Of course, it is indeed difficult to measure. But in your judgment this kind of adjustment is, for example, going on at the present time?

Mr. MARTIN. Going on right now. No question of it. That is one of the encouraging signs.

Senator CASE. Just one other and a general question. The complaint is made that we have attempted to use this instrument of monetary policy, credit control policy, beyond its potential, to rely too exclusively on it, and that we had better not only modify our use of that but search until we find some other complementary means of general control if possible, and, if not, specific control.

I am no expert in the field. I guess it would certainly be right that to continue too long any kind of controls would mean they lose their effectiveness and would have adverse effects. Certainly that applies, does it not, to credit stringencies?

Mr. MARTIN. It does indeed. It certainly does.

Senator CASE. Have you any comments about your general role? I do not mean to ask you to talk it down. But is it true that what we have done in effect is, as I think some prominent economist said, to get back to the best thinking of the 1920's but not progress beyond that in this general field?

Mr. MARTIN. I think a review of the whole thing would be very useful. I am probably too close to it to have as objective a view as one should. I think we tend in our own shop to either exaggerate our possibilities or to underestimate them, and I think it is awfully hard when you are as close to something as we are to really get an objective appraisal of it.

Take, for example, the question as to whether you could by monetary policy halt inflation in its tracks. If you were willing to just starve the money stream so it would dry up you could produce chaos,

but I do not think anybody contemplates that type of money and credit policy.

Now, if you are talking about using money and credit policy to achieve against a whole lot of other things, such as slow expenditure stream, then I do not think it is equal to the task. I do not think it should be expected to be equal to the task. It can be a red flag and it can help hold back the water in some respect.

Senator CASE. Thank you, Mr. Chairman.

Senator FREAR. Senator Clark?

Senator CLARK. Mr. Martin, I want to congratulate you on what seems to me to be a very clear and lucid and extremely helpful presentation this morning.

I would like to note that I have no criticism of your actions in the past. I think within the limits of human frailty your board has done a first-class job.

I want to indicate agreement with you that we should not look for a tax cut at this time.

And having therefore established somewhat of a rapport, I wonder whether you would agree that a deficit for the current fiscal year is practically inevitable and is quite probable for the next fiscal year.

Mr. MARTIN. I think it is probable, yes.

Senator CLARK. In view of that, is it not important we increase the debt limit ceiling promptly?

Mr. MARTIN. Well, I think you have no alternative.

Senator CLARK. And, therefore, you would favor it?

Mr. MARTIN. I would favor it.

Senator CLARK. Do you not think in the interest of flexibility the sooner it is done the better?

Mr. MARTIN. I do.

Senator CLARK. I agree with you too that the patient needs a rest. I suggest that while he is resting he needs some nourishment, and I think a good way to give him some nourishment would be to make him work for it and create some wealth in the public sector of the economy where it is badly needed.

I am speaking in terms of housing, schools, and highways; just to mention a few categories.

Last year you will recall there were many—I do not recall whether you were one or not—who said that Federal, State, and local public works should be postponed to prevent adding to inflation. I wonder if you would agree that at this time there is no further need to keep the brakes on Federal, State, and local public works in view of the substantial decrease in spending in the private sector of the economy?

Mr. MARTIN. I would agree with that. I would say that there ought not to be at this juncture created works just for the sake of creating employment. They should be items that are needed and necessary and going to contribute something. They should not be just strawmen.

Senator CLARK. I agree with you completely on that. We do not want to get back into a leaf-raking program.

Mr. MARTIN. That is right.

Senator CLARK. But I think my State is the third hardest hit of the 48 in terms of unemployment. It is really very serious. We have 435,000 Pennsylvanians entirely out of work and another 100,000

working half time or less. And we are trying to get going at the local, State, and National level an expediting process for already-authorized public-works programs with special emphasis in the three areas I mentioned, which are schools, housing, and roads.

There is nothing in your philosophy which would indicate that was an unsound move, is there?

Mr. MARTIN. No.

Senator CLARK. I was interested to note your reference in passing, in answer I think to Senator Case's questions, which I think indicated a philosophy very similar to my own, about selective controls. You will recall that you and I and Mr. Riefler had a little discussion about that last year.

Mr. MARTIN. Yes.

Senator CLARK. I hope you have not given up a careful consideration of the possibility of selective controls and that you will keep on thinking about the possibility of finding some way of free credit for areas in the public sector of the economy where we are very backward if not obsolete. Where the need is very clear, and where for the past 2 years we have been able to do so little because your own monetary policies, taken I am sure conscientiously and probably correctly in regard to the overall economy, have made it impossible to move ahead with badly needed construction and improvements in the public sector of the economy.

Has your thinking progressed at all as to how we can move ahead to get more houses and more schools in a situation where you have to put monetary brakes on because you are afraid of inflation on the overall picture?

Mr. MARTIN. No, I am afraid you would not think it had moved forward at all, because I think that the market is pretty nearly the only way you can do it.

Now, take the matter of schools, for example. We discussed that before. Naturally we are not against school construction. But it was the cost of the school building, not the cost of financing, that in my judgment was getting the better of the school program. The inflation was just mounting on all sides, you see.

Now, the interest rate did postpone I think some buildings of that sort because they said, "Well, we will not pay more than 3 percent," or something of that sort. Now, those can come back in at the present time. They have been postponed.

And you can say, "Would there not have been some way of keeping these luxury apartments from going up over here and transferring it over there?"

Well, there you are up against the problem of who does it and would we have a more satisfactory society administered that way. And you can have differences of judgment on that.

But I think, by and large, we will be happier and get more in the long run by the market process, although I frequently dislike it just as much as you do.

Senator CLARK. I wonder if you would go so far in your free-market philosophy as to oppose the present low interest rate on the college-loan program which was created, as you know, under the auspices of the chairman of this committee, to enable some very badly needed college dormitories and other buildings to be built at very low rate of interest.

Mr. MARTIN. Well, if that low cost is maintained, as I think it was in the last couple of years, at the cost of having the price of building materials and all the things that go into the college housing program going up somewhat more—there is no mathematical ratio on this—I would say that that is a pretty heavy expense to pay for something that is an ideally good thing.

Senator CLARK. Would you not agree that had that interest rate been allowed to reach its market level we just would not have gotten any of these dormitories built?

Perhaps you would not agree. But that is certainly my judgment based on the evidence we have had before this committee.

Mr. MARTIN. Well, I question that. I am enough of a free-market man to believe there might have been more.

Senator CLARK. I guess you are still pretty unregenerate, Mr. Martin. I will leave you on that subject.

I am glad to note a little change in attitude. Maybe the erosive process over the years will result in some change.

Let me shift to just one more question and then I will be through. I am concerned with the fact that there appears to be so great a lag between the reduction in your interest and rediscount rates and the spread of those cuts through the free market. I am particularly concerned because I understood you to say that you thought there had been a substantial easing in the mortgage market—and it may well be that there are national statistics to back that up.

All I can say is that I still am having a very rough time getting a mortgage at what I consider to be an appropriate rate of interest on my own house, and I see no indication that the change in the Federal policy has resulted in any real easing in the mortgage market.

I wondered on what you based your view that it has. I am sure you have some statistics to show that I am just dealing with a stubborn pack.

Mr. MARTIN. Well, I have no very convincing statistics at the moment, but the reports we get from all over the country have certainly changed in character from what we were getting 4 months ago. And we also have a slight increase in housing starts, and we have more and more indication from various areas that money is available.

In fact, I have even talked to a number of people who were seeking out—

Senator CLARK. Let's hope that turns out to be right. Certainly one man's experience is no trend. But I think you would agree, would you not, that low interest rates are essential to the creation of an effective demand in the low and moderately priced housing market?

To rephrase it another way, you cannot build a house and finance it at a price which at least half the number of American families can afford unless they can finance it at a far cheaper interest rate than was available while your tight-money policies were in effect last year?

Mr. MARTIN. Well, I question whether you could afford to go on with the increase in building materials and other components in the house also.

Now, here is a \$13,000 house that cost \$15,000. I would much rather do something on that area than worry about a half percent interest on the financing.

Senator CLARK. I know you would, and that is one place where we differ a bit. My point there would be that history would seem to indicate, recent history would seem to indicate, that there are no effective measures by which decrease in those costs can be induced either by monetary policy, by fiscal policy, by antitrust policy, or by any other means. And that is what gives me such great concern. I do not see how we are going to fight ourselves out of this administered price tradition which seems to be spreading from the automobile and steel industries into bank rates on mortgages and into the price of everything that we buy.

The end result, I fear, is going to be we are just not going to create the wealth we must have if we are going to keep up, as Senator Proxmire said, with the material as well as the intellectual leadership of the world in competition with Russia.

I do not suppose I am really asking you a question. I am just hoping that that first-class mind of yours is going to continue to think about these problems.

Mr. MARTIN. Well, let me just reiterate my own thinking on this. I have never favored high interest rates per se. I would like to see interest rates as low as you can have them without having inflationary counterparts, because I believe that will contribute the most to the capital formation. And I want that capital formation to proceed just as rapidly as it can in this country.

But I think we have to recognize that we have to have savings, and the saver is entitled to some consideration also. He has to have a wage for his saving.

Senator CLARK. I agree with that. But now we have noted that the spending for plant and improvements and other capital facilities in the private sector of the economy has dried up pretty rapidly in the last 6 months. Would you not agree?

Mr. MARTIN. It has declined sharply, yes.

Senator CLARK. Well, now, in order to help cure this recession, could we not afford to put a good many billions of dollars into public improvements in the public sector of the economy without running into a renewed threat of inflation?

Mr. MARTIN. I think at the moment you can, but the point I am trying to stress there is that I would not be too discouraged on your point, because time does quite a lot in this. This is a process—the sort of movement that does not occur in a 30-day swing or a 90-day swing. It reverses itself over a period of 6 months to a year.

Senator CLARK. That I understand.

Mr. Chairman, I will wind it up with just the note that I hope and I am sure that our very good and most able friend is not going to come down here and tell us we should not move very fast indeed with a strong housing program and, if we can get it through the Congress, a strong school construction program, not only because we need them so desperately for our civilization but because it is going to help us get out of this recession.

This is your last chance to say no.

Mr. MARTIN. I will reserve comment.

Senator CLARK. Thank you, Mr. Chairman. That you very much.

Senator FREAR. Thank you.

Mr. Chairman, we are indebted to you for spending some time with us this morning and answering the questions in very enlightening manner. I think most of the members of this committee—as a matter of fact, I believe all of them—have great confidence in you. Especially the chairman of this subcommittee is always happy when you come down. I think we get a stimulus from your answers, and we like the manner of disagreement at times.

It has been nice to have you with us, sir, and any time this committee, or especially this subcommittee, can be of assistance to the Federal Reserve System—which is probably a suggestion in reverse—we offer our services.

Mr. MARTIN. Thank you very much.

Senator FREAR. The subcommittee is adjourned.

(Whereupon, at 12:25 p. m., the subcommittee was adjourned, subject to the call of the chairman.)

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