INVESTIGATION OF THE FINANCIAL CONDITION OF THE UNITED STATES

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INVESTIGATION OF THE FINANCIAL CONDITION OF THE UNITED STATES

TUESDAY, AUGUST 13, 1957

UNITED STATES SENATE,
COMMITTEE ON FINANCE,
Washington, D. C.

The committee met, pursuant to recess, at 10:10 a. m., in room 312 Senate Office Building, Senator Harry Flood Byrd (chairman) presiding.

Present: Senators Byrd, Kerr, Long, Martin, Williams, Flanders, Carlson, Bennett, and Jenner.

Also present: Winfield Riefler, assistant to the Chairman, Board of Governors of the Federal Reserve System; Woodlief Thomas, economic adviser, Board of Governors of the Federal Reserve System; and Edward Wayne, first vice president, Federal Reserve Bank of Richmond.

Elizabeth B. Springer, chief clerk; and Samuel D. McIlwain, special counsel.

The CHAIRMAN. The committee will come to order. Mr. Martin, we are pleased to have you here. I believe this is your first appearance before the Senate Finance Committee.

Mr. MARTIN. That's right, sir.

The CHAIRMAN. The Chair assumes that you know the Senate Finance Committee is undertaking to make a complete study of the financial condition of the United States, including—

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

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

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

This study has been understaken as a result of conditions confronting the committee in the discharge of its direct responsibilities for legislative matters relating to Federal revenue and debt, tariff and trade, and social security and pensions.

These conditions involve the existing credit and interest situation and, more important, inflation which has started again with its ominous threat to fiscal solvency, sound money and credit, and individual welfare.

The committee is exploring these areas and examining the conditions in a serious effort to determine the causes, and so far as possible find the remedies.

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To make such a study complete, the committee must examine fiscal and monetary policies, mark the distinctions between them, and study their relationships, one to the other.

In the discharge of its more direct responsibilities, the committee is necessarily more familiar with other policies involved than it is with monetary and credit policies. The record at this point in the study contains the testimony of the Secretary and the Under Secretary of the Treasury as a basis for consideration of fiscal policy and debt management.

The Federal Reserve Board determines general monetary and credit policy and, as a basis for consideration of this aspect of the conditions which confront us, the committee would be pleased to have your testimony, as Chairman of the Board, with respect to these and related subjects.

You are invited to proceed in your own way to a discussion of conditions, policy and action in this area, but for the record it would be appreciated if, at the outset, you would briefly—

1. Summarize the provisions of the Federal Reserve Act, as amended;
2. Outline the powers, facilities, functions, and responsibilities of the Federal Reserve System and the Board;
3. Describe their organization;
4. Review their relationships with the fiscal agencies and policies of the Government, and the banking system of the Nation; and
5. Explain the purposes of monetary and credit policy, how it is made, why and when it is changed, and how it is implemented.

In addition, it would be helpful to the committee if, in the course of your statement you would discuss the following questions:

1. What, in your own words, is the best simple layman's definition of inflation?
2. Are we in a period of inflation now, and if so, when did it start?
3. Do you regard inflation as our greatest domestic problem at this time?
4. What are the factors which ordinarily cause and contribute to inflation?
5. What caused the value of the dollar to decline between 1940 and 1952?
6. Why did it stabilize between 1952 and April 1956?
7. With basic production generally equal to or in excess of demand, and in the absence of deficit financing, what caused the decline in the value of the dollar to be renewed in April 1956, and the continual decline since that date?
8. Can present inflation be traced in any degree to increased Federal spending started in fiscal year 1956, and the easy availability of Federal loans and Federal guaranties and insurance on mortgages since that time?
9. To what extent is this inflation being caused by increasing labor costs in a degree out of proportion to labor's increase in productivity?
10. To what extent is this inflation being caused by increasing interest costs in a degree out of proportion to the increased productivity of the money borrowed.
11. Is inflation being accelerated now? If so, what is the cause? If not, what is the stabilizing influence?

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12. If inflation continues, how far can it go, and what will be the effects in the process?

13. Once inflation is started, how can it be stopped and can the value of the dollar ever be regained?

14. Generally, will you distinguish between fiscal policy (embracing expenditures, taxes and debt), and monetary and credit policy, and then relate them, one to the other?

15. How does Federal Reserve policy accelerate or control inflation? Roughly, will you list in chronological order the major Federal Reserve policy actions in this respect since World War II?

16. Is fiscal policy action usually necessary as a complement to Federal Reserve policy action with respect to money and credit? If so, will you list recent instances of such policy combinations, cite the occasions, and evaluate the effects or results?

17. I quote section 2 of the so-called Full Employment Act of 1946:

> The Congress hereby declares that it is the continuing policy and responsibility of the Federal Government to use all practical means consistent with its needs and obligations and other essential considerations of national policy, with the assistance and cooperation of industry, agriculture, labor, and State and local governments, to coordinate and utilize all its plans, functions, and resources for the purpose of creating and maintaining, in a manner calculated to foster and promote free competitive enterprise and the general welfare, conditions under which there will be afforded useful employment opportunities, including self-employment, for those willing, and seeking work, and to promote maximum employment, production, and purchasing power.

Will you estimate and describe the weight of this statutory requirement on Federal Reserve decisions? Will you estimate and describe the weight of this statutory requirement on the combination of monetary, credit, and fiscal policy decisions?

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

In your testimony it is not necessary that you take these questions in the order I have listed them; please treat them in any combination better arranged for clarity of discussion, but I would like a written statement concisely answering these questions—to be submitted at the conclusion of your testimony.

(The answers subsequently submitted by Chairman Martin to the above questions by Chairman Byrd follow:)

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

Inflation can, of course, be defined in various ways. The most important thing, it seems to me, is to focus on its causes, its course, its effects, and the means of overcoming and preventing it. My opening statement, as a whole, is devoted to that purpose. See in particular these sections: The Current Problem of Inflation, Conflicting Views on Causes, the Inflationary Spiral, Expectations of Continuing Inflation, Creeping Inflation, Effects on Productive Enterprise, Effects of Inflation, Basic Factors in Recent Inflationary Pressures, What More Can Be Done? (to restrain inflation), and Action Required.

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

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

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

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

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

The sharp increase in consumer spending in 1955 was reflected both in that year and in 1956 by expansion of business expenditures for fixed capital—currently in record volume. In the second half of 1955 and in the course of 1956, aggregate demands appeared sufficiently strong to permit increases in wage and other costs to be recovered through price advances. With the demand-cost-price spiral well underway, expectations of continued inflation became widespread. These expectations, as well as the advanced level of prices, are major influences on continued strong demands for funds. Lenders today have no difficulty whatever in finding favorable outlets for their funds. Industrial prices are now 8 percent and consumer prices 5 percent higher than 2 years ago. Average hourly earnings in manufacturing industries have increased almost 9 percent.

The following table indicates the extent to which increases in the dollar totals of gross national product over the past 2 years have reflected rising prices and increases in the physical volume of goods and services.

Increase in gross national product, 1954–57

Period	Current dollars	Prices	Physical output
	Percentage increase		
2d quarter 1944 to 2d quarter 1955	8.1	1.1	7.0
2d quarter 1955 to 2d quarter 1956	6.0	2.6	3.3
2d quarter 1956 to 2d quarter 1957	5.7	3.5	2.2
	Distribution of increase (percent)		
2d quarter 1954 to 2d quarter 1955	100	14	86
2d quarter 1955 to 2d quarter 1956	100	45	55
2d quarter 1956 to 2d quarter 1957	100	62	38

Increases in physical volume of product were more difficult to achieve after mid-1955 than earlier, since manpower and industrial resources were by then intensively utilized. Moderate increases in output have been achieved over the past 2 years, but inflationary pressures have been so strong that half or more of the dollar increase in product has represented rising prices. The wide disparity between the two over the past year largely represents the steady rise in consumer prices.

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

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

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

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

"CONFLICTING VIEWS ON CAUSES

"There is much current discussion of the origin of inflationary pressures. Some believe they reflect a recurrence of demand pulls, similar to those present in the earlier postwar period. Others believe they originate in a cost push engendered by administered pricing policies and wage agreement that violate the limits of tolerance set by advances in productivity.

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

"There is much to be said for the view that contractual or other arrangements designed as shelters or hedges from inflation have the effect of quickening its tempo. The 5-percent rise in the cost of living which we have experienced over the last 2 years has probably reflected and been reflected in more rapidly rising wage costs because of the prevalence of cost-of-living clauses in many modern wage contracts. Cost-plus contracts tend to have the same quickening effect on the inflationary spiral.

"The spiral is also, however, a demand spiral. At each point of time in the development of the inflationary spiral, there must be sufficient demand to take the higher priced goods off the market and thus keep the process moving.

"THE INFLATIONARY SPIRAL

"The workings of the spiral of inflation are illustrated by the economy of the moment. As has been brought out at some of the earlier hearings of this committee, we are now faced with the seeming paradox that prices are expected to continue to rise, even though the specific bottlenecks in capacity that impeded the growth of production in 1956 have now been largely relieved, and investment in productive facilities continues at very high levels. Houses, automobiles, household appliances, and other consumer goods, as well as most basic materials, are all readily available—at a price. The problem is no longer one of specific shortages or bottlenecks causing prices of individual commodities to be bid up because of limited availability but rather it is one of broad general pressure on all of our resources. In other words, aggregate demand is in excess of aggregate availabilities of these resources at existing prices.

"Taking the situation as a whole, as individuals, corporations, and governments proceed with their expenditure plans, buttressed by borrowed funds, they are in the position of attempting to bid the basic factors of production—land, labor, and capital—away from each other and in the process the general level of costs and prices is inevitably pushed upward. Recently, this general pressure has been expressing itself particularly in rising prices for services as compared with goods. Despite the existence in some lines of reduced employment and slack demand, many employers now face rising costs when they seek to expand activity by adding appreciably to the number employed. Often, the additional manpower required has to be bid away from other employers. As a result, many current plans for further expansion of capacity place great emphasis on more efficient, more productive equipment rather than on more manpower.

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"This generalized pressure on resources comes to a head in financial markets in the form of a shortage of saving in relation to the demand for funds. A considerable volume of expenditure is financed at all times out of borrowed funds. When these funds are borrowed from others who have curtailed their own expenditures, no additional demand for resources is generated. On balance, however, demands for funds by those who have wanted to borrow money to spend in excess of their current incomes have outrun savings. Those who have saved by limiting their current expenditures, and thus made funds available for lending, have still not kept pace with the desire of governments, businesses, and individuals to borrow in order to spend."

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

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

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

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

These heavy demands for goods and services, backed by large accumulations of cash and of Government securities in the hands of consumers, business, banks, and other financial institutions, imposed strong pressures on the administrative effectiveness of existing price and rationing controls. As these were relaxed and finally eliminated, prices rose rapidly. Moderate cash surpluses in the Federal budget in 1947 and 1948 helped to restrain inflationary pressures in these years, as did regulation of the use of installment credit. On the other hand, the Federal Reserve was inhibited from exercising flexible market restraints by the continued policy of supporting market prices of Government securities. Thus member bank reserves were provided virtually on the demand of holders of such securities. Between 1945 and 1948 the Consumer Price Index rose one-third; this 3-year period accounts for about one-half the absolute increase in the Consumer Price Index from 1940 to 1952.

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

This upward price movement was sharply accelerated during the Korean war as consumers and businesses stepped up their purchases of goods acting upon expectations of inflation and shortages that might result from the Korean hostilities and the defense program then being formulated. This expansion of private buying was financed in part by a large and rapid expansion in bank loans. Until March 1951, when the Federal Reserve policy of supporting Government securities was ended, there was little deterrent to sales of Government securities by banks and other holders for the purpose of expanding private expenditures. Moreover, enlarged Government expenditures in connection

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with the Korean hostilities as well as the defense buildup here and abroad soon added to the overall demand for goods and services. Price and wage controls, materials allocations, and installment credit regulations were reimposed. Wholesale prices turned down in early 1951, but consumer prices continued to creep upward during the rest of that year and in 1952, as rents, transportation and utility rates, and other lagging prices continued to rise slowly.

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

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

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

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

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

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

During this period of changing economic climates, Federal Reserve policy was aimed at supplying adequate credit for growth but at the same time avoiding credit excesses. Restraint on bank credit expansion was strengthened in 1952 and early 1953. During the slackening in activity from mid-1953 until the last half of 1954, the major contribution of credit policy was to facilitate bank lending and to avoid a decrease in the money supply. The easier credit availability provided support for mortgage lending and for financing by utilities and by State and local governments. In addition to easier credit, large tax

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reductions in 1954 helped to stimulate both consumer buying and business investment. After mid-1955, resumed economic expansion and accelerated credit demands again pressed upon the limits of productive capacity and the supply of savings available for investment. Credit restraints were exerted to help keep monetary growth within reasonable bounds.

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

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

7. With basic production generally equal to or in excess of demand, and in the absence of deficit financing, what caused the decline in the value of the dollar to be renewed in April 1956, and the continual decline since that date?

The basic cause of renewed decline in the value of the dollar, to quote from my opening statement, is that "aggregate demand is in excess of aggregate availabilities of these resources at existing prices." It is true that expenditures for some important products—notably automobiles and houses—declined considerably in the course of 1956 and currently are smaller than in the third quarter of 1955. Business inventory accumulation this year has also been smaller than in 1955 and 1956. On the other hand, other demands have increased. Business outlays for plant and equipment are currently 28 percent above the level of 2 years ago. Consumer outlays for nondurable goods and services and State and local government expenditures have risen without interruption. If demands for autos and housing had continued as strong as earlier, in addition to the demand pressure we have actually experienced, overall inflationary pressures would have been even more intense than they have been.

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

[In billions of dollars]

Fiscal year	Federal surplus or deficit (−)	
	Budget	Cash
1955	−4.2	−2.7
1956	1.6	4.5
1957	1.6	[1] 2.0

[1] Estimate.

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

Fundamentally, the force of inflationary pressures has not been interrupted over the past 2 years, although its pattern of influence has changed. In the late winter and early spring of 1956, the opinion was expressed in some quarters that the boom was coming to an end and that inflationary pressures were virtually over. In retrospect, it is clear that this view was a misreading of the situation. The view relied heavily on the decline in consumer outlays for automobiles and housing. It did not adequately appraise the formidable strength of

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business demand for fixed capital. When the McGraw-Hill and Commerce-SEC surveys of business intentions to spend on plant and equipment, available in the spring of 1956, revealed intentions of further large expansions, from already record levels, and as business concerns began to borrow in enormous volume both in the long-term capital market and from banks (particularly at the March and June tax dates), views about the future again became generally bullish. Moreover, throughout this period consumer demands for nondurable goods and services and State and local government demands related to capital programs and current operations continued very strong.

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

8. Can present inflation be traced in any degree to increased Federal spending started in fiscal year 1956, and the easy availability of Federal loans, and Federal guaranties and insurance on mortgages, since that time?

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

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

In retrospect, considering the course of events over the last 2 years, it is clear that in an economy as large as ours and with the proportion of Government-stimulated activity as high as it is in our economy, the Federal Government should plan on larger budget surpluses in periods of high activity. As I commented in my statement, "The present situation calls both for a larger budgetary surplus than we have had or have in prospect, and a continuance of restraint upon creation of new supplies of money."

9. To what extent is this inflation being caused by increasing labor costs in a degree out of proportion to labor's increase in productivity?

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

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

The facts for the postwar period indicate fairly clearly that real weekly earnings have increased significantly only in those periods in which prices were stable. (See table at end of answer.) Over the past year rising consumer

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prices have offset wage increases with little or no real gains in earnings for the average worker. Workers have been attempting increasingly, through cost-of-living escalator clauses or current wage negotiations, to obtain wage increases which will both meet the rise in prices and also provide for increases in standard of living. If past experience is any guide, however, further increases in money wages are not likely to result in gains in average real earnings as long as prices rise. This is one manifestation of the process of inflation in which rising costs and prices mutually interact upon each other over time with a spiral effect.

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

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

In the nonmanufacturing sector, measurement of output per man-hour is subject to even greater qualification than in the manufacturing industries, because it is so difficult to measure output in physical terms. In any event, the very expansive demands in all nonindustrial activities in the past 3 years—especially in the trades, services, and State and local governments—have been a significant factor in bidding up wages and prices in these activities.

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

Rises in "real weekly earnings" in manufacturing industries in the postwar period have varied from year to year and have not always paralleled yearly

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changes in productivity. In the long run, real wages have increased in line with rising productivity, but in the postwar era money wage rates have risen fairly steadily from year to year, while real gains in earnings occurred when consumer prices were relatively stable. Average wage increases were only about sufficient to offset higher prices when prices were rising rapidly, but they were accompanied by real advances in worker's earnings when prices were stable. From mid-1946 to mid-1948, a period of sharply rising prices following the conclusion of World War II, both consumer prices and average weekly earnings in manufacturing rose by almost 25 percent. This was followed by a period of little change in prices between mid-1948 and mid-1950, prior to the outbreak of Korean hostilities. In this period "real" weekly earnings increased about 10 percent. In the following 2 years, mid-1950 to the spring of 1952, sharply rising prices again offset rising weekly wages, each rising about 10 percent in the period. With prices again relatively stable between the spring of 1952 and early 1956, weekly wages continue to rise and significant gains in "real earnings" were achieved. In contrast, since early 1956 consumer prices have advanced by 5 percent, about the same as the rise in weekly earnings in manufacturing industries.

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

Changes in consumer prices and in average weekly earnings in manufacturing, July 1946–June 1957

Period	Percentage changes	
	Consumer Price Index	Average weekly earnings in manufacturing
July 1946 to July 1948	23.3	24.4
July 1948 to July 1950	−1.3	9.7
July 1950 to July 1952	10.9	11.2
July 1952 to July 1954	1.0	7.7
July 1954 to July 1956	1.6	10.8
March 1956 to June 1957	4.8	5.1

10. To what extent is this inflation being caused by increasing interest costs in a degree out of proportion to the increased productivity of the money borrowed?

In my opening statement, I discussed the question "Do rising interest rates add to inflation?" as follows:

"We must be clear in viewing these relationships to distinguish cause from effect and not to confuse them. It is sometimes said that rising interest rates, by increasing the costs of doing business, lead to higher prices and thus contribute to inflation. This view is based upon an inadequate conception of the role of interest rates in the economy, and upon a mistaken idea of how interest costs compare with total costs. In municipal government budgets, it is about 2 percent; in many utilities, it is 3 to 5 percent. Thus, as an element of cost, interest rates are relatively small; but, as a reflection of demand pressures in markets for funds, interest rates are highly sensitive. As previously explained, rising interest rates result primarily from an excess of borrowing demands over the available supply of savings. Since these demands are stimulated by inflation, under these circumstances rising interest rates are an effect of inflationary pressures, not a cause. Any attempt to prevent such a rise by creating new money would lead to a much more rapid rise in prices and in costs than would result from any likely increase in interest rates. Such an attempt, moreover, would not remove the need for a fundamental adjustment in the relation between saving and consumption and probably would fail in its purpose of stabilizing interest rates."

I went on to say:

"A major cause of recent inflationary pressures has been the attempt to crowd into this period a volume of investment greater than the economy could take without curtailing consumption more than consumers have been willing to do.

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In fact, there has been some increase in consumption on borrowed funds. Increases in interest rates naturally come about under such conditions; they are the economy's means of protecting itself against such excessive bunching of investment or the building up of an unsustainable rate of consumption. While the effect of a moderate change in interest rates on the cost of goods currently being produced and sold is small and relatively unimportant, changes in interest rates do assume importance as a cost in the planning of new investment outlays. These costs do not affect current operations or add to upward price pressures to any substantial extent. They do tend to deter the undertaking of new investment projects and to keep the amount of investment spending that is being undertaken in line with the economy's ability to produce investment goods. To maintain artificially low interest rates under these conditions, without introducing any other force to restrain investment, would be to invite an unbridled investment boom, inflation, and an inevitable collapse later.

"It is necessary to emphasize that there are many influences, other than monetary policies and interest rates, that affect the volume of consumption, investment, and saving and their relationships."

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

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

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

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

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

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

Changes in labor productivity are generally measured by dividing changes in total output of goods by changes in the total input of man-hours expended in producing the goods. Actually, of course, increased output results largely

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from providing workers with more and improved machinery and equipment, so that in a sense changes in output per man-hour measure changes in the productivity of capital as well as labor.

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

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

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

Increase in public and private debt, Dec. 31, 1954, to June 30, 1957

[Billions of dollars]

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

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

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

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

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

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

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

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

12. If inflation continues, how far can it go, and what will be the effects in the process?

13. Once inflation is started, how can it be stopped and how can the value of the dollar ever be regained?

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

"Once such a spiral is set in motion, it has a strong tendency to feed upon itself. If prices generally are expected to rise, incentives to save and to lend are diminished and incentives to borrow and to spend are increased. Consumers who would normally be savers are encouraged to postpone saving and, instead, purchase goods of which they are not in immediate need. Businessmen, likewise, are encouraged to anticipate growth requirements for new plant and equipment. Thus, spending is increased on both counts. But, because the economy is already operating at high levels, further increases in spending are not matched by corresponding increases in production. Instead, the increased spending for goods and services tends to develop a spiral of mounting prices, wages, and costs."

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

The most constructive results ensue when inflation is stopped because appropriate fiscal and monetary policies are applied in time. As I said in my statement. "The most constructive result is the encouragement of a volume of savings and investment that permits continued expansion of productive facilities at a

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rate consistent with growing consumption demands." This type of constructive result takes place recurrently in the course of the business cycle when the forces generated during the upswing do not culminate in an inflationary spiral but rather diminish in potential as full capacity is reached. Adjustment of this type takes place without severe price repercussions. The higher price level prevailing at the time of the adjustment tends to be maintained except as it may subsequently reflect increases in productivity.

An inflation will stop when a condition is achieved where current investment can be financed out of savings without undue reliance on newly created money and where prospective savings and investment are not motivated by the expectation of further or continued inflation. As I said in my statement, "Only in this way can the standard of living for a growing population be improved and the value of savings be maintained.

"Such constructive adaptations, if made in time at the onset of inflationary pressures, need not be large in order to restore balance between prospective demands and the resources available to meet them. It is essential, however, that the adjustment be made. Otherwise prospective expenditures will continue to exceed the resources available and the pressure of excess demand will foster an inflationary spiral."

14. Generally, will you distinguish between fiscal policy (embracing expenditures, taxes, and debt), and monetary and credit policy, and then relate them, one to the other?

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

The article is as follows:

"Federal Financial Measures for Economic Stability [1]

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

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

"Credit and Monetary Measures

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

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

"Bringing about credit restraint or ease through these measures has widespread effects on the economy. Their most direct impact is on the amount of

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

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

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

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

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

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

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

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

"FISCAL MEASURES

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

"The influence of fiscal action on economic stability arises chiefly out of a difference between the Government's cash receipts and cash expenditures. The

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difference causes a cash flow of payments between the private sectors of the economy and the Government. In general, a cash flow from the Government has expansive effects on the economy's overall expenditures, while a cash inflow has contractive effects. These effects induce further spending or restriction of spending in the private sector.

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

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

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

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

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

"Different combinations of taxation and Government expenditures result in deficits or surpluses and accordingly involve Treasury borrowing or permit repayment of borrowing. The amount of the borrowing or repayment is determined by fiscal action; the manner and kind of borrowing or repayment are in the realm of debt management. The extent of the expansive or restrictive impact of fiscal measures depends not only on the relation between taxation and expenditures but in part on debt management operations. The effects of fiscal

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action in attaining economic stability are thus related also to debt management, and the effectiveness of this relationship in turn depends on the financial climate created by credit and monetary measures.

"DEBT MANAGEMENT

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

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

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

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

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

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

"Within the standards set for debt balance, current debt management can operate to reinforce or offset in part the impact of a Federal deficit or surplus. For example, a deficit in a recession period may be made somewhat more effective if in its financing the emphasis is placed on the use of shorter term obligations. The expansive effects will tend to be greater and will support an expansionary credit and monetary policy to the extent that such issues are absorbed by the

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banking system and foster expansion in the money supply. Conversely, a surplus in a boom period will be more effective as a restraint on expenditures if it is used to retire short-term debt rather than to purchase long-term securities in the market. The restraining effects will tend to be increased and will reinforce restrictive credit and monetary policy if the repayment of debt reaches the holdings of short-term issues by the banking system, thus affecting bank liquidity positions.

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

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

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

"INTERACTION OF FINANCIAL MEASURES

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

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

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

"In depressed periods, credit and monetary measures should ease bank reserve positions, making bank credit and other credit cheaper and more readily available. Such action will encourage the use of credit and prompt a rise in Government security and other capital values, thus increasing the economy's liquidity. This kind of policy will also facilitate financing of any Federal deficit. If some substantial portion of the new securities offered are shorter term obligations, debt management will be functioning at the same time to increase the liquidity of the economy. To the extent that such securities are purchased by banks there will be an offset to contraction of private bank credit and a consequent

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stabilizing effect on the volume of money. Along with an expansionary credit and monetary policy, this will help to develop a condition of banking liquidity favorable to private bank credit expansion and resumed growth in the money supply. Increased liquidity of lenders generally will also help to swell the flow of credit.

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

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

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

15. How does Federal Reserve policy accelerate or control inflation? Roughly, will you list in chronological order the major Federal Reserve policy actions in this respect since World War II?

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

The article is as follows:

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

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

"The first article in this series provided a brief description of the nature of money, of the processes by which changes occur in the quantity of money, and of the reserve banking measures that influence expansion of the money supply. In the present article, the discussion is pursued further to consider the ways by which reserve banking action affects the lending and investment decisions of

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

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

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commercial banks and other lenders, alters the decisions of borrowers, and influences the lending, spending, and saving of all sectors of the economy. The discussion deals only with the mechanism by which credit and monetary measures affect the tempo of economic activity and thus contribute to stable economic progress.

"SOME GENERAL OBSERVATIONS

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

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

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

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

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

"A general tightening of credit results from a reduction in the availability of credit relative to the demand for it. Such tightening may develop because the supply of credit has contracted without a corresponding reduction in demand, because the demand for credit has increased without a corresponding increase

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in supply, or from some combination of these. In a boom period, demand for credit typically increases and credit conditions tend to tighten even though there is an actual increase in the volume of credit granted. In order to keep credit from tightening under such conditions, reserve banking policy would need to permit the total credit and monetary base to expand at the pace set by the progress of the boom, regardless of the inflationary or other unsound developments that might be occurring.

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

"EFFECT ON LENDERS

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

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

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

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

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

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

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

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

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

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

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

"Thus in a period of tightening credit, long-term lenders and investors, while at first attracted by the higher yields available on assets of less than top grade, gradually become more restrictive and selective. They become less willing to sell prime securities to acquire higher yielding but more risky assets, partly

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because they can sell the prime securities only at a loss, which they hesitate to accept. They also become more interested in retaining in or adding to their portfolios the more liquid types of assets, because of concern about the decline in the market value of their entire investment portfolio and the general uncertainty about future developments. In addition, the higher interest rates on these more liquid assets in a period of tightening credit come closer to providing the average interest rate which institutional lenders must obtain on their earning assets in order to meet contracts with their own creditors.

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

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

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

"EFFECT ON BORROWERS

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

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

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

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investment expenditures because they expect to be able to borrow later at considerably lower interest costs.

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

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

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

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

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

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

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

"*Consumer borrowers.*—Use of credit by consumers is not subject to direct restriction by higher interest rates in the credit market. Consumer credits are generally extended on fairly standardized terms and at relatively high and inflexible credit charges. The rates paid for money at wholesale by the institutions that lend to consumers is only one of a number of important cost elements in the credit charge to consumers at retail. Thus changes in interest

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

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

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rates in the credit market have a less than corresponding effect on the charge for credit to consumers. Nevertheless, the interest cost is one important element in lenders' costs, and general credit tightness or ease tends to be transmitted to consumer credit through its influence on the strictness or leniency of credit standards applied by consumer-credit-granting institutions. Alteration of credit standards is a method by which lenders in this area control other important elements of their costs, namely, collection costs and losses by default. Because of the nature of the consumer credit market, selective credit regulation has been used in this field during emergency periods.

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

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

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

"EFFECT ON SAVING

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

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

"For saving by individuals, credit tightness and a rise in interest rates, for example, may set up several cross-currents of response. Some individuals save for the purpose of building up assets that will provide a retirement income of a certain size. As long-term interest rates rise, the amount of saving required

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for such an income declines. Such savers can reduce their saving and still meet their needs, if they choose to do so. On the other hand, some individuals are concerned about the current return and will save more when a more attractive return is available. It is not easy to establish where the balance of these motivations may be.

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

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

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

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

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

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

"In a period of recession, increased credit availability and declining interest rates, together with the expectation of continuing monetary ease, will tend to make employed individuals more willing to spend and go in debt for consumption and business purposes and corporations more willing to maintain dividend pay-

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ments even though borrowing is required to provide for plant and equipment outlays. Both individuals and corporations will be encouraged by the greater certainty of credit availability and capital gains on assets held to rely on sales of such assets if necessary to meet future needs. Added to all this will be a growing confidence that declines in incomes and prices will be checked. Relatively low levels of interest rates on prime assets under such circumstances may encourage savers to invest in lower grade, higher yielding securities.

"EFFECTS TRACED BY CATEGORIES OF ECONOMIC ACTIVITY

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

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

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

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

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

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

"Since services are usually not bought on credit, credit tightness will have relatively little direct effect on such spending. Expenditures in this area will

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be affected indirectly in ways similar to the effect on spending for nondurable goods.

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

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

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

"SECONDARY EFFECTS

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

"MAGNITUDE OF INTEREST RATE CHANGES

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

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

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

"*Kinds of interest rates.*—There are many interest rates because there are many kinds and grades of loans and investments. They are all related to one

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another in some degree and reflect in varying measure the relationship in the market between the demand for credit and the supply of funds available for lending and investing.

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

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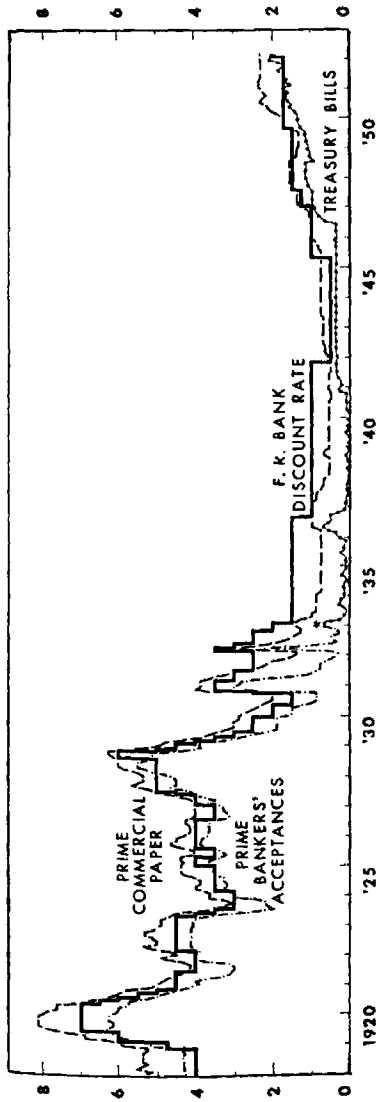
SHORT-TERM INTEREST RATES

Percent per annum



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

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

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

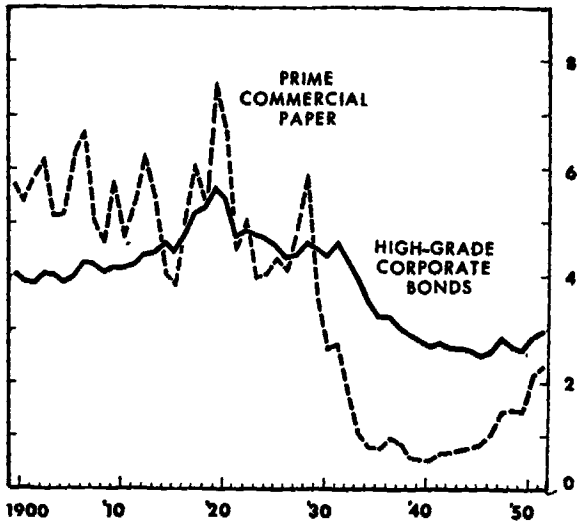
"Long-term rates generally rise when short-term rates rise and decline when short-term rates decline. The tighter or easier credit conditions which accompany changes in business activity are generally felt directly in both long- and short-term fields. Moreover, for some lenders the long-term markets for credit are competitive with the short-term markets.

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

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

LONG- AND SHORT-TERM INTEREST RATES

Percent per annum



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

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

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

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

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

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

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

"Under such circumstances, credit actions taken to restrict the general availability of credit could not easily be made effective in curbing an unsustainable speculative boom in the stock market except by affecting economic activity in general and in that way making investment in equities unprofitable. Despite the decline in long-term interest rates in the downturn that followed the eventual stock market crash, long-term borrowing was still considerably less attractive than the equity financing that had been available to

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many prime borrowers in 1929. Legislation designed to prevent a repetition of this situation authorized the Federal Reserve through margin requirements to regulate the use of credit in the stock market.

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

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

"CONCLUDING COMMENT

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

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

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

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

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Principal policy actions of Federal Reserve System, February 1945–August 1957

Date	Action	Basis of action
February 1945 to January 1946.	Margin requirements raised from 40 to 50 percent of market value in February; to 75 percent in July; and to 100 percent in January 1946.	Continued upward trend of stock prices, volume of trading, and stock-market credit.
April to May 1946	Removal of preferential discount rate of ½ percent on advances secured by short-term Government securities.	Required borrowing banks to pay regular discount rate of 1 percent and thereby made it less easy for member banks to obtain Federal Reserve credit on the basis of which to expand loans. Indicated that the Federal Reserve System did not favor a further decline in interest rates in the circumstances then prevailing.
January 1946 to October 1947.	Reduced total holdings of Government securities by more than $2,000,000,000. Retirements of about $7,000,000,000 of maturing securities offset in part by $5,000,000,000 net purchases of other short-term securities. Buying rate on bankers' acceptances raised (July-August 1946).	Restrained growth in member bank reserves (due chiefly to gold inflow) by redeeming maturing United States securities as Treasury retired securities using accumulated balances in war loan accounts and budget surplus. Business active; inflationary pressures were strong.
December 1946	Removed noninstallment credit from regulation; list of articles under credit control curtailed.	For purpose of simplifying the regulation, making it administratively more workable, and narrowing its scope to a minimum consistent with the exercising of a stabilizing influence on the economy. Amended regulation covered approximately 70 percent of installment credit.
February 1947	Margin requirements reduced from 100 to 75 percent of market value.	Stock prices and the volume of credit in the stock market had been reduced to levels at or below those prevailing at the time of the previous increase in requirements.
July 1947 to October 1947.	Discontinued buying rate of ⅜ percent on Treasury bills and support of certificates at ⅞ percent.	Relieved Federal Reserve System of necessity of continuing to buy short-term securities at the extremely low wartime rates and thereby providing the basis for further monetary expansion. Business activity at very high levels; inflationary pressures strong. Coupon rates on new issues of certificates raised by Treasury to 1 percent.
November 1947 to March 1948.	Bought $5 billion Treasury bonds.	Bought large amounts of Treasury bonds in November and December to stem decline in bond prices. Dropped buying prices in late December to levels slightly above par. Bought bonds thereafter to maintain these price levels.
	Sold or redeemed over $6 billion of short-term Government securities. Buying rate on bankers' acceptances raised (December 1947–January 1948).	Sold or redeemed short-term Treasury securities, partly to offset effect on bank reserves of bond purchases and continued gold inflow, in the effort to restrain the growth in bank credit. Inflationary pressures continued strong. Short-term rates rose further.
November 1947	Joint statement by bank supervisory authorities.	Urged banks to avoid making nonessential loans in view of inflationary conditions. Statement was followed by action by American Bankers Association to arrange bankers' meetings in various parts of the country early in 1948 to urge avoidance of unnecessary or undesirable extensions of credit.
January 1948 to August 1948.	Buying rate on bankers' acceptances raised (August). Raised discount rate from 1 to 1½ percent at all banks.	Part of an anti-inflationary program designed to keep pressure on member bank reserves and thereby to restrain expansion of bank credit and at the same time continue the policy of stabilizing the long-term rate on Government bonds.
February 1948 to September 1948.	Bought $2,000,000,000 Government securities in September including $1,500,000,000 bonds and $500,000,000 bills, certificates, and notes. Raised reserve requirements on demand deposits from 20 to 26 percent at central Reserve city banks; 20 to 22 percent at Reserve city; and 14 to 16 percent at country banks; on time deposits from 6 to 7½ percent at all banks.	Reserve requirement action to help absorb additional reserves made available by gold inflow and by Federal Reserve purchases in support of the market for Government securities. Congress provided authority (until June 30, 1949) for increases in reserve requirements above those otherwise authorized. Securities purchased in open market to maintain the stability of the market and to assist temporarily in the adjustment of member banks to increased reserve requirements.

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Principal policy actions of Federal Reserve System, February 1945–August 1957—Continued

Date	Action	Basis of action
September 1948	On installment credit for a list of consumer durable goods reimposed downpayment of 20 to 33⅓ percent; maximum maturity 15 to 18 months; same maturity on installment loans.	Congress restored (until June 30, 1949) Board's authority to regulate consumer credit, which it had terminated in November 1947. Consumer installment credit was expanding at a rate of $2,000,000,000 a year; this growth was contributing to inflationary pressures. Regulation as reestablished affected about 70 percent of consumer installment credit.
March 1949	Margin requirements reduced from 75 to 50 percent of market value.	Stock market credit outstanding was close to the lowest level on record. Stock prices declining and volume of trading low. Equity financing of business small.
March 1949 to April 1949.	On consumer installment credit reduced downpayment to 10 percent (except on autos); increased maturity to 24 months on all listed articles.	Consumer buying pressures had moderated significantly; many commodities covered by regulation in larger supply; consumer installment credit expanding less rapidly than formerly; general inflationary pressures had abated somewhat.
May 1949 to September 1949.	Reduced reserve requirements on demand deposits by 4 percentage points; on time deposits by 2½ percentage points. Changes in several steps.	Recession in business and prices. Credit policy aimed at encouraging a high level of business activity, but avoiding conditions of such ease as would prevent needed adjustments or encourage undue expansion.
January 1949 to September 1949.	Reduced holdings of Government securities by more than $5,000,000,000. Sold over $3,000,000,000 of bonds from january through June; sold or redeemed $2,000,000,000 of bills, certificates, and notes.	To prevent prices of long-term bonds from rising sharply and to meet heavy demands for short-term United States securities arising out of reduced member bank reserve requirements, net Government disbursements, reduced currency circulation, gold inflow, and other factors More flexible credit policy announced June 28 determining operations on basis of the needs of general business and credit situation and of maintaining orderly conditions in the Government security market, rather than a fixed pattern of rates on U. S. Government securities. Open market operations throughout the period consistent with easier credit conditions, while recession lasted.
November 1949 to June 1950.	Sold $1,500,000,000 of long-term Treasury bonds.	Sales of bonds to meet market demand for long-term securities and discourage overextension of private long-term financing.
	Bought a net of $1,600,000,000 of short-term Government securities. Little change in total portfolio.	Operations designed to allow money market to firm moderately in response to increased demand for funds, as business recovery gained momentum and signs of inflationary pressures reappeared, and at same time to aid Treasury refunding. Slight rise in yields on both short-term and long-term securities.
August 1950	Buying rate on bankers' acceptances raised. Raised discount rate from 1½ to 1¾ percent at all banks. Request by bank supervisory agencies for voluntary cooperation of lenders in restraining credit.	Output and employment close to peacetime record levels; accelerated expansion of credit; prices rising; prospective increases in Government expenditures for military purposes. System announced it was prepared to use all means at its command to restrain further bank-credit expansion consistent with policy of maintaining orderly conditions in Government securities market.
August 1950 to December 1950.	Bought $8 billion of maturing Government securities (August), $1 billion of restricted bonds (September–December), and $1.4 billion of short-term securities (December).	Purchases to aid Treasury refundings and prevent decline in long-term bonds below par.
	Sold $7 billion of short-term Government securities (August).	Sales of short-term securities at lower prices (higher yields) to offset effect of purchases. NOTE.—The above-mentioned sales did not completely offset purchases so that the actual net effect of operations for this period was expansionary.

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Principal policy actions of Federal Reserve System, February 1945–August 1957—Continued

Date	Action	Basis of action
September 1950 to October 1950.	On installment credit for list of consumer durable goods downpayment 10–33⅓ percent; maximum maturity 15 months, except home improvements 30 months; maximum maturity of 15 months on installment loans. On real-estate credit downpayments 10–50 percent of value of residential property; maximum maturity 20 years with certain exceptions.	Unprecedented rate of expansion of consumer installment and real-estate credit. Regulations are parts of fiscal, monetary, and credit measures to restrain inflationary pressures and facilitate diversion of critical material and manpower to production of defense needs, under authority of Defense Production Act of 1950. For reasons of administrative and regulative efficiency consumer credit regulation confined to installment credit and scope set to affec about 75 percent of such business.
November 1950	Banks again requested to restrain unnecessary credit expansion.	Unprecedented expansion in bank loans from midyear to mid-November. Continued expansion in credit put upward pressure on prices, impairing purchasing power of dollar and adding to cost of defense program.
January 1951 to February 1951.	Bought $800,000,000 of long-term Treasury bonds.	To maintain prices of long-term Government securities.
	Raised reserve requirements by 2 percent on demand deposits; 1 percent on time deposits; maximum limits except at central Reserve city banks.	Continued expansion of bank credit. Action taken to absorb about $2 billion of funds, largely from seasonal return of currency and System purchases of bonds, and generally to reduce the ability of banks to expand credit that would add to inflationary pressures. At central Reserve city banks requirements were raised to a level considerably above those that prevailed during most of the war period.
	Bought a net of $300,000,000 of short-term Government securities.	To facilitate adjustment to reserve requirement increase.
January 1951	Margin requirements raised from 50 to 75 percent of market value.	Continued upward trend of stock prices, volume of trading, and stock-market credit.
January to February 1951.	Real-estate credit control extended to cover multifamily and certain nonresidential properties.	To add further restraints on inflation by limiting the credit available for the financing of nonresidential construction and to bring about a decrease in building to provide materials and labor for the defense program.
February to May 1951	All financing institutions requested to participate in program of voluntary credit restraint.	Program formulated by representatives of banks, investment bankers, and life-insurance companies, in consultation with Federal Reserve representatives, for organized effort by all types of financing institutions to restrain unnecessary credit expansion in accordance with the Defense Production Act of 1950.
March to mid-April 1951	Lowered buying prices on Government securities.	Action taken, under Treasury-Federal Reserve accord, to terminate support of Government securities market at fixed prices, with a view to promoting a self-sustaining market and discouraging sales of Government securities to Federal Resrve System to obtain funds with which to extend credit to private borrowers.
	Bought $1,100,000,000 of Treasury bonds and $100,000,000 of bills.	Interim purchases taken to maintain orderly market conditions in transition to self-sustaining market and to facilitate exchange of long-term marketable bonds into nonmarketable bonds with longer term and higher interest coupon.
April 1951	Ceased purchases of Government securities except primarily to maintain orderly market conditions.	To minimize monetization of public debt without jeopardizing necessary Government financing; to enable the Federal Reserve System to regain greater control over its extensions of Federal Reserve credit through security operations, and thereby more effectively to restrain inflationary expansion of credit.
Mid-April 1951 to November 1951.	Bought $300,000,000 of long-term bonds through June, and $1,500,000,000 of short-term securities during refunding periods.	Purchased restricted bonds to aid in readjustment of bond market; purchased short-term securities to aid in Treasury refundings.
	Sold or redeemed $1,700,000,000 of short-term Government securities at other times.	Sales to absorb reserves created by above purchases.

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Principal policy actions of Federal Reserve System, February 1945–August 1957—Continued

Date	Action	Basis of action
July 1951	On installment credit for list of consumer durable goods and for installment loans increased maximum maturity to 18 months (home improvements, 36 months); downpayment on appliances reduced to 15 percent cash or cash and trade-in.	Action taken to bring regulation W into conformity with the provisions of the Defense Production Act amendments of 1951.
September 1951	Increased maximum maturity to 25 years for houses up to $12,000; raised maximum value per family unit for specified downpayment requirements; suspended credit restrictions for programed housing in critical defense housing areas.	Action taken to bring regulation X into conformity with the provisions of the Defense Housing and Community Facilities and Services Act of 1951.
December 1951	Increased holdings of securities in late December by about $600,000,000 net.	To meet seasonal reserve needs.
January 1952	Reduced holdings of securities by $1,100,000,000, net.	To offset currency inflow and the effects of other seasonal factors on bank reserves.
February to June 1952	Increased holdings by about $200,000,000, net.	Large purchases of securities made in February and June to facilitate market adjustments to Treasury financings. Most of those purchases were offset by sales of other securities.
September 1952	Suspension of regulation of real estate credit.	To conform with the terms of the Defense Production Act, as amended, requiring suspension of regulation if housing starts in each of 3 consecutive months fell short of an annual rate of 1,200,000 units, seasonally adjusted.
July to December 1952	Limited net purchases of U. S. Government securities in open market to $1,800,000,000.	To meet seasonal and other reserve drains only in part, requiring banks to borrow some of the reserves needed so as to restrain bank credit and deposit expansion at a time when credit demand was very large and the economy was fully employed. Purchases in August and September were made primarily at times of Treasury refunding operations and were offset in part by subsequent sales.
January to April 1953	Sold in open market or redeemed $800,000,000 net of U. S. Government securities.	To offset seasonal changes in factors affecting reserves and thus to maintain pressure on member bank reserve positions.
January 1953	Raised discount rates from 1¾ to 2 percent and buying rates on 90-day bankers' acceptances from 1⅞ to 2⅛ percent.	To bring discount rates as well as buying rates on acceptances into closer alinement with open market money rates and to provide an additional deterrent to member bank borrowing from the Reserve banks.
February 1953	Reduced margin requirements on loans for purchasing or carrying listed securities from 75 to 50 percent of market value of securities.	To reduce margin requirements from the high level imposed early in 1951, in the judgment that the lower requirement would be adequate to prevent excessive use of credit for purchasing and carrying stocks.
May to June 1953	Purchased in open market about $900,000,000 of United States Government securities.	To provide banks with reserves and to permit a reduction of member bank borrowing from the Reserve banks at a time when such borrowing was high, credit and capital markets were showing strain, and seasonal needs for funds were imminent.
July 1953	Reduced reserve requirements on net demand deposits by 2 percentage points at central Reserve city banks and by 1 percentage point at Reserve city and country banks, thus freeing an estimated $1,200,000,000 of reserves.	To free additional bank reserves for meeting expected seasonal and growth credit demands, including Treasury financing needs, and to further reduce the pressure on member bank reserve positions.
July to December 1953	Made net purchases in open market of U. S. Government securities totaling $1,700,000,000.	To provide banks with reserves to meet seasonal and growth needs and to offset continuing gold outflow with little or no additional recourse to borrowing. This action and the one below were taken in pursuance of a policy of active ease adopted in view of the business downturn.

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Principal policy actions of Federal Reserve System, February 1945–August 1957—Continued

Date	Action	Basis of action
January to June 1954	Limited net sales to about $900,000,000 of U. S. Government securities in open market.	To absorb only part of the reserves made available by seasonal deposit contraction and return flow of currency thereby further easing bank reserve positions.
February 1954	Reduced discount rates from 2 to 1¾ percent and buying rates on 90-day bankers' acceptances from 2⅛ to 1¾ percent.	To bring discount rates as well as buying rates on bankers' acceptances into closer alinement with market rates of interest and to eliminate any undue deterrent to bank borrowing from the Reserve banks for making temporary reserve adjustments.
April to May 1954	Reduced discount rates from 1¾ to 1½ percent and buying rates on 90-day bankers' acceptances from 1¾ to 1½ percent.	Do.
June to August 1954	Reduced reserve requirements on net demand deposits by 2 percentage points at central Reserve city banks and by 1 percentage point at Reserve city and country banks, and requirements on time deposits by 1 percentage point at all member banks, thus freeing about $1,500,000,000 of reserves in the period June 16 to Aug. 1.	To supply the banking system with reserves to meet expected growth and seasonal demands for credit and money, including Treasury financing needs.
	Sold in open market or redeemed U. S. Government securities totaling about $1,000,000,000 in July and August.	Reductions in reserve requirements were offset in part by temporary sales of securities in order to prevent excess reserves from increasing unduly at the time, but security purchases were resumed as need for funds developed.
September to November 1954.	Made net purchases in open market of approximately $850,000,000.	To supply the banking system with reserves to meet expected growth and seasonal demands for credit and money.
December 1954	Made net purchases of U. S. Government securities in open market of less than $50,000,000, all under repurchase agreements with dealers and brokers. Member bank borrowing increased to an average of $250,000,000 in December.	To meet part of the temporary end-of-year needs of banks for reserve funds, but in view of rising credit demands, to permit these needs to be reflected in part in slightly less easy reserve positions.
January to June 1955	Sold in the open market or redeemed U. S. Government securities totaling $1,300,000,000. Member bank borrowing increased to an average of more than $400,000,000 in the second quarter.	To offset effects of seasonal factors affecting bank reserve positions and, in view of strong credit demands, to bring about somewhat greater member bank borrowing from Federal Reserve banks.
January 1955	Raised margin requirements on loans for purchasing or carrying listed securities from 50 to 60 percent of market value of securities.	To help prevent an excessive use of credit for purchasing or carrying securities in a period of increasing use of credit for carrying securities.
April 1955	Raised margin requirements on loans for purchasing or carrying listed securities from 60 to 70 percent of market value of securities.	Do.
April 1955	Raised discount rates from 1½ to 1¾ percent.	To bring discount rates into closer alinement with open-market money rates and make borrowing by individual banks more expensive.
March to December 1955	Made net purchase of bankers' acceptances in open market totaling $28,000 000.	To recognize increased use of bankers' acceptances by business as a means of financing international trade.

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***Principal policy actions of Federal Reserve System, February 1945–August 1957*—Continued**

Date	Action	Basis of action
July to December 1955	Made outright purchases of Treasury bills in the open market totaling $700-000,000 net and increased repurchase agreements with dealers and brokers by $300,000,000. Member bank borrowing increased to an average of about $850,000,000 in September and more than $1,000,-000,000 in November but declined to about $850,-000,000 in December.	To meet part of reserve needs associated with seasonal factors, thus requiring banking system to meet needs in part by further increasing indebtedness. This action was taken with a view to providing for seasonal needs while limiting undue expansion of bank credit.
November to December 1955.	Purchased when-issued Treasury certificates of indebtedness totaling $167,000,000.	To facilitate Treasury refunding in period of money market stringency. Supply of reserve was consistent with overall open market policy at time.
August to September 1955.	Increased discount rates from 1¾ to 2¼ percent. This increase was made in 2 steps at all Reserve banks except Cleveland.	To keep discount rates in an appropriate relationship with market rates of interest and thus maintain a deterrent on excessive borrowing by individual banks at the Reserve banks.
November 1955	Increased discount rates from 2¼ to 2½ percent.	
January 1956	Reduced System holdings of U. S. Government securities by over $1,400,000,-000 through sales in the market, redemption of maturing bills, and termination of repurchase agreements. Member bank borrowings increased to weekly averages of $900,000,000 in late January.	To offset seasonal return flow of currency and reduction in reserve needs and restore degree of restraint prevailing before December action to moderate restraint temporarily.
February to March 1956	Bought small amounts of Government securities at times. Member bank borrowings declined somewhat in February but increased substantially in March as result of sharp increase in required reserves.	To meet changing reserve needs and avoid an increasing degree of credit restraint in view of growing tone of uncertainty as to economic prospects.
April to May 1956	Discount rates raised from 2½ percent to 2¾ percent at 10 Reserve banks and to 3 percent at 2 banks around middle of April; System holdings of U. S. Government securities reduced by $350,000,000. Member bank borrowings at Reserve banks rose to over $1 billion.	To increase restraint on credit expansion, in view of sharp increase in bank credit in March and indications of broad increase in spending, growing demands for credit, and upward pressures on prices and costs.
Late May to early August 1956.	Increased System holdings of U. S. Government securities around end of May and end of June and maintained holdings at higher level than in previous period.	To meet currency needs around holidays, to cover added demands for reserves around tax payment and midyear settlement periods, and to avoid increasing the degree of restraint in view of uncertainties in economic situation.
August to November 1956.	Discount rates raised late in August to 3 percent at the 10 Reserve banks with rates of 2¾ percent. System holdings of U. S. Government securities increased by nearly $1,-000,000,000; member bank borrowings at Reserve banks rose to average of $900,000,000 in August and averaged between $700,-000,000 and $800,000,000 in other months.	Discount rates increased in conformity with rise in market rates resulting from vigorous credit demands. Policies designed to increase and maintain restraint on undue credit expansion while covering seasonal and other temporary variations in reserve needs, including effects of frequent Treasury financing operations.

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Principal policy actions of Federal Reserve System, February 1945–August 1957—Continued

Date	Action	Basis of action
December 1956	System holdings of U. S. Government securities and bankers' acceptances increased by over $550,000,000, including substantial repurchase agreements with dealers. Member-bank borrowings declined to weekly averages of around $600,000,000, except in last week of year, and at times were less than excess reserves.	To supply reserve funds in recognition of additional pressures in money, credit, and capital markets resulting from seasonal factors and international conditions, at a time when lower liquidity ratios of banks were themselves exerting restraint on bank lending.
January to June 1957	Reduced holdings of Government securities by about $1,800,000,000. Member-bank borrowings increased from an average of $400,000,000 in January to $1,000,000,000 in June.	To offset the effect on reserves of seasonal factors and the sale of $600,000,000 of gold to the U. S. Treasury by the International Monetary Fund, and to exert pressure on bank reserve positions by bringing about a higher level of member bank borrowings.
August 1957	Discount rates raised from 3 to 3½ percent at 8 Reserve banks (through Aug. 16).	To bring discount rates into closer alinement with open-market money rates.

16. Is fiscal policy action usually necessary as a complement to Federal Reserve policy action with respect to money and credit? If so, will you list recent instances of such policy combinations, cite the occasions, and evaluate the effects or result.

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

Throughout the postwar period, fiscal policy and Federal Reserve policy generally have worked in the same direction. During a considerable part of the period, however, the ability of the Federal Reserve System to combat economic instability was seriously limited by its policy of supporting the United States Government securities market. Fiscal policy performed well in fiscal years 1947 and 1948 as Federal expenditures declined and tax rates were maintained, producing cash surpluses totaling $15.7 billion in the 2 years. In this period the Federal Reserve supported the Government securities market and consequently one of its most important policy tools—open market operations—could not function in a counter-inflationary manner. As long as the Federal Reserve acted as a residual buyer of securities offered in the market, the initiation in the creation of bank credit rested with the market, not the Federal Reserve authorities. Attempts were made to offset these effects by resort to other actions. For example, reserve requirements were increased on three occasions in 1948 and the discount rate twice; also selected regulations were applied to stock market credit and consumer credit.

Both fiscal and Federal Reserve policy shifted as the economy started to decline in the winter of 1948–49. During the fiscal years 1949 and 1950, Federal cash expenditures rose, the $5 billion tax cut that had been enacted earlier in 1948 took effect, and the cash surplus was replaced by a small cash deficit. The Federal Reserve eased credit conditions. It reduced reserve requirements by 2 percentage points in the summer of 1949, eased consumer credit regulation in 2 steps, before the temporary authority finally expired, and reduced margin requirements.

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

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

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

During the past 2 fiscal years of inflationary pressures, fiscal and monetary policy have operated in the same direction. Scheduled tax reductions were postponed and no new reductions were enacted. Although tax rates were not increased, receipts rose—mainly as a result of increases in incomes—and a substantial cash surplus of $4.5 billion was achieved in fiscal 1956. In fiscal 1957, the surplus declined despite further increases in Federal revenues from further expansion of incomes and profits, which, in part, reflected price increases, as Federal expenditures rose by a larger amount. The impact of monetary policy has been on the side of restraint; open-market operations have been designed to restrain undue growth in the money supply, and as market rates rose discount rates have been increased several times in order to maintain a deterrent on excessive borrowing by members banks.

17. I quote section 2 of the so-called Full Employment Act of 1946:

"The Congress hereby declares that it is the continuing policy and responsibility of the Federal Government to use all practical means consistent with its needs and obligations and other essential considerations of national policy, with the assistance and cooperation of industry, agriculture, labor, and State and local governments, to coordinate and utilize all its plans, functions, and resources for the purpose of creating and maintaining, in a manner calculated to foster and promote free competitive enterprise and the general welfare, conditions under which there will be afforded useful employment opportunities, including self-employment, for those willing, and seeking work, and to promote maximum employment, production, and purchasing power."

Will you estimate and describe the weight of this statutory requirement on Federal Reserve decisions? Will you estimate and describe the weight of this statutory requirement on the combination of monetary, credit, and fiscal policy decisions?

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

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

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

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

"The goal of price stability, now implicit in the Employment Act, can be made explicit by a straightforward declaration and directive to all agencies of the Government that anti-inflationary actions are to be taken promptly whenever the cost of living begins to rise."

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

A direct answer is given in my statement: "The Federal Reserve System, itself a creation of the Congress, can—and I assure you that it will—make every effort to check excesses in the field of money and credit that threaten the cost of living and thus undermine sustained prosperity and growth of our economy." In that effort, the Federal Reserve will continue to use the powers assigned it by the Congress, as enumerated in the opening part (pp. 2–8) of my statement, in the manner most appropriate in the light of economic developments as they occur, to achieve the System's objective "to promote monetary and credit conditions that will foster sustained economic growth together with stability in the value of the dollar."

Mr. Martin, will you proceed, sir, in your own way?

STATEMENT OF WILLIAM McCHESNEY MARTIN, JR., CHAIRMAN, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM

Mr. MARTIN. I will be very glad to give you the written statement at the end, Mr. Chairman.

The CHAIRMAN. Just one point there. I think I would like the written statement at your earliest convenience; not at the end.

Mr. MARTIN. I will be very glad to get it.

The CHAIRMAN. There will probably be some questions I would like to ask you in relation to it.

Senator MARTIN. If we had it before us, it would help all of us.

Senator KERR. How long do you think it would take you to do that?

Mr. MARTIN. I think I can do it in a couple of days.

Senator MARTIN. I think it would be helpful to all of us if we could have it.

Senator FLANDERS. It would complicate Mr. Martin's presentation but I wonder if it would be possible for him to have these questions before him and then from time to time say, "This relates to question No. 16," or have someone else doing it who is familiar with what you are presenting. That perhaps complicates the thing and it was just a quick suggestion.

The CHAIRMAN. Please accommodate yourself. We don't want to disarrange your presentation, but when you can get a written response to the questions we would like to have it.

Mr. MARTIN. We will go right to work on it, Senator.

Our country has been experiencing a period of unusual prosperity, featured by heavy spending, both governmental and private. As a nation, we have been trying to spend more than we earn through production, and to invest at a rate faster than we save. The resulting demands, strong and incessant, have pressed hard upon our resources, both human and material. In consequence, prices have been rising, and the purchasing power of the dollar has been falling.

It is of the utmost importance to bring to bear on this critical problem all of the information and intelligence that we can muster. That

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is what you are seeking, and that is why this opportunity to appear here is timely and most welcome.

We are not facing a new, or insoluble problem—it is as old as the invention of money—and history is marked with both defeats and triumphs in dealing with this invisible but deadly enemy of inflation.

The question is not whether we can solve the problem, but how best to deal with it under our form of government and free-enterprise institutions. Solve it we can—solve it we must.

You have been inquiring particularly into fiscal policies and it is equally important to inquire into credit and monetary policies. They are closely interrelated, and are the two paramount and time-tested means available to the Government in combating inflation. There are undeniably practical limitations of timing and scope upon both, but they are the most effective weapons in the arsenal against this destructive invader. In fact they are indispensable.

By way of preface and for the record I should like to outline first the general structure and organization of the Federal Reserve System. Then I want to go into the nature and character of the problems the Nation is now facing.

FEDERAL RESERVE STRUCTURE

The Federal Reserve Act of 1913 was the outgrowth of prolonged congressional study of the history of central banking in other countries and of our own experience, particularly with the First and Second Banks of the United States.

The Congress, seeking to avoid either political or private domination of the money supply, created an independent institution which is an ingenious blending of public and private participation in the System's operations under the coordination of a public body—the Federal Reserve Board—here in Washington.

This question of independence has been thoroughly debated throughout the long history of central banking. On numerous occasions when amendments to the Federal Reserve Act were under consideration the question has been reexamined by Congress and it has repeatedly reaffirmed its original judgment that the Reserve System should be independent—not independent of Government, but independent within the structure of the Government. That does not mean that the Reserve banking mechanism can or should pursue a course that is contrary to the objectives of national economic policies. It does mean that within its technical field, in deciding upon and carrying out monetary and credit policy, it shall be free to exercise its best collective judgment independently.

The Reserve System is an instrument of Government designed to foster and protect the public interest, so far as that is possible through the exercise of monetary powers. Its basic objective is to assure a monetary climate that permits economic growth together with stability in the value of our money.

Private citizens share in administering the System, but, in so doing, they are acting in a public capacity.

The members of the Board of Governors and the officers of the Federal Reserve banks are in a true sense public officials; the processes of policy determination are surrounded with carefully devised safeguards against domination by any special interest group.

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Broadly, the Reserve System may be likened to a trusteeship created by Congress to administer the Nation's credit and monetary affairs—a trusteeship dedicated to helping safeguard the integrity of the currency. Confidence in the value of the dollar is vital to continued economic progress and to the preservation of the social values at the heart of free institutions.

The Federal Reserve Act is, so to speak, a trust indenture that the Congress can alter or amend as it thinks best. The existing System is by no means perfect, but experience prior to 1914 suggests that either it or something closely approximating it is indispensable. In its present form, it has the advantage of being able to draw upon the knowledge and information of the directors and officers of its 12 banks and 24 branches in formulating and carrying out credit and monetary policies.

BOARD OF GOVERNORS

The Board of Governors, as you know, is composed of 7 members appointed by the President and confirmed by the Senate, each for a term of 14 years.

In appointing the members of the Board, the President is required to give due regard to a fair representation of the financial, agricultural, industrial, and commercial interests, as well as the geographical divisions of the country.

From among these members the President designates a Chairman and a Vice Chairman for terms of 4 years. Some of the functions of the Board of Governors are (1) to exercise supervision over the Federal Reserve banks; (2) to fix, within statutory limits, the reserves which member banks are required to maintain against their deposit liabilities; (3) to review and determine the discount rates which are established biweekly at each Federal Reserve bank, subject to approval of the Board in Washington; (4) to participate, as members of the Federal Open Market Committee, in determining policies whereby the System influences the availability of credit primarily through the purchase or sale of Government securities in the open market; (5) to fix margin requirements on loans on stock exchange collateral; and (6) to perform various supervisory functions with respect to commercial banks, such as examinations, that are members of the System and to administer Federal Reserve, holding company, and other legislation.

FEDERAL RESERVE BANKS

Each Federal Reserve bank has a board of 9 directors, of whom 6 are elected by the member banks. Of these, 3 are bankers, 1 from a large, 1 from a medium, and 1 from a small bank.

Three more must not be bankers, but must be engaged in some nonbanking business.

The idea here was to have the lenders recognized. The other three members are appointed by the Board of Governors in Washington, which also designates one to be the chairman and another the deputy chairman. None of these three may be an officer, director, employee, or stockholder of any bank. The directors of a Reserve bank supervise its affairs. Subject to approval of the Board of Governors, they appoint the president and first vice president. Subject to review and

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determination by the Board of Governors, they establish discount rates.

The stock of each Federal Reserve bank is held by the member banks of its district. This stock does not have the normal attributes of corporate stock; rather, it represents a required subscription to the capital of the Reserve bank, dividends being fixed by law at 6 percent. The residual interest in the surplus of the Federal Reserve banks belongs to the United States Government, not to the bank's stockholders.

FEDERAL OPEN MARKET COMMITTEE

The Federal Open Market Committee consists, according to law, of the 7 members of the Board of Governors, together with 5 presidents of the Federal Reserve banks. Four of these five presidents serve on a rotating basis; the fifth, the president of the Federal Reserve Bank of New York, is a permanent member of the committee. Since June 1955, when its executive committee was abolished, this committee has usually met at 3-week intervals, on a number of occasions 2 weeks, to direct the sale and purchase of securities in the open market.

In practice, all 12 presidents attend these meetings and participate freely in the discussion, although only those who are members of the committee vote.

In the past 2 years, Mr. Chairman, we have been using this Open Market Committee as a forum, a clearinghouse for all of the aspects of policy determination in the System, not failing to recognize the statutory responsibility of the Board of Governors for reserve requirements and for stock-market margins as distinct from the Open Market Committee, but using this committee as a forum where all aspects of the problems of the System can be discussed. Since we met at 3-week intervals it means that all 12 of the presidents can meet with the 7 members of the board, that is 19 men, and survey all aspects of System problems and policies on a 3-week interval. That is not in disregard of the statute but it is the modus operandi that we have been using to effect credit policy recently in, we think, a more desirable way and without any conflict with the present statute.

FEDERAL ADVISORY COUNCIL

The Federal Reserve Act also provides for a Federal Advisory Council of 12 members. One is elected by the board of each Reserve bank for a period of 1 year. The Council is required by law to meet in Washington at least four times each year. It is authorized to confer directly with the Board of Governors respecting general business conditions and to make recommendations concerning matters within the Board's jurisdiction.

The members of this Council are chosen from representative and outstanding bankers in each district, and I wanted to make that clear here. I want to quote—in looking through all the literature on this it seems to me that this excerpt from the report of the House Committee on Banking and Currency on the original Federal Reserve Act outlines the nature of the Federal Advisory Council better than anything I have been able to come across, and I will read that.

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Section 13 provides for the creation of a Federal advisory council which is to consist of as many members as there are Federal Reserve districts, each such district electing through the board of directors of its Federal Reserve bank a representative of that bank. The functions of this board are wholly advisory and it would amount merely to a means of expressing banking opinion, informing the Reserve Board of conditions of credit in the several districts, and serving as a source of information upon which the board may draw in case of necessity. The desirability of such a body as a source of information and counsel is obvious, and it is believed that it gives to the banking interests of the several districts ample power to make their views known, and, so far as they deserve acceptance, to secure such acceptance.

I might say that in our experience in the last 6 years, this Council has proved very useful. It has in no way dominated the decisions of the Federal Reserve Board, but it has given us an opportunity to get firsthand advice and counsel from people who are closely in touch with the banking activities of their particular districts.

JUDGING ECONOMIC TRENDS

Now at this point I want to take up the operations and the work of the System, and it is obvious that the most important task that we set for ourselves is judging economic trends. The work of the System requires a continuous study and exercise of judgment in order to be alert to the way the economy is trending and what Federal Reserve actions will best contribute to sustained economic growth. Such decisions are often hard to make because of the existence of cross currents in the economy. Even in generally prosperous times, some parts of the economy may not fare as well as others.

Credit policy must, however, fit the general situation and not reflect unduly either the condition of certain industries experiencing poor business, or that of other industries enjoying a boom. Residential construction, I think, illustrates this point.

In 1956 and so far in 1957 demand pressures on available resources have been generally strong and prices have been moving up, but housing construction has receded considerably from its 1955 peak. The home-building industry undoubtedly could supply housing at a faster rate than is now prevailing.

But even at the current volume, building costs continue to increase. The prices of some building materials have fallen, it is true, but the overall cost of housing construction has increased appreciably even in the face of moderately lower demand.

The explanation is to be found in the fact that expenditures for all major types of construction except residential have been maintained at or above record levels.

This example shows why credit policy must take account of the overall situation, and cannot be deterred unduly by special cases that are not typical of the whole.

Another factor complicating economic interpretation is that even in a period of broad advance and upward pressure on prices, there may be lulls when conditions seem to be stabilizing and the next turn of events is difficult to appraise.

The flexible character of monetary policy permits prompt adaptation to changed circumstances, and this is something that we are always anxious to determine.

Senator FLANDERS. I don't find that passage in the manuscript.

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Mr. MARTIN. I added it, Senator.
Senator FLANDERS. I thought you were still reading.
Mr. MARTIN. I am ad libbing a little bit here and there.

PURPOSES

The objective of the System is always the same—to promote monetary and credit conditions that will foster sustained economic growth together with stability in the value of the dollar.

This goal may be thought of in human terms and should be. The first part may be considered as concerned with job opportunities for wage earners; the latter as directed to protecting those who depend upon savings or fixed incomes, or who rely upon pension rights. In fact, however, a realization of both aims is vital to all of us. They are inseparable. Price stability is essential to sustainable growth. Inflation fosters maladjustments. In some periods these broad aims call for encouraging credit expansion; in others, for restraint on the growth of credit. The latter is what is required at present, for clearly the most citical economic problem now facing this country in our judgment is that of inflation, or put in the terms of the man on the street, it is the rising cost of living.

THE CURRENT PROBLEM OF INFLATION

This problem is far different from the one that beset us during the depressed 1930's, and left an indelible impression on our thinking. The problem then was one of drastic deflation with widespread unemployment, both of men and material resources. Today's problem has persisted through the years since World War II. It consists of inflationary price increases and the economic imbalances that have resulted.

This is the overriding problem that faces the Federal Reserve System today, for a spiral of mounting prices and wages seeks more and more financing.

It creates demands for funds in excess of savings, and since these demands cannot be satisfied in full, the result is mounting interest rates and a condition of so-called tight money. If the gap between investment demands and available savings should be filled by creating additional bank money, the spiral of inflation which tends to become cumulative and self-perpetuating would be given further impetus. If the Federal Reserve System were a party to that process, in our judgment it would betray its trust.

CONFLICTING VIEWS ON CAUSES

There is much current discussion of the origin of inflationary pressures. Some believe they reflect a recurrence of demand-pulls similar to those present in the earlier postwar period.

Others believe they originate in a cost push engendered by administered pricing policies and wage agreements that violate the limits of tolerance set by advances in productivity.

These distinctions, I think, present an oversimplification of the problem. Inflation is a process in which rising costs and prices mutually interact upon each other over time with a spiral effect. Inflation always has the attributes, therefore, of a cost push. At the same time,

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demand must always be sufficient to keep the spiral moving. Otherwise the marking up of prices in one sector of the economy would be offset by a reduction of prices in other sectors.

There is much to be said for the view that contractual or other arrangements designed as shelters or hedges from inflation have the effect of quickening its tempo.

The 5-percent rise in the cost of living which we have experienced over the last 2 years has probably reflected and been reflected in more rapidly rising wage costs because of the prevalence of cost-of-living clauses in many modern wage contracts. Cost-plus contracts tend to have the same quickening effect on the inflationary spiral.

The spiral is also, however, a demand spiral. At each point of time in the development of the inflationary spiral, there must be sufficient demand to take the higher priced goods off the market and thus keep the process moving.

THE INFLATIONARY SPIRAL

The workings of the spiral of inflation are illustrated by the economy of the moment. As has been brought out at some of the earlier hearings of this committee, we are now faced with the seeming paradox that prices are expected to continue to rise, even though the specific bottlenecks in capacity that impeded the growth of production in 1956 have now been largely relieved, and investment in productive facilities continue at very high levels.

Houses, automobiles, household appliances, and other consumer goods, as well as most basic materials, are all readily available—at a price. The problem is no longer one of specific shortages or bottlenecks causing prices of individual commodities to be bid up because of limited availability but rather it is one of broad general pressure on all of our resources.

In other words, aggregate demand is in excess of aggregate availabilities of these resources at existing prices.

Taking the situation as a whole, as individuals, corporations, and governments proceed with their expenditure plans, buttressed by borrowed funds, they are in the position of attempting to bid the basic factors of production—land, labor, and capital—away from each other and in the process the general level of costs and prices is inevitably pushed upward. Recently, this general pressure has been expressing itself particularly in rising prices for services as compared with goods.

Despite the existence in some lines of reduced employment and slack demand, many employers now face rising costs when they seek to expand activity by adding appreciably to the number employed.

Often, the additional manpower required has to be bid away from other employers. As a result, many current plans for further expansion of capacity place great emphasis on more efficient, more productive equipment rather than on more manpower.

This generalized pressure on resources comes to a head in financial markets in the form of a shortage of saving in relation to the demand for funds. A considerable volume of expenditure is financed at all times out of borrowed funds.

When these funds are borrowed from others who have curtailed their own expenditures, no additional demand for resources is gen-

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erated. On balance, however, demands for funds by those who have wanted to borrow money to spend in excess of their current incomes have outrun savings. Those who have saved by limiting their current expenditures, and thus made funds available for lending, have still not kept pace with the desire of governments, businesses, and individuals to borrow in order to spend.

Just as an intense general pressure on available resources manifests itself in rising wages and prices, a deficiency of savings relative to the demand for borrowed money manifests itself in an increase in the price of credit. In such circumstances, interest rates are bound to rise. The rise in rates might be temporarily held down by creating new bank money to meet borrowing demands, but this, as I have said, would add fuel to inflation and bring about further increases in demands.

In the end, as prices rose ever faster, interest rates could not be held down. In summary, whatever the special features of the current inflation, the important fact is that it is here, and that it has created demands for borrowed funds in excess of financial savings, even though these have grown appreciably.

Any attempt to substitute newly created bank money for this deficiency in savings can only aggravate the problem and make matters worse.

EFFECTS OF HIGHER INTEREST RATES

The response to higher interest rates is complex. One result is that some would-be borrowers draw on cash balances to finance projected expenditures or lenders draw on their balances to lend at the higher rates, thus reducing their liquidity and increasing the turnover of the existing money supply.

In recent years, with the large volume of Federal Government securities outstanding, many holders of these securities—both institutions and individuals—have liquidated their holdings in order to shift funds to other uses.

This has been an important influence in bringing about the decline in bond prices. To the extent that accumulated cash balances or other past savings can be used more actively, expenditures remain high relative to available resources and prices tend to rise, but the reduced financial liquidity eventually exerts restraint on borrowing and spending.

Another result of higher interest costs, together with greater difficulty in obtaining loans, is that many potential borrowers revise or postpone their borrowing plans. To the extent that expenditures are revised or deferred, inflationary pressures are reduced.

The most constructive result is the encouragement of a volume of savings and investment that permits continued expansion of productive facilities at a rate consistent with growing consumption demands. Only in this way can the standard of living for a growing population be improved and the value of savings be maintained.

Such constructive adaptations, if made in time at the onset of inflationary pressures, need not be large in order to restore balance between prospective demands and the resources available to meet them.

This is particularly true in a country that is as strong and vigorous and as dynamic as the American economy. It is essential, however, that the adjustment be made. Otherwise prospective expenditures

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will continue to exceed the resources available and the pressure of excess demand will foster an inflationary spiral.

EXPECTATIONS OF CONTINUING INFLATION

Once such a spiral is set in motion it has a strong tendency to feed upon itself. If prices generally are expected to rise, incentives to save and to lend are diminished and incentives to borrow and to spend are increased.

Consumers who would normally be savers are encouraged to postpone saving and, instead, purchase goods of which they are not in immediate need.

Businessmen, likewise, are encouraged to anticipate growth requirements for new plant and equipment. Thus, spending is increased on both counts. But, because the economy is already operating at high levels, further increases in spending are not matched by corresponding increases in production. Instead, the increased spending for goods and services tends to develop a spiral of mounting prices, wages, and costs.

Unfortunately, during the past year, as price indexes gradually rose, some segments of the community apparently became reconciled to the prospects of a creeping if not a runaway inflation.

One of the baneful effects of inflation stems from the expectation of inflation. While a price increase, in itself, may cause serious dislocations and inequities, other and more serious effects occur if the price rise brings with it an expectation of still other increases.

Expectations clearly have a great influence on economic and financial decisions, much more so, perhaps, than we sometimes realize. In fact decisions to spend or to invest too much in a given time are a direct cause of inflation. Also, if further inflation is expected, speculative commitments are encouraged and the pattern of investment and other spending—the decisions on what kinds of things to buy—will change in a way that threatens balanced growth.

CREEPING INFLATION

The unwarranted assumption that creeping inflation is inevitable deserves comment. This term has been used by various writers to mean a gradual rise in prices which, they suggest, could be held to a moderate rate, averaging perhaps 2 percent a year. The idea of prices rising 2 percent in a year may not seem too startling—in fact, during the past year, average prices have increased by more than 2 percent—but this concept of creeping inflation implies that a price rise of this kind would be expected to continue indefinitely.

According to those who espouse this view, rising prices would then be the normal expectation and the Federal Reserve accordingly would no longer strive to keep the value of money stable but would simply try to temper the rate of depreciation. Business and investment decisions would be made in the light of this prospect.

Such a prospect would work incalculable hardship. If monetary policy were directed with a view to permitting this kind of inflation—even if it were possible to control it so that prices rose no faster than 2 percent a year—the price level would double every 35 years and the value of the dollar would be cut in half each generation.

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Losses would thus be inflicted upon millions of people, pensioners, Government employees, all who have fixed incomes, including people who have part of their assets in savings accounts and long-term bonds, and other assets of fixed dollar value. The heaviest losers would be those unable to protect themselves by escalator clauses or the other offsets against prices that were steadily creeping up.

Moreover, the expectation of inflation would react on the composition of savings. A large part of the savings of the country is mobilized in savings deposits and similar claims that call for some stated amount of dollars. If people generally come to feel that inflation is inevitable, they will not save in this form unless they are paid a much higher interest premium to compensate them for the depreciation of their saved dollars.

It is for this reason that it is impossible, in a period of demand in excess of savings, to maintain lower interest rates through a policy of easy credit.

The country is experiencing a period of generally high employment in which investment outlays remain high, but if fears of inflation cause people to spend more of their incomes and save less, the result could only be more rapid inflation and still less saving in relation to income. Such saving as remained, furthermore, would be less and less in the form of loanable funds to finance homes, highways, school construction, and other community needs.

EFFECTS ON PRODUCTIVE ENTERPRISE

An inflationary psychology also impairs the efficiency of productive enterprise—through which our standard of living has made unparalleled strides. In countries that have had rapid or runaway inflations, this process has become so painfully obvious that no doubt remained as to what was happening to productivity. In the making of decisions on whether or not to increase inventory, or make a capital investment, or engage in some other business operation, the question of whether the operation would increase the profit from inflation became far more important than whether the proposed venture would enable the firm to sell more goods or to produce them at lower cost. The incentive to strive for efficiency no longer governed business decisions.

The man who suffers the most from this is the consumer.

PRODUCTIVITY—KEY TO SUSTAINED PROSPERITY

Why have real wages in this country risen to the highest levels in the world, thus permitting our standard of living to rise correspondingly?

Certainly, it is not just because wages have risen as the cost of living has risen.

Some people seem to think that is the reason for it. The big source of increase has been the increasing productivity of our national economy. Real incomes have gone up because the total size of the pie, out of which everybody receives his share, has grown so magnificently.

What has enabled the productivity of the American economy to achieve the levels that make all this possible? One vital factor has

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been the striving by so many people, each in his own field, for better and more efficient ways of doing things. Equally important has been the willingness to set aside a part of current income to provide the machines, tools, and other equipment for further progress. Both are essential if our standard of living and material welfare are to go on advancing.

EFFECTS OF INFLATION

Inflation does not simply take something away from one group of our population and give it to another group. Universally, the standard of living is hurt, and countless people injured, not only those who are dependent on annuities or pensions, or whose savings are in the form of bonds or life-insurance contracts.

The great majority of those who operate their own businesses or farms, or own common stocks or real estate, or even those who have cost-of-living agreements whereby their wages will be raised, cannot escape the effects of speculative influences that accompany inflation and impair reliance upon business judgments and competitive efficiency.

I may say parenthetically here, Mr. Chairman, that in some respects inflation is not unlike war in that you may point out certain war profiteers and others that benefit by war but in the long run nobody really benefits out of war. The point I am trying to make here is that really nobody benefits out of inflation.

Speculators and slick operators and others may temporarily derive benefit, but the common welfare becomes the welfare of all of us, as Adam Smith once said, and I question very much whether a case can be made that anybody specifically benefits over any period of time out of inflation. It has a deleterious effect on all of us.

Finally, in addition to these economic effects, we should not overlook the way that inflation could damage our social and political structure.

Money would no longer serve as a standard of value for long-term savings. Consequently, those who would turn out to have savings in their old age would tend to be the slick and clever rather than the hard working and thrifty.

Fundamental faith in the fairness of our institutions and our Government would deteriorate. The underlying strength of our country and of our political institutions rests upon faith in the fairness of these institutions, in the fact that productive effort and hard work will earn an appropriate economic reward. That faith cannot be maintained in the face of continuing, chronic inflation.

There is no validity whatever in the idea that any inflation, once accepted, can be confined to moderate proportions. Once the assumption is made that a gradual increase in prices is to be expected, and this assumption becomes a part of everybody's expectations, keeping a rising price level under control becomes incomparably more difficult than the problem of maintaining stability when that is the clearly expressed goal of public policy.

Creeping inflation is neither a rational nor a realistic alternative to stability of the general price level.

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PEGGING THE MARKET

It has been suggested, from time to time, that the Federal Reserve System could relieve current pressures in money and capital markets without, at the same time, contributing to inflationary pressures.

If such were the case, it would be nice and I am sure we would have endeavored to work out something along these lines a long time ago. These suggestions usually involve Federal Reserve support of the United States Government securities market through one form or another of pegging operations. There is no way for the Federal Reserve System to peg the price of Government bonds at any given level unless it stands ready to buy all of the bonds offered to it at that price.

This process inevitably provides additional funds for the banking system, permits the expansion of loans and investments and a comparable increase in the money supply—a process sometimes referred to as monetization of the public debt.

One of my predecessors referred to it as turning the Federal Reserve into an engine of inflation.

Senator FLANDERS. I didn't get that.

Mr. MARTIN. I said one of my predecessors described it as turning the Federal Reserve into an engine of inflation.

The CHAIRMAN. Who was that?

Mr. MARTIN. Mr. Eccles.

The amount of the inflationary force generated by such a policy depends to some extent upon the demand pressures in the market at the time. It would be dangerously inflationary under conditions that prevail today. In the present circumstances the Reserve System could not peg the Government securities market without, at the same time, igniting explosive inflationary fuel.

DO RISING INTEREST RATES ADD TO INFLATION?

We must be clear in viewing these relationships to distinguish cause from effect and not to confuse them. It is sometimes said that rising interest rates, by increasing the costs of doing business, lead to higher prices and thus contribute to inflation.

This view is based upon an inadequate conception of the role of interest rates in the economy, and upon a mistaken idea of how interest costs compare with total costs. In municipal government budgets, it is about 2 percent; in many utilities, it is 3 to 5 percent. Thus, as an element of cost, interest rates are relatively small; but as a reflection of demand pressures in markets for funds, interest rates are highly sensitive.

As previously explained, rising interest rates result primarily from an excess of borrowing demands over the available supply of savings. Since these demands are stimulated by inflation, under these circumstances rising interest rates are an effect of inflationary pressures, not a cause.

Any attempt to prevent such a rise by creating new money would lead to a much more rapid rise in prices and in costs than would result from any likely increase in interest rates. Such an attempt, moreover, would not remove the need for a fundamental adjustment in the relation between saving and consumption and would probably fail in its purpose of stabilizing interest rates.

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I would like to make it clear at this point, Mr. Chairman, as I have repeatedly testified, that I do not favor high interest rates.

I would like to see interest rates as low as it is possible to have them without inducing an inflationary process, because I believe you will have the greatest formation of capital under those conditions, but you have to recognize that interest is a wage to the saver as well as a cost to the borrower, and that interest rates, when they ignore the inflationary forces are just adding fuel to the fire, although of course, they are one of the costs, one of the prices that have to be paid, but they are a balancing factor in the economy.

BASIC FACTORS IN RECENT INFLATIONARY PRESSURES

A major cause of recent inflationary pressures has been the attempt to crowd into this period a volume of investment greater than the economy could take without curtailing consumption more than consumers have been willing to do.

In fact, there has been some increase in consumption on borrowed funds.

Increases in interest rates naturally come about under such conditions; they are the economy's means of protecting itself against such excessive bunching of investment or the building up or an unsustainable rate of consumption.

While the effect of a moderate change in interest rates on the cost of goods currently being produced and sold is small and relatively unimportant, changes in interest rates do assume importance as a cost in the planning of new investment outlays.

These costs do not affect current operations or add to upward price pressures to any substantial extent.

They do tend to deter the undertaking of new investment projects and to keep the amount of investment spending that is being undertaken in line with the economy's ability to produce investment goods.

To maintain artificially low interest rates under these conditions, without introducing any other force to restrain investment, would be to invite an unbridled investment boom, inflation, and an inevitable collapse later.

It is necessary to emphasize that there are many influences, other than monetary policies and interest rates, that affect the volume of consumption, investment, and saving and their relationships.

Monetary policies operate directly through the volume of bank credit and bank-created money.

The volume of current saving out of income and the uses made of new and outstanding savings have a more important bearing upon the availability of investment funds than bank credit.

Interest rates, therefore, are influenced by the relationship between investment demands and the availability of savings, independently of monetary policies.

Interference with these relationships through monetary policies, in fact, may prevent necessary and healthy adjustments that help to maintain equilibrium in economic growth.

IN A NUTSHELL

A. An inflationary spiral is always characterized by—

1. An interaction between rising costs and rising prices; and

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2. An increase in overall effective demand sufficient to keep the spiral going. As prices generally keep rising, a larger and larger volume of demand (in dollar terms) is needed to sustain the same volume of transactions (in physical terms).

As long as it persists, therefore, an inflation will always show evidence of both demand pulls and cost pushes with their relative manifestations shifting as the inflation runs its course.

B. The tempo of interaction between rising costs and rising prices will be speeded up if the situation is characterized by—

1. The release of a previously created overhang of pent-up money demand (such as existed when direct controls broke down or were relaxed at the end of the war).

I might just point out there that from the time regulation W was taken off, in the course of a year $5 billion more was expended in that area alone. I am not criticizing it, but that is a fact.

2. The creation in volume of new money demand through excessive credit expansion and/or activation of existing cash balances (such as happened when war broken out in Korea).

3. The widespread existence in the economy of escalators which act automatically to transfer rising costs or prices into rising prices and costs (cost-of-living clauses in collective-bargaining agreements, cost-plus contracts, etc.).

4. The degree to which a speculative psychology backed by effective demand pervades business decisions.

C. The tempo of interaction between costs and prices will also be affected by the degree to which administered prices and wage rates are prevalent in the economy. These effects are not always in the same direction. The net effect of the many and various factors influencing administered prices and wages sometimes tend to slow up and sometimes to accelerate price movements, depending upon the particular circumstances.

D. Whatever the mix of the above ingredients, an inflation once underway will tend to persist as long as the credit necessary to finance the rising level of costs and prices is forthcoming. Credit may be supplied through new bank credit expansion or by activation of already existing money.

E. What its antecedent characteristics, an inflation will tend to feed upon itself and be accentuated once the investing and saving public come to think of further inflation as the prospect.

F. It is the nature of inflation hedges to act as aggravating rather than equilibrating factors.

G. No one suffers more than the little man from the ravages of inflation.

H. A monetary authority dedicated to promoting the public welfare must not relax restraints in the face of continuing inflationary pressures, since any efforts to relax merely add to the forces tending to keep the inflation in motion.

Mr. Chairman, I want to conclude this phase of my statement with a call for action.

WHAT MORE CAN BE DONE?

How, then, may further inflation be restrained? Bluntly, the answer is to be found in a moderation of spending, both governmental and private, until the demands for funds are balanced by savings.

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This prudence must be coupled with sound fiscal policy, which means a larger budget surplus as well as effective monetary policy to restrain the growth of bank credit.

Among the factors influencing saving and consumption are those fiscal policies relating to taxes and governmental budgets. These require special attention because they are not as responsibe to changes in the availability of credit and interest rates as are private activities.

Untimely fiscal policies can create or aggravate imbalance in the economy and thus dilute the effectiveness of monetary policies. On the other hand, fiscal measures that help to maintain balance can reduce the degree of restraint that monetary policies might otherwise have to exert.

Experience over the centuries has demonstrated that there is no tolerable alternative to adequate fiscal and monetary policies, operating in an environment of open, competitive markets under our system of human freedoms.

Neither an economic dictatorship nor complacent acceptance of creeping inflation is a rational or tolerable way of life for the American people.

There is no panacea, no magical means of assuring orderly economic growth, nor are we much more likely in the future than in the past to achieve perfect performance in the timing and execution of policy and action.

We have every reason to believe, nevertheless, that we can discern and follow the right path. Thus, it is clear that the present situation calls both for a larger budgetary surplus than we have had or have in prospect, and a continuance of restraint upon creation of new supplies of money.

ACTION REQUIRED

Let us not follow the defeatist path of believing that widespread unemployment is the alternative to inflation.

There is no question that the Federal Government and the American people, pulling together, have the power to stabilize the cost of living. The only question is, whether there is the will to do so.

If the will is there, and it is demonstrated convincingly to the American people, the cost of living can be stabilized, interest rates will relax, and a sufficient volume of savings will be encouraged to provide for the economic growth needed in this generation and the next.

I might say parenthetically here that I am one of those who believe we haven't even scratched the surface so far as the potential development and opportunities in this country are concerned.

This committee and the Congress can contribute greatly to that end by declaring resolutely—so that all the world will know—that stabilization of the cost of living is a primary aim of Federal economic policy.

The goal of price stability, now implicit in the Employment Act, can be made explicit by a straightforward declaration and directive to all agencies of the Government that antiinflationary actions are to be taken promptly whenever the cost of living begins to rise.

The executive and legislative branches of Government, in conjunction, can assure adjustment of Federal revenues and expenditures so that, in times when total spending threatens to burst the bounds of capacity and drive up the cost of living, the Federal Government will

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set an example of restraint in outlays and at the same time produce a surplus to counter inflationary pressures from any quarter.

The Congress and the Executive can take steps to assure that free and vigorous competition is maintained in all segments of the economy as the bedrock of our free-enterprise system.

The Federal Reserve System, itself a creation of the Congress can—and I assure you that it will—make every effort to check excesses in the field of money and credit that threaten the cost of living and thus undermine sustained prosperity and growth of our economy.

In all of these ways we can, if we have the will, set the face of the Nation so resolutely against inflation as to keep that enemy from our gates.

No greater tragedy, short of war, could befall the free world than to have our country surrender to the easy delusion that a little inflation, year after year, is either inevitable or tolerable.

For that way lies ultimate economic chaos and incalculable human suffering that would undermine faith in the institutions of freemen.

The CHAIRMAN. Thank you, Mr. Martin.

Mr. MARTIN. I would like at this point, Mr. Chairman, if I could, to ask Mr. Wayne, who is the first vice president of the Federal Reserve Bank of Richmond, one of the banks that has performed yeoman service in explaining our activities to the public through the years, if he would put on as the concluding part of this presentation this morning a flannelboard presentation of the structure and organization of the system. I would ask him to stop at the end of the structure of the system, and I would like if it is agreeable to you to put on first thing in the morning a continuation of his show which will take about 45 minutes, which will give our diagnosis of the situation in a little different way, but exactly in parallel to what I have put in the printed statement that I have here and having completed that, I would then open myself to questions and I will go immediately to trying to get the answers to these questions that you have given me here, and try to get them up here just as quickly as I can.

The CHAIRMAN. You have completed your initial statement as I understand it.

Mr. MARTIN. I have, sir.

The CHAIRMAN. Do you have charts?

Mr. MARTIN. Yes, Mr. Wayne, will you take over at this point, sir?

STATEMENT OF EDWARD WAYNE, FIRST VICE PRESIDENT, FEDERAL RESERVE BANK OF RICHMOND

Mr. WAYNE. Mr. Chairman, we would like to place on this flannelboard a diagram of structure of the Federal Reserve System to illustrate what Chairman Martin has been saying.

Certain features of the Federal Reserve System are in sharp contrast to those of foreign central banks. Most notable is the apparent determination of the founders of the system that exercise of system powers would be based upon a blending of divergent views and experience. It has been said that in the determination of policy the plurality of origin is an essential aspect of the competition of ideas which marks the democratic process.

Representation on the policymaking groups within the Federal Reserve System reaches into all regions of the country. Balance of

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power within the System rests with the Board of Governors of the Federal Reserve System, but the System organization was so designed that we might have a single national credit policy based upon information drawn from the widest possible practical day-to-day contacts with different areas in the national economy.

The structure of the Federal Reserve System includes more than 6,400 member banks. Not quite half of the commercial banks in the United States belong to the Federal Reserve System, but these banks hold about 85 percent of the Nation's banking resources. The law stipulates that these member banks must provide the capital for the 12 Federal Reserve banks. Each member bank may be required to subscribe to the capital of its Reserve bank an amount equal to 6 percent of its capital and surplus, but only half of that amount has been paid in. The other 3 percent is subject to call.

The 12 Federal Reserve banks operate all told 24 branches, and with these 36 offices throughout the United States perform many public services. Among others providing the currency needed to meet seasonal and other demands of the economy, clearing of checks that are so essential in the functioning of a highly developed exchange economy, making telegraphic transfer of funds for member banks and their customers, making appropriate loans to member banks temporarily in need of funds, acting as fiscal agent of the United States Government in issuing and redeeming Government securities and handling the Treasury's principal checking accounts and so on.

Profits are not the object of operation of the Federal Reserve banks and their stockholders, the member banks, do not have the usual rights of owners . They do elect six of the directors of the Federal Reserve banks. Class A directors may be and usually are bankers, but 3 of the 6 directors elected by member banks may not be bankers. They may be neither officers nor directors nor employees of banks, and must be actively engaged in commerce, industry, or agriculture in the district which they represent.

Now the Board of Governors of the Federal Reserve System, as you gentlemen know, comprises seven members appointed by the President with the approval of the Senate. Each member is appointed to 14-year terms, and the terms are so staggered that 1 appointment expires every 2 years. No 2 members of the Board may come from any 1 Federal Reserve district. The Board of Governors appoints the remaining 3 directors of the Federal Reserve bank, class C directors, and from these directors the Board of Governors designates 1 of these class C directors as Chairman and 1 as Deputy Chairman.

These class C directors can be neither officers, directors, nor employees of banks. In fact they are prohibited by law from being even stockholders. These directors together with the 150 plus directors of the branches provided an unparalleled source of economic information essential to Federal Reserve policy formulation.

The Board also exercises general supervision over the individual Federal Reserve banks. The members of the Board sit as members of the open market committee along with five of the presidents of the Federal Reserve banks who are elected by the Federal Reserve bank directors. As Chairman Martin has pointed out, 4 or these 5 are on rotation service.

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The Federal Reserve bank directors also elect the members of the Federal Advisory Council, one from each of the districts, usually a banker. The Federal Advisory Council advises the Board of Governors on matters of current interest.

The basic tools of monetary policy are reserved 1 to each of these 3 groups. The Board of Governors determines the Reserve requirements of member banks. It also administers selective restrictions, when they are in effect, determines the maximum interest rates paid by member banks on time deposits and has many other responsibilities.

The open-market committee is responsible for the determination of open-market policy. The New York Federal Reserve Bank acts as agent for the system in executing the mechanics of open-market operations for the obvious reason that the money market is physically located in New York City.

The directors of the 12 Federal Reserve banks establish the discount rate subject to review and determination by the Board of Governors of the Federal Reserve System. The directors are also responsible for the discount policy of the Reserve banks within the provisions of regulations issued by the Board of Governors.

So this, in a diagrammatic form, is the Federal Reserve System, a unique istitution designed by Congress to assist in meeting the credit and monetary needs of a large, diversified, and complex economy. The power of decision over the 3 basic instruments of monetary policy are divided among these 3 bodies. The organization of the System was designed to insure that the vitally important decisions in the field of monetary policy would be made on the basis of maximum evidence and informed judgment in the crucible of the conflict of views and ideas.

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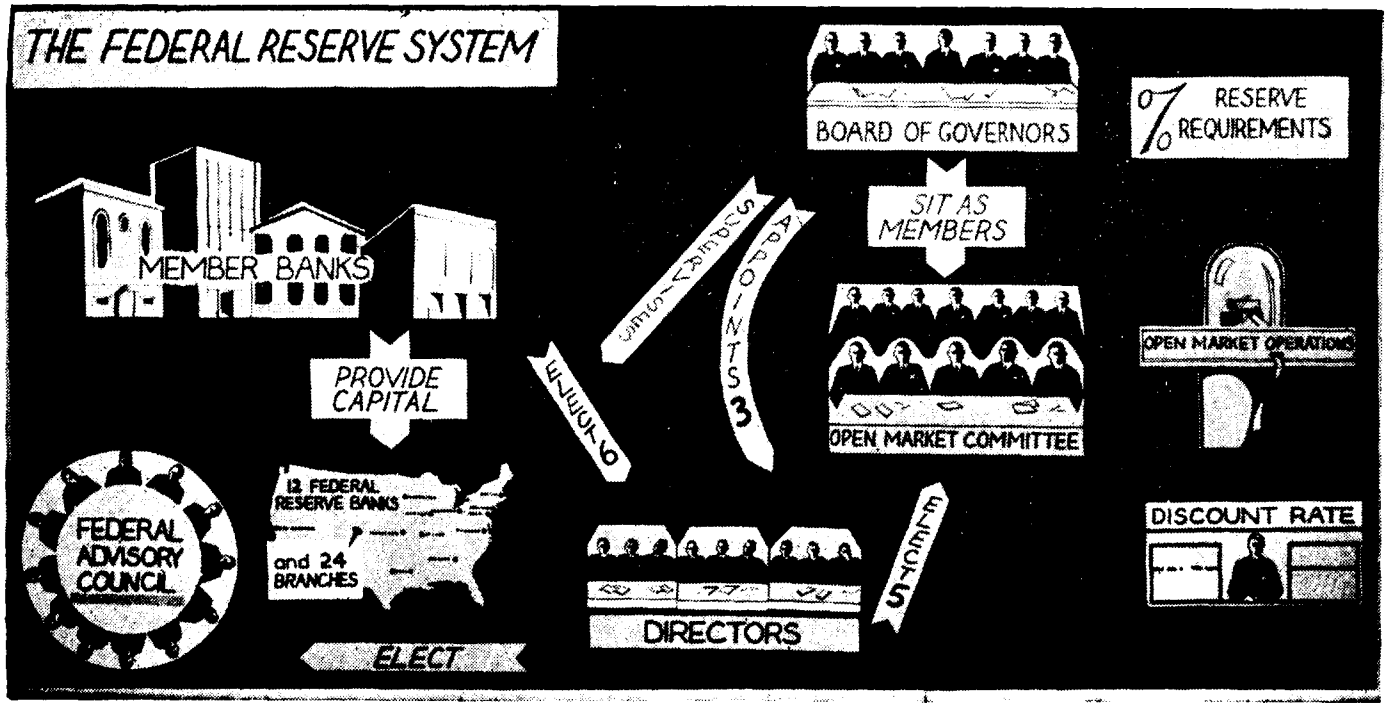

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Mr. WAYNE. Mr. Chairman, that concludes the brief presentation of the structure of the Federal Reserve System through the use of visual aids. As Chairman Martin says, with your permission we would return to the other portions of our presentation tomorrow.

The CHAIRMAN. We have a half hour yet.

Mr. MARTIN. I would like to hold it over because it will go too long. Then it would go past 1 o'clock and I would like to bring these up a little closer too if I could, for the overall presentation, if you wouldn't mind.

The CHAIRMAN. How long will it take tomorrow to complete it? Will you have any further statement?

Mr. MARTIN. No, I won't have anything further. We can speed this up a little bit, but I would like to get that whole presentation in if I could.

The CHAIRMAN. How long would it take tomorrow?

Mr. MARTIN. Tomorrow we could do it in an hour, I'm sure, and then we can take questions.

The CHAIRMAN. What is the pleasure of the committee?

Senator FLANDERS. Mr. Chairman, I hate to stop. I would like to keep going and if there is an hour's presentation tomorrow, why can't we have it now?

Mr. MARTIN. I think it would be better for the continuity if we could be sure we went through the whole thing, Senator Flanders.

The CHAIRMAN. I think the chairman has made his plans and as far as I am concerned I would be willing to comply with them.

Is there any objection?

Senator BENNETT. Further, Mr. Chairman, if an orderly and full presentation would require a little more than an hour, I would rather the time tomorrow than have them feel that they are under pressure to crowd it in.

The CHAIRMAN. There will be an hour or more for questioning tomorrow. Without objection the committee will recess until 10 o'clock tomorrow morning.

(Whereupon, at 11:35 a. m., the hearing was adjourned, to reconvene at 10 a. m., Wednesday, August 14, 1957.)

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INVESTIGATION OF THE FINANCIAL CONDITION OF THE UNITED STATES

WEDNESDAY, AUGUST 14, 1957

UNITED STATES SENATE,
COMMITTEE ON FINANCE,
Washington, D. C.

The committee met, pursuant to recess, at 10:10 a. m., in room 312, Senate Office Building, Senator Harry Flood Byrd (chairman) presiding.

President: Senators Byrd, Kerr, Long, Smathers, Anderson, Gore, Martin, Williams, Flanders, Carlson, Bennett, and Jenner.

Also present: Winfield Riefler, assistant to the chairman, Board of Governors, Federal Reserve System; Woodlief Thomas, economic adviser, Board of Governors, Federal Reserve System; Edward A. Wayne, first vice president, Federal Reserve Bank of Richmond; George W. McKinney, Jr., assistant vice president, Federal Reserve Bank of Richmond; Robert R. Fentress, assistant cashier, Federal Reserve Bank of Richmond, Richmond, Va.

Elizabeth B. Springer, chief clerk; and Samuel D. McIlwain, special counsel.

The CHAIRMAN. The committee will come to order.

STATEMENT OF WILLIAM McCHESNEY MARTIN, JR., CHAIRMAN, BOARD OF GOVERNORS, FEDERAL RESERVE SYSTEM—Resumed

Mr. MARTIN. I will turn the floor over to Mr. Wayne, if that is all right.

The CHAIRMAN. Yes; please identify him for the record.

Mr. MARTIN. This is Mr. Edward Wayne, first vice president of the Federal Reserve Bank of Richmond.

Will you identify, Eddie, when you come to it, the two officers you want to help you?

Mr. WAYNE. Yes, sir.

The CHAIRMAN. All right. You may proceed, sir.

Mr. WAYNE. Mr. Chairman and gentleman, in continuing this presentation this morning it is not our purpose here to forecast the future of the dollar nor to predict the course of economic events in the months that lie ahead.

We propose merely to recall for you certain basic facts and fundamental economic principles with which the monetary authorities and all thinking citizens should be and are vitally concerned.

An American statesman recently observed that:

> Within a decade this Nation has been thrust into a position of enormous responsibility in a highly uncomfortable new world.

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This is the first basic fact with which we are confronted.

The free world looks to the United States for security not only in a political but in an economic sense, and so the value of the American dollar, your money's worth, has meaning, it seems to us, for peoples throughout the whole world.

The second basic fact is that in the past several decades our economy has undergone a fundamental shift from an economy with a deflationary bias to one with a distinctly inflationary bias.

From the days of the earliest settlers in this country until perhaps the early part of this century, one of the prime limiting factors in the Nation's fabulous growth was the inability of the money supply to adjust itself to a rapid expansion.

As the population grew and spread, the country was plagued with a series of so-called money panics. Our money supply simply could not adjust itself with sufficient rapidity to meet the growing needs of the economy.

As all of you gentlemen know, one of the stated objectives of the Federal Reserve Act was to achieve an elastic currency. Our problem in recent years has been too much money rather than too little money most of the time.

In the past couple of decades we have also accelerated this shift to an inflationary bias in our economy by certain measures which have gained wide acceptance, and many of which have been written into the laws of the land.

In addition to antideflation curbs which have been built into our economy, the Congress has declared it to be the established policy of this Nation to exercise the powers of Government to achieve and maintain employment and production at maximum sustainable levels.

In other words, we are now confronted and must deal with a changed and changing situation. As the economists would say, we have a new "frame of reference."

The third basic fact is that in the past several years this inflationary bias has been intensified by the pressures of World War II, by the Korean conflict, and other developments, with the result that your money's worth, our money's worth, has been under severe attack.

The ensuing inflation has cut the value of our dollar almost in half, in terms of pre-World War II levels—it is now a 49-cent dollar.

With your permission, in making this presentation we would like to adopt medical terminology. It seems to convey the idea satisfactorily.

If you would assume with us that the patient we are examining is the economy of the United States of America, we would like to explore the nature of the virus that infects the bloodstream of our economy, and list the prescriptions available in our Nation's medicine chest.

Mr. Robert Fentress, assistant cashier of the Federal Reserve Bank of Richmond, and Mr. George McKinney, assistant vice president of the Federal Reserve Bank of Richmond, will assist in this presentation.

Mr. Fentress will undertake to, again continuing the use of medical terminology, diagnose the patient's illness; and Mr. McKinney will undertake to outline the treatments which are available to us.

Then I shall return to summarize and answer any questions you may wish to present concerning the presentation.

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This gentleman is Mr. McKinney; and this is Mr. Fentress.

Mr. Fentress?

Mr. FENTRESS. Much we will say this morning will be couched in terms of inflation. This is not necessarily because of the short-run outlook, but rather, we do it for three reasons:

First of all, someone has said that today was born yesterday. If we are to understand where we are now, we must look at the road we traveled to get here.

Second, in the interest of conserving time, we shall treat only one side of the picture. Deflation is essentially the reverse of inflation. As we proceed, we shall see that the causes are but the opposite of each other; even the remedies are essenially the same medicine applied in reverse.

The third reason is that, no matter what the short-run outlook, we are convinced that the long-run outlook is definitely for more inflationary pressures.

Well, just what has the patient's history shown? Let's look at inflation's fever chart. It is a little hard to realize, but for the period since the Japanese surrender in 1945, prices consumers pay have risen 55 percent.

Let me say here, however, that rising prices are no more the cause of inflation than rising fever is the cause of a patient's illness. Both are but manifestations of the disorder, but both are pretty good measures of the extent of the disorder.

Well, let us see just what has been taking place in this postwar period.

In August of 1945, the Bureau of Labor Statistics' index of consumer prices stood at 78, based on the 1947–49 average as 100. In the succeeding 10 months, business was busy converting to peacetime production. Most wartime controls were still in effect, and the index climbed only a couple of points.

Then what happened? Well, in June of 1946 most direct controls were lifted. The lids were off. Rationing was abandoned. Most controls over prices and wages were lifted. It was then that we got immediate proof that controls do not prevent inflation. They merely dam up, postpone the demand.

When the floodgates are again opened, this pent-up demand bursts on the market with the effect of a tidal wave. Consumers pour into the market seeking consumer goods. Business pours into the market seeking larger plants, new equipment, and to expand inventories, and prices are forced higher and higher.

Well, the inevitable happened. Prices spiraled. The index reached 105 as of August 1948. That was a 25-point rise in just 26 months.

By then, much of this overhanging consumer demand had been satisfied. Certain fiscal and monetary actions were taking effect. Inventory accumulation had about run its course. In fact, many businesses found themselves in oversupply, and the pipelines were full.

A short time later, a mild so-called inventory recession got under way, and continued through 1949, with the index sliding to 100 as of February 1950.

In the first half of 1950, strong upward pressure was again evident. In spite of decreased Federal spending and a substantial rise in production, the index climbed another point or two; and then, Korea.

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On top of this high level of business activity, we superimposed a huge war and military-aid budget. With plants already going full blast, with labor scarce, with consumers mindful of the shortages of the recent war and possessed of abundant disposable income and liquid savings, another buying wave was on and prices spiraled once again.

Then, in the spring of 1951, the Federal Reserve and the Treasury reached their now famous "accord."

Basically, this involved an agreement to permit market forces to determine the prices of Government securities, and permitted much more effective use of the tools of monetary policy in combating inflationary pressures.

In addition, other monetary and fiscal measures were taken: "Scare buying" subsided somewhat. The balanced inventory position blunted the edge of consumer buying, and higher prices themselves brought buyer resistance.

These and other factors induced a lull in the feverish rise of consumer prices, and the index leveled out in March and April of 1951 at about 110. Then the Nation entered upon the most sustained period of price stability in its history.

During the next 5 years, the index climbed only 5 points, a contrast of a point a month in the earlier period with a point a year in this period.

In the spring of 1956, however, consumer prices started to rise again, and today our index stands at 120.

Of course, a rise in prices is just another way of saying that the dollar has depreciated in terms of purchasing power in some base period.

Since our chart is based on the 1947–49 average as 100, an index number of 120 today means that, in terms of prices then, a dollar today is worth only 83 cents. However, in terms of prewar purchasing power, say 1939, a dollar today is worth only 49 cents.

Of course, the real question that all this poses is: How is our fever chart going to read 6 months or a year from now? Will we be able to regain this substantially sidewise movement which we had during this period? Will deflation bring about a serious downturn, or will persistent inflationary forces push our fever chart even higher?

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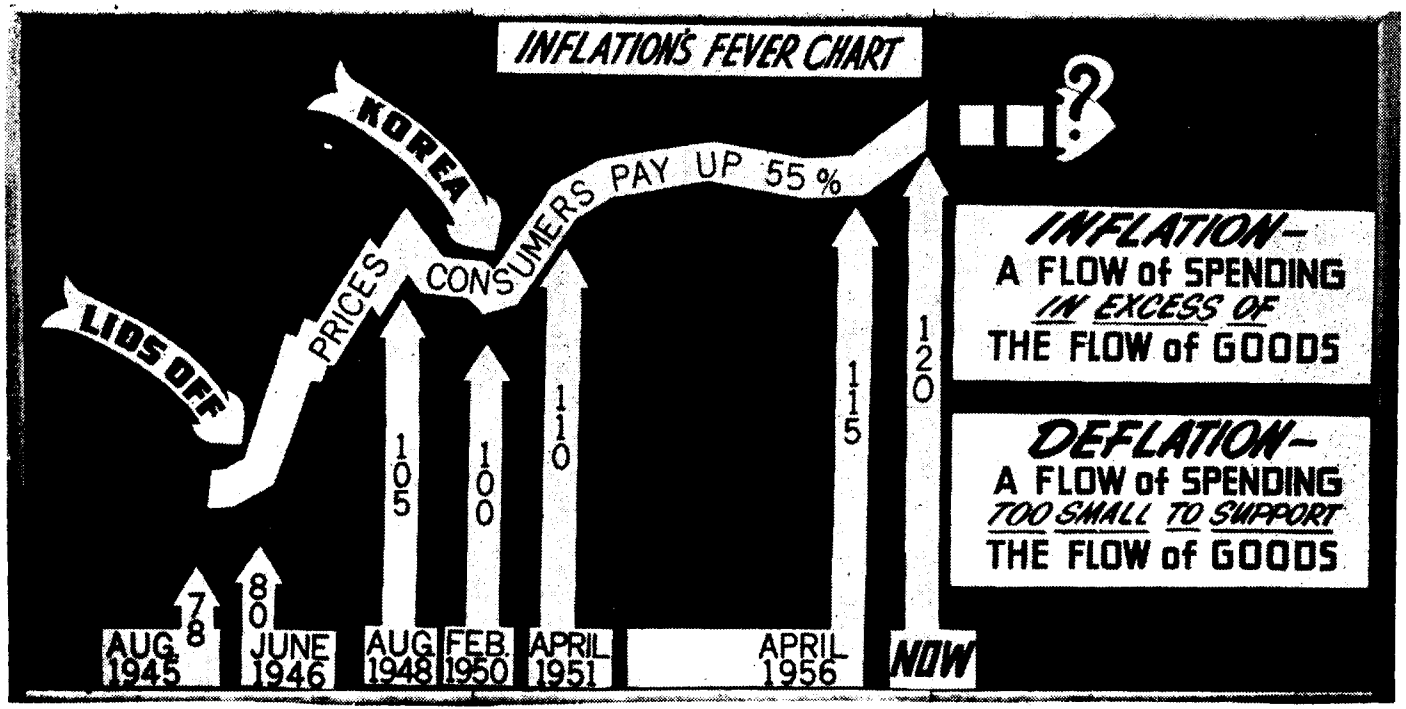

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These are the questions, important questions, for every thinking citizen. But they are of particular significance for the monetary authorities who are charged with endeavoring to attain and maintain economic stability.

Monetary authorities are concerned primarily with the cost and availability of money as a means of influencing the spending stream, attempting to moderate swings in our economy by indirection, by influencing the economic climate, and leaving to individuals the freedom of choice as to specifics.

The objectives, of course, are to create easy money conditions when business is depressed, and to restrain the growth in the money supply in boom time.

Inflation creates such an aura of prosperity and works to undermine our Nation's economy in such insidious ways that confusion is bound to result whenever we look only at the effects of inflation.

Inflation is so persistent and insidious, it presents one of the chief threats to the defense of the dollar and our way of life, and for that reason I think we should look closely at the nature of the disease and its spread. Perhaps we should first begin by defining our terms.

We have adopted a fairly simple, nevertheless sound, definition of inflation: "Inflation is a flow of spendings in excess of the flow of goods and services." Conversely, "Deflation is a flow of spendings too small to support the flow of goods and services."

I find it easier to understand this concept of a flow of spending supporting a flow of goods and services if I remember that one man's expense is another's income.

Let us assume that this factory is representative of any and all industry, and that this machine operator represents not only the factory's labor costs but all other costs as well. What is expense to the factory is income to the worker and raw materials supplier.

In turn, the worker's expenses, his suit of clothes from the merchant, for example, become income to the retailer and others from whom he buys.

The retailer then pays his clerk, replenishes inventory, with his expense becoming income to those from whom he purchases things.

So here we have the flow of spending carrying with it the flow of goods and services. If there is no change in the flow of spending, and no change in the flow of goods and services, there can be no pressure on prices.

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It is an economic truism that income can never exceed spending. Only that which is spent can become income.

On the other hand, spending may be either more or less than current income. We can spend more than current income by withdrawing savings, the spending of yesterday's income today, or by borrowing, the spending of tomorrow's income today.

We can spend less than current income by saving a part of it or by repaying debt.

What is true of the individual is equally as true of business and industry.

Government derives its income primarily from taxes. It can levy these taxes at any point in this spending stream. Normally, the taxing in and of itself is deflationary; it draws dollars from the spending stream.

On the other hand, expenditures by Government pour dollars into the spending stream.

Let us emphasize that these two processes, taxing and spending, are distinct and separate.

Now, just as in the case of individuals and business, Government can spend less than it takes in in taxes, running a surplus and retiring debt, as it did in the first few postwar years.

On the other hand, Government can spend more than it takes in in taxes. Of course, this spending in excess of taxes, this deficit financing, puts pressure on prices.

In a period of mobilization, military buildup, and extensive foreign aid, such as we have had during much of this period, not only does this excess spending add to the spending stream, but the diversion of strategic and scarce materials into the production of defense material tends to limit the flow of goods available for consumers.

The result is we have twin pressures on prices—more dollars chasing fewer goods.

To the extent that this excess spending can be siphoned off into savings, the purchase of defense bonds, for example, the pressure on prices is relieved. That is why we say that bond purchases, defense bond purchases, are such effective anti-inflation medicine. I would like now to convert this spending flow into dollars and cents figures for the postwar period.

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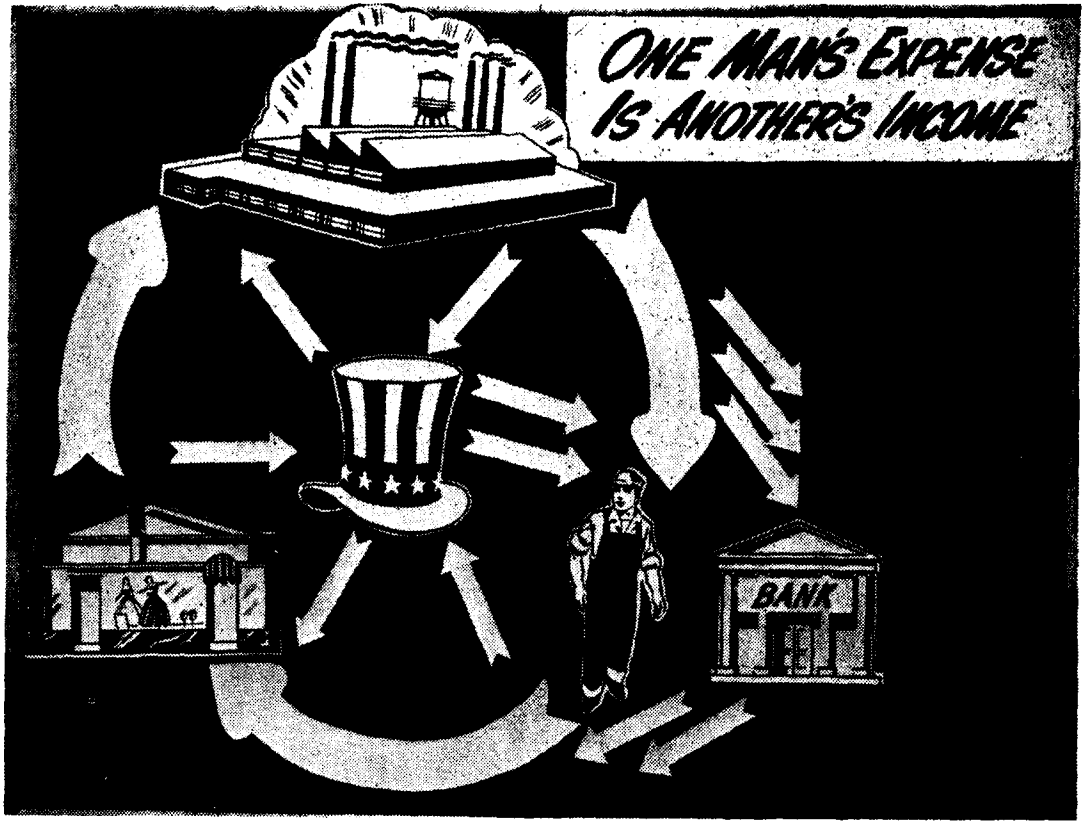

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Spendings of consumers, business, and Government make up our total spending flow. By tracing their movements relative to the flow of goods and services, you get a much clearer picture of the nature and extent of our postwar inflation.

By looking ahead to probable future spendings of these components, relative to prospective changes in output, we can make a reasonable stab at predicting the course of the patient's illness in the months that lie ahead.

Let us first take a close look at the first few postwar years.

Our patient's fever was mounting rapidly from year-end 1945 through the first quarter of 1951. During this period of roughly 5¼ years, spending of consumers went up from an annual rate of $128 billion to an annual rate of $210 billion.

Business spending for investment went up from $14 billion per year to $57 billion per year.

Government spending at the year-end 1945 was at the rate of $55 billion a year, including $49 billion for national security. Thereafter, Government spending fell as low as $27 billion or $28 billion. But by the first quarter of 1951, it had risen again and totaled $52 billion, including $27 billion for defense.

Total spending had risen from $197 billion to $319 billion, up $122 billion.

Now, in physical terms, that is, in dollars of 1945 purchasing power, we were able to increase our flow of goods and services in this same period from an annual rate of $197 billion to an annual rate of $228 billion. That is a substantial 16-percent increase in our Nation's production during this period of 5¼ years.

Now, of this $122 billion increase in spending, $31 billion was balanced off by increased purchases of goods and services, leaving $91 billion which spilled directly into prices, and the Consumer Price Index went up from 78 to 110, as we have seen on the fever chart.

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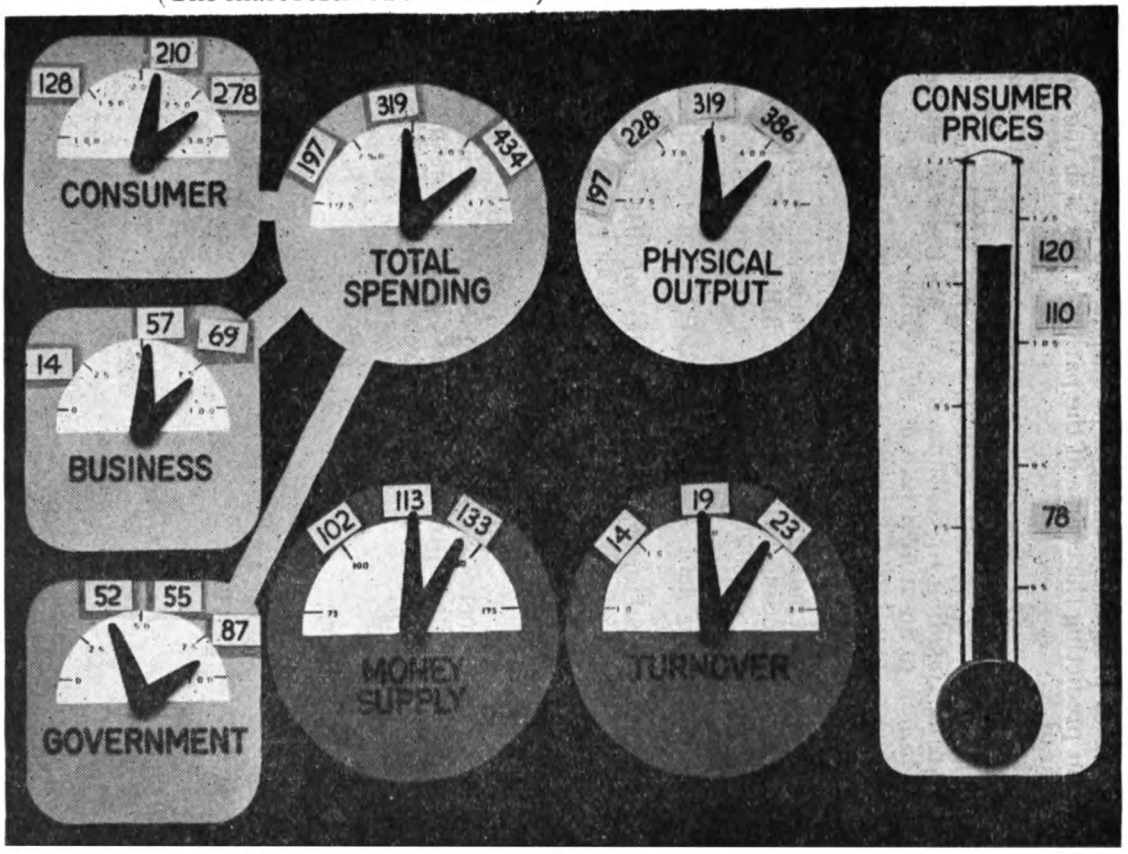

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Now, that is inflation—a flow of spending which increases faster than the flow of goods and services. The excess spending inevitably spills over into prices. There is just no other place for it to go.

Well, we have to look now at what enables this increase in spending to take place. Of course, I am talking about the money supply and the turnover of money. I would like to make just a couple of points here:

First, this money supply includes deposit money as well as currency. You can spend by check perhaps even more readily than with cash.

Second, the most common way in which the money supply is increased is through the making of loans by banks or the purchase of securities by banks.

To illustrate this bank creation of money, let us look at what happens when a bank makes me a loan.

Normally, the proceeds of this loan would be credited to my checking account. This now means that I have more money which I can spend as I see fit.

But does anyone else have any less money? No. There has been a creation of deposit money which did not previously exist, and this country's money supply has been increased in exactly the same amount.

Money is created in just the same way when Government bonds are sold to our banks. From year-end 1945 through the first quarter of 1951, our money supply rose from $102 billion to $113 billion.

But that was not all of it. We were also spending our money faster.

That $10 bill which we got yesterday and spent again today is going to be turned over many times during the year. It would be almost impossible to measure the number of times it is turned over. But we can measure the turnover of checking accounts, and they are money, too.

At year-end 1945, the turnover of checking accounts at 338 centers in the country was at a rate of 14 times per year. That means simply this: For every hundred dollars average balance which I might have in my checking account at year-end 1945, I was writing, at an annual rate, $1,400 worth of checks.

By the first quarter of 1951, instead of $1,400 worth of checks, I was writing checks at an annual rate of $1,900 for every hundred dollars average balance in my checking account.

Now, these are the factors which permitted the growth in spending. The swollen spending stream relative to the flow of goods and services is the inflation. The inevitable result is a rise in prices.

Now let us look at another period of just about the same length, the 6¼ years since the first quarter of 1951.

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During this period, each of these components of spending for output increased once again. These permissive factors went up. The money supply, $113 billion in 1951, is now $133 billion.

We still have been spending our money faster. The turnover of checking accounts today is 23 times a year.

Each of these components of spending for output has increased substantially. Consumer spending is up from $210 billion to $278 billion.

Business spending for investment is now at $69 billion, while Government spending has gone up to $87 billion per year. Total spending is up from $319 billion to $434 billion.

But in this period, we were able to hold our flow of spending to a more reasonable relationship to the flow of goods and services. This time our physical output went up from $319 billion to $386 billion.

That is about a 21-percent increase in our flow of goods and services in 6¼ years, despite the fact the flow of spending was not increasing quite so rapidly during this period.

Of this $115 billion increase in spending, $67 billion was balanced off by increased flows of goods and services, leaving only $48 billion to spill over into prices; and the consumer price index climbed only 10 points.

As we saw from the fever chart, 5 of these 10 points have been since the spring of 1951——

Senator BENNETT. 1956.

Mr. FENTRESS. 1956, excuse me.

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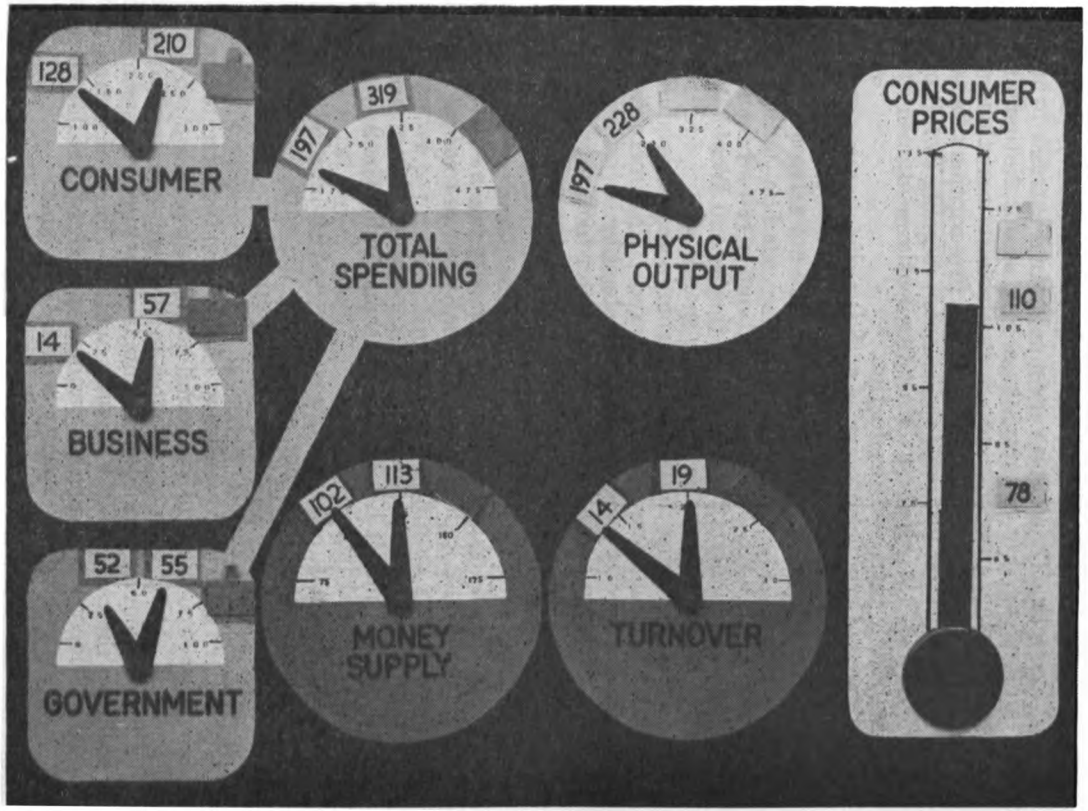

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Mr. FENTRESS. Whatever the future holds for our patient, the chills and fever he faces from time to time arise from a common cause: A flow of spending either too large or too small to support the flow of goods and services which this Nation's productive capacity can turn out.

With this, we have completed our diagnosis of the patient's illness.

Now George McKinney will list the prescriptions available to treat the illness.

The CHAIRMAN. Thank you very much, Mr. Fentress.

Mr. MCKINNEY. Let us now take a look at our Nation's medicine chest and see what prescriptions are available to treat this malady of instability in our economy. What are our prescriptions for stability?

Logically, the most desirable treatments are going to fall under the heading of nature's remedies. Most frequently mentioned as an anti-inflation cure is increased production.

But increased production carries with it a certain amount of spending arising out of the payments for the goods and services, so that it also adds to the spending stream and you do not necessarily come out ahead on that.

We did have, as Mr. Fentress pointed out, a 16-percent increase in 5¼ years immediately after the end of the Second World War, but it was not enough to match the rise in our spending.

The real contribution in this area is from increased productivity, increased output per every man-hour worked. This increased productive capacity is pretty generally brought about by business investment, bigger and beter plants and equipment, better tools to work with.

At the time that business is spending for the acquisition of new plant and equipment, it is pouring additional dollars into the spending stream and actually intensifying the inflation process.

But once the additional productive capacity becomes available, the larger flow of goods and services materially serves to offset the excess spendings that are bidding up prices.

During the postwar period, we had some unusual increases in productivity. At times it has been more than double the 2 or 3 percent traditional annual increase.

The second of nature's remedies is increased savings. By "saving," I mean the negative act, not spending. We save, as Mr. Fentress pointed out, when we build up our liquid assets. We also save by repayment of debt.

Any dollar that we save pulls out of this spending stream one dollar which does not continue to go around bidding up prices.

Increased saving also contributes to the long-run solution of the inflation problem by making available true savings which can be used to build up the capital stock of our country. That, of course, would increase tomorrow's productivity and offset some of that flow of spending when the productive capacity becomes available.

This particular medicine can be too effective. Back in 1933, we were saving every dollar we could get our hands on, and we saved so much that it shrunk this spending stream to a point where it could not support our maximum sustainable flow of goods and services, and a substantial portion of our Nation's resources were wasted in idleness.

But saving has been very effective in a more helpful way in the past 6 years. Following the accord between the Treasury and the Federal Reserve in the spring of 1951, consumers substantially in-

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creased their rate of saving, principally because they cut down on the amount of dissaving that they were doing.

The net rate of saving in the spring of 1951, the first quarter, was about 3½ cents out of every dollar of income available after taxes. By the fourth quarter of 1951, that rate had gone up to 9 cents out of a dollar of income.

Since then, it has fluctuated. Now it is more than 7 cents we are saving out of a dollar of income after taxes, more than twice the rate of saving when this fever chart was shooting up so rapidly.

Saving was one of the very effective factors contributing to the leveling off of the price index.

If nature's remedies prove inadequate to solve the problem of inflation, what is our next logical step? It is the use of preventive medicines.

These preventive medicines fall under the heading of fiscal policy and monetary policy.

Fiscal policy relates to any action of government in the field of taxing, spending, and the management of the public debt. That, of course, includes Federal, State, and local government.

We usually think in terms of the Federal Government, for a couple of reasons: One is that two-thirds of this $87 billion total is Federal Government spending for goods and services; and secondly, the Federal Government is concerned with the effects on the spending stream of their taxing and spending activities.

Reduced spending is a very effective anti-inflation medicine. To the extent that you can cut down on the number of dollars that Government pours into this spending stream, a contribution is made toward solving the problem of inflation.

Increased taxes are, within limits, directly deflationary. Of course, too high tax rates can have adverse effects by substantially diminishing the incentive to produce, but basically, taxation pulls dollars from this spending stream, thereby serving to reduce it and countering inflationary pressures.

The third fiscal policy medicine: debt management. The management of the public debt, tailoring it so that it fits conditions in the economy at the time, plays a very important role in the treatment of the virus of inflation. To the extent that our national debt can be placed in the hands of nonbank investors, we avoid creation of new money.

The most important medicines of monetary policy fall under the heading of general treatments, general restrictions. These treatments mark out the bounds of play.

This illustration is supposed to be a football field. This marks out the bounds of play, but does not restrict the actions of the individual players.

The indirect influence of these general treatments is brought to bear through member-bank reserves. These member-bank reserves are the key to the money-creating process, and the key to the way in which banks are able to create money. By affecting the access of banks to reserves, these general monetary medicines influence the cost and availability of money, which in turn exert an influence on this spending stream.

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This influence is in no way punitive. No individual is told what he can or cannot do. Rather, it seeks to help bring about a flow of spending just adequate to support our maximum sustainable flow of goods and services so that there is no excess spending to be wasted in price increases, on the one hand, and, on the other hand, there is no wastage of our Nation's resources in idleness.

These influences are applied in three ways:

First, reserve requirements. The laws of the Federal Government and of the several States prescribe certain reserves which must be maintained by the banking system. These requirements determine the extent to which banks have access to these reserves, and determine the extent to which banks can create money on the basis of a given volume of reserves.

Actually, it is these excess reserves, reserves in excess of requirements, which are the focal point of these monetary medicines.

The Federal Reserve System, whose member banks hold 85 percent of the banking resources of this country, can vary these reserve requirements, increasing them or decreasing reserve requirements within limits prescribed by law.

Increasing them has a double-barreled anti-inflationary effect. Here is how that works.

Under current conditions, $1 of reserves will support about $6 of deposit money. Banks usually carry some excess reserves. An increase in reserve requirements will serve to wipe out some of these excess reserves by making them required reserves.

Secondly, an increase in reserve requirements cuts down on the expansion potential of new reserves. Whereas the banking system now can create $6 deposit money if it is supplied with $1 of new reserves, if reserve requirements were increased from one-sixth of deposits to, say, one-fifth of deposits, then $1 of new reserves would permit the creation of only $5 of new deposit money.

This is a very effective medicine, but changes in reserve requirements are drastic treatments. Their impact often is greatest in those sections of the country which are least able to adjust to the change. Such indiscriminate and blunt treatments must be used with extreme caution.

Then a second medicine: Banks can borrow reserves which increases their excess reserves and increases their lending power accordingly.

The rediscount rate, then, is our second medicine, the cost to banks of borrowing those reserves from the Federal Reserve System. To the extent that a higher rediscount rate discourages member bank borrowing, it also discourages this creation of excess reserves, because borrowings from the Federal Reserve System are reserves.

Even when banks are not borrowing extensively, an increase in the rediscount rate has a psychological effect, in that it is usually interpreted as a caution signal.

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Banks generally are reluctant to borrow, and they are quick to repay when they do borrow. Therefore, when the need to borrow becomes widespread across the country, the rediscount rate acts as a flexible drag on further creation of new money.

This medicine, the rediscount rate, works very closely with open-market operations which increase or decrease the needs of banks to borrow.

Under current conditions, open-market operations, the third monetary medicine, are our most effective monetary medicine, and because of that fact I would like to trace briefly, if I could, how open-market operations have their effect.

If you will pardon me, I will not stick strictly to the way that this occurs literally, but this is more diagrammatic.

Let us assume that institutional investors are dumping large quantities of bonds on the market. Now, this will create a downward pressure on prices. But this pressure on prices is perfectly normal. It happens continually in any free market when selling pressures build up.

If those bonds are purchased by nonbank investors, let us say by the individual's group, then the immediate effect is a transfer of existing money between two groups. The check given in payment for the bonds is deposited in the bank, increasing the deposit account of the seller. Then it is charged against the checking account of the buyer, reducing his checking account accordingly, and the only thing that happens is a transfer of assets between groups, and a transfer of money between groups.

But if commercial banks pick up these bonds, then again the check given in payment for the bonds increases the deposit account of the seller, but there is no corresponding reduction in deposits. There is, rather, a 1-for-1 expansion of the money supply.

So banks create money when they purchase bonds from outside the banking system.

If the Federal Reserve System enters the picture and purchases these bonds, again, in effect, we give a check in payment for them; that check will increase the deposit account of the seller. The bank which receives that check will then present it to the Federal Reserve System for collection, and collection is effected by crediting the reserve account of that member bank—a creation of bank reserves which did not previously exist.

So the Federal Reserve System by purchasing securities in the open market can create bank reserves.

Similarly, by the sale of securities, we can destroy bank reserves.

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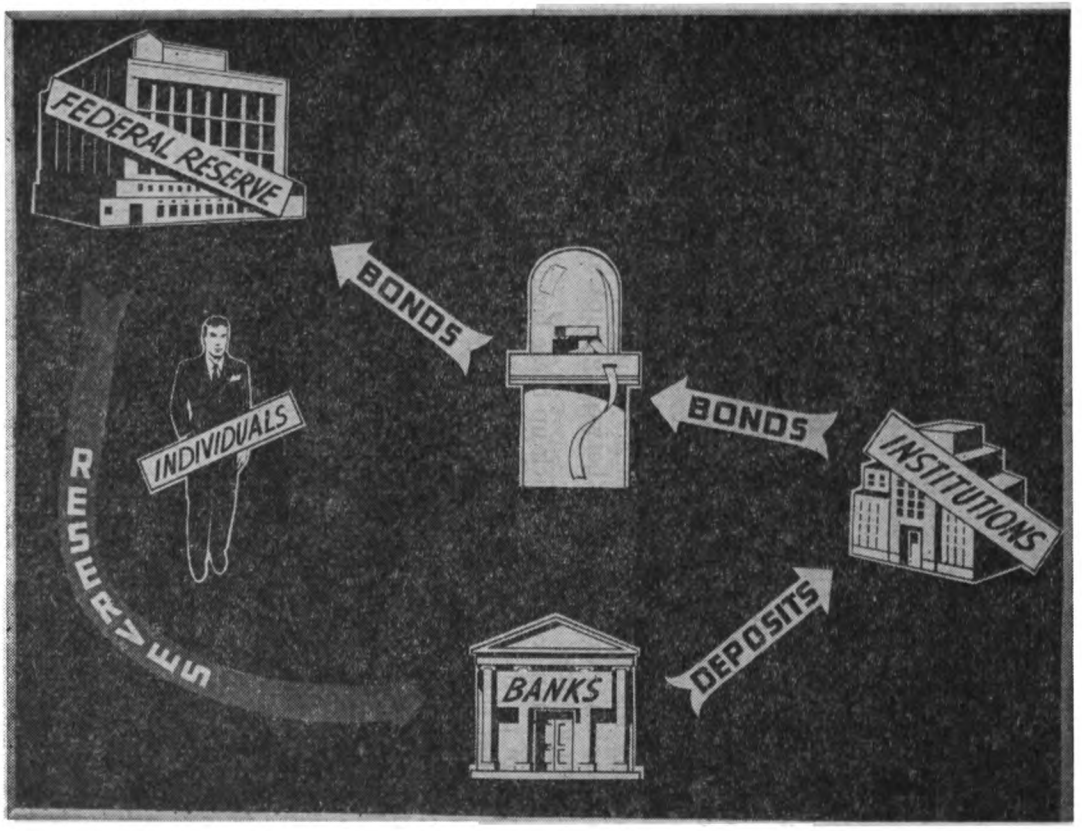
(The chart referred to follows:)



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These three medicines—the reserve requirements, which may be increased or decreased; the discount rate, which may affect member-bank borrowing; and the purchases and sales of securities in the open market—these three medicines can be used separately or in combination.

In addition to these general restrictions of monetary medicines, I would like to mention one more.

In recent years, at the direction of the Congress, the Federal Reserve System has made use of selective medicines, selective restrictions that are designed to limit expansion of particular kinds of credit.

These have included controls over stock margins, consumer credit, real-estate credit. Only the authority over stock margins is still in effect.

There remains one further category of treatments available in our Nation's medicine chest. In the case of an emergency, such as a full-scale war, we may have a need to resort to the straitjacket of direct controls, or we may place our patient in this straitjacket even though he shows no signs of becoming violent.

Controls—holding the lid on prices, holding down wages, doling out and rationing allocations of materials—these controls can be made to work, particularly under the stimulus of patriotic motives, as in wartime.

However, to the extent that direct controls are effective, they are very apt to substantially diminish the incentive to produce, and may actually intensify the inflationary problem by cutting back on production.

Further, to the extent that these direct controls are effective, the day-to-day decisions are taken out of the hands of the 171 million Americans and are placed in the hands of some central planning authority.

In any event, direct controls serve to conceal and defer and not to cure inflationary pressures.

Well, with this, we have completed the inventory of our anti-inflation prescriptions.

The chart referred to follows:

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We also have here on the board a diagnosis of the patient's illness in the last 11½ years. Mr. Wayne will summarize our discussion.

Mr. WAYNE. Mr. Chairman and gentlemen, in this particular presentation we have used this morning, I would like to say a word about its origin. This presentation was designed essentially for use before business groups and students, who are from time to time visitors at the Reserve bank or who ask us to provide an illustrated discussion of monetary theory and instruments.

It was not designed for presentation to the Senate of the United States, nor have we changed its presentation materially. We have shortened 1 or 2 phases of the presentation in the interest of saving time.

We have tried in the presentation to indicate our concept of the problem with which monetary policies deal. We tried to indicate that, as we see the situation, all of the instruments of monetary policy are dealing with a set of relative conditions rather than absolute conditions; that this stream of spending is a changing stream, the growth of which is essential to the expanding economy which is the objective of all of us.

But the problem arises when there are distortions that enter into it and when imbalance creeps into the two sides of this equation. These monetary instruments are balancing instruments in part, and active instruments in part.

It is not the purpose of our presentation to discuss the use of the instruments in the recent past at all, but rather, to outline them, to outline the problem, and on yesterday to put before you in diagrammatic form the structure of the Federal Reserve System.

If you wish, Mr. Chairman, I can quickly place that structure on the board so that you can see it. Maybe you could not see it back there yesterday.

The Federal Reserve System includes the 6,400 member banks who by statute provide the capital for the 12 Federal Reserve banks and their 24 branches.

The directors of the Reserve banks, of which there are 9 in each of the 12 Reserve banks, are elected, 6 by the member banks, 3 of whom traditionally are bankers, 3 of whom by statute may not be bankers.

The coordinating body at the center of the System is the Board of Governors, and that is the body which appoints the remaining 3 of the 9 directors at each of the Reserve banks, and from these 3 designates a Chairman and Deputy Chairman.

Members of the Board of Governors sit as members of the Open Market Committee along with 5 representatives from the 12 presidents of the Reserve banks, who are elected by these directors.

The Board of Governors supervises the Federal Reserve banks, exercises general supervision over them.

These directors of the Reserve banks elect the members of the Federal Advisory Council, 1 from each of the 12 districts.

The instruments of the System are divided, their statutory responsibility, between these three groups, the Board of Governors having within its sole jurisdiction authority over reserve requirements; the Open Market Committee, a merger of the two, having within its jurisdiction the direction of open-market operations; and the directors of the Reserve banks fixing the rediscount rates, subject to review and determination by the Board of Governors.

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That, Mr. Chairman, is our presentation. Thank you.

The CHAIRMAN. I want to thank the Richmond group for this splendid presentation. I'm very proud of them.

Senator Kerr desires to defer his questioning, and I desire to defer mine.

The Chair recognizes Senator Martin.

Senator MARTIN. Mr. Chairman, again I want to congratulate you upon the fine manner in which you are conducting these hearings.

Also, I would like to express my appreciation for the very excellent and comprehensive questions which you submitted to Mr. Martin to be answered later.

Next, I want to congratulate you, Mr. Martin, on the splendid statement you made yesterday. It was most informative. I feel that it provides a solid foundation for further inquiry into the many phases of the inflationary problem.

The committee and the Nation have been most fortunate in having the benefit of the testimony of the Honorable George M. Humphrey, former Secretary of the Treasury, and the Honorable W. Randolph Burgess, the Under Secretary. Both are men of outstanding ability, and have a thorough understanding of governmental financing.

One of the most encouraging developments has been the interest shown by Members of Congress, the press, and the general public, in the financial situation confronting them.

Many of the problems we face today grow out of the vast expansion that has taken place in the United States in the last half century. No nation in all history has experienced so great an expansion in a similar period of time.

We have the most extensive transportation system ever conceived. Our methods of communication have improved far beyond anything thought possible a half century ago. We have many industries and plants located in widely separated parts of the country; many industries and plants in distant parts of the world.

All are brought close together by the modern systems of transportation and communication.

We have the greatest prosperity ever enjoyed by this or any other nation, with our people almost fully employed.

Current income is at an alltime high, and spending has been augmented by borrowing in every field. Public and private debt have grown at a rate never before witnessed in this or any other country, reaching record totals with each passing month.

The cost of Government has reached unprecedented heights. The demands for credit are pressing harder and harder on the available supply of funds, finding expression in increased interest rates.

Now, Mr. Martin, I would like to ask you a few questions. Some of them you gave answers to yesterday, but I feel they are of such great importance that it will be necessary to repeat them from time to time.

Mr. Chairman and members of the committee, I have been very much encouraged by the interest that the people of the United States are taking in this hearing. I think all of them have a better understanding of the monetary situation and what fiscal policies mean than we have ever had before.

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These first questions, you gave very good answers to yesterday; but, again, I think they are so important that they must be repeated, maybe many times.

What are the purposes of the Federal Reserve System as expressed in the Federal Reserve Act?

Mr. MARTIN. Well, the purpose, Senator, is to produce a monetary climate which will be conducive to growth in the economy, and to stable prices and to the well-being of all of us.

Those are the purposes and the objectives which the System is directing its efforts to at all times.

I stated it here in my prepared statement—

to promote monetary and credit conditions which will foster sustained economic growth, together with stability in the value of the dollar.

And I emphasized there that we have to translate those into human terms, which are job opportunities, employment, and at the same time recognize that the savings of people, the money that they have preserved out of their thrift and industry, has to be safeguarded, also, because that is their nest egg.

And that applies to older people, people who cannot any longer enter actively into any business activities, and we must recognize the two purposes are inseparable in that sense; and we have to recognize that, particularly now that we have social security and pension funds and others, there is a twofold obligation here both to provide job opportunities and to preserve the purchasing power of the dollar.

Senator MARTIN. In the United States, we pass an act of the Congress, and then as we go along we frequently interpret it in various ways.

I would like to ask you, regarding the purposes of the Federal Reserve System as expressed or implied in other sources, what they are.

Mr. MARTIN. Well, the most important additional piece of legislation, I would say, is the Employment Act of 1946, and I subscribe fully to the objectives of the Employment Act.

The preamble is stated for us here in the questions the chairman has given us to answer, and it seems to me that all the efforts of the Government should be directed toward achieving, as it says in that statement, maximum production, maximum employment, and maximum purchasing power.

Senator MARTIN. I think we all are in agreement with that. But I will come back to that, because I think that is a very important thing that all of us have an understanding of it.

Mr. MARTIN. Right.

Senator MARTIN. What are the principal powers or functions of the Federal Reserve System as expressed in the statute?

You have covered that to some extent, but I think that is worth repeating.

Mr. MARTIN. Well, I have listed here the ones that seemed to me to cover the entire act. We, of course, have to exercise continuous supervision over the Federal Reserve banks. That is a full-time job for the Board of Governors here in Washington.

We have to fix, within statutory limits, the reserves which the member banks are required to maintain against their deposit liabilities. The Congress has given us limits upon that.

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It is 13 to 26 percent in the case of central Reserve city banks, 10 to 20 percent in the case of Reserve city banks, and 7 to 14 percent in the case of country banks. Those geographical divisions were given us in the Federal Reserve Act. Some of us feel those divisions are no longer particularly important, but in terms of monetary policy we have been able to adjust within them.

We also have to review and determine the discount rates which are established biweekly at each Federal Reserve bank subject to our approval, and we have to consider those and determine whether, in our judgment, the recommendations of the local banks are in accord with national interests and our national policy.

Then we participate, as shown in the outline, with five of the presidents of the Reserve banks, in the Open Market Committee, to determine the purchases and sales of securities that we feel ought to be made at a given time, it being clear, of course, that purchases of securities add money to the market, and sales of securities take money out of the market.

Also, I ought to make clear there that we do not have unlimited authority for the creation of money, because the Congress has given us a limitation there.

The base of our currency is gold, and the Congress has stated to us that our liabilities for the Federal Reserve notes which are issued, and for our deposits including the deposits which the member banks keep with the Reserve banks, which constitute their reserves, must never exceed four times our holding of gold certificates.

In other words, there is a limit there. Our ratio must always be watched, our ratio at the present time being approximately 47 percent.

Senator MARTIN. As a matter of fact, the matter of currency is a congressional responsibility——

Mr. MARTIN. That is right.

Senator MARTIN. Which is placed there in the Constitution, and personally, I doubt whether Congress has the right to delegate any of its responsibilities.

What are the principal methods or means by which you exercise the powers in the Federal Reserve Act?

Mr. MARTIN. Well, we do it through the reserve requirements under the general restrictions or limits I mentioned earlier. We do it through the rediscount rates; that is, the rate which is placed on the borrowing that member banks can make from us, and the discount window is always open.

Senator MARTIN. Do you happen to have—I was going to ask one of the men there a moment ago, because I think that is one of the most interesting demonstrations that I have observed for a long while. I was going to ask the question, and then the chairman did not want us to take the time, as to how much money our banks now have borrowed from the Federal Reserve.

Do you have those figures?

Mr. MARTIN. It is about a billion dollars, Senator.

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

Mr. MARTIN. For the latest week—through August 7—it is about double, I would say, the preceding week and about a tenth above a year ago.

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

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

Senator MARTIN. Mr. Chairman, the next two questions are most debatable, and if you feel they are improper, I will not ask you to answer them.

Do you consider your obligation to encourage price stability, prevent inflation, as important as your obligation to foster economic growth, prevent unemployment?

Mr. MARTIN. I do not think there is anything improper in the question at all, Senator. I think that is the problem we are dealing with almost continuously.

What I have come to believe in the last few years is that you cannot completely separate the two.

I think that we have a responsibility for growth. We should increase the money supply to provide for that growth. But I like to put it in terms of a stream or a river: We should try to get the flow of money in such a way that the growth factors can be maintained by a growing riverbed for that stream without overflowing the banks on either side and flooding the fields; that we should provide for growth and we should provide for maximum employment and maximum job opportunities.

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

Now, in terms of the situation that we have been struggling with in the last 6 years, the only possible means of attaining the objectives of the Employment Act, in my judgment, are to resist inflation.

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

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

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

If you are talking about temporary employment, if you are talking about the expendiency of employment created for a period of 3 or 4 months which will not be sustained, that is a different thing.

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

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

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

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

Mr. MARTIN. Again, Senator, I think it depends on the point you are at in the process of inflation.

Inflation is a process. It is a spiral. It is excesses. It really does not make too much difference whether you are talking about wage inflation, price inflation, credit inflation—you are talking about excesses that have their origin in imprudence and improvidence, that take the form of a cancerous growth.

It is not a narcotic that you can just take in small doses and control. It produces a spiral.

I do not want a recession of any sort at any time. I do not want any man to be unemployed in this country if it is possible to avoid it. But I still think you have to come face to face with the reality that under conditions of excess, extravagance, waste, incompetence, and inefficiency—under those conditions somebody has to take a loss.

This is a loss economy as well as a profit economy, and we have no way of getting away from the fact that if a child puts his hand into the fire—I am not saying it is a good thing he gets burned—but he does get burned, and I think that we have got to weigh at all times, in answering the question you have propounded, that question of whether this economy can take adjustments and take them promptly and properly, without destroying itself, or whether we think we are all-powerful, masterful controllers that can prevent any pain or suffering in life.

It is my conviction, Senator, that we can recognize the forces of the market, and that it is not money and credit policy that controls the matter.

I am constantly talking to people who say, "You are balancing on the thin, razor edge of inflation and deflation, and what the Federal Reserve does will be terribly important; it may destroy this economy for years to come."

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I hope you will not mind my saying, if I really thought those people were accurate, I think I would give up the job. I could not sleep any more. But I just do not believe it.

I think the vitality and the strength and the capacity of this economy is so great that the Federal Reserve may make a few mistakes—and I think it has already made a number of mistakes, and I think the rest of us can make mistakes—without catastrophe. I have more confidence in the vitality and the adjustability of this economy than most people have, and less confidence in the ability of money or credit policy or other Government policy to work economic miracles.

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

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

I illustrate that by saying that of the increase in the gross national product from 1955 to 1956, in those 2 years, over $10 billion of it—some people may say this is a small amount, but I do not think it is, even on a $400 billion gross national product—over $10 billion of that increase is a markup in prices with no additional goods and services.

Now, that is an imbalance for which some adjustment has to be made, and I do not believe that it is money and credit policy that makes that adjustment. I think the adjustment is made when demand, although still there—at a price—fades to where either prices have to be reduced in order to stimulate demand, or adjustments have to be made in the level of inventories; or some businesses have to recognize that perhaps they are expanding too fast, and that they are developing temporary overcapacity—not overcapacity permanently, but temporary overcapacity—which necessitates adjustments.

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

Senator MARTIN. Thank you very much.

All of us assembled here this morning—the Chairman of the Federal Reserve Board said they have made mistakes, in Congress we have made mistakes, as Americans we have made mistakes.

But is it not marvelous to live in a country where there is no danger of being purged when an official makes a mistake? And if we all use a little commonsense, we will come out of it.

That is why I am working so hard in this. I feel that we have one of the most important jobs in any committee in Congress that has ever been undertaken; we want to have a stable economy in this country, and we want our people employed.

Industry is entitled to a profit; the farmer is entitled to a profit on his production. But in the long run, all of us need a stable dollar.

Senator KERR. Off the record.

(Discussion off the record.)

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Senator MARTIN. Getting back on the record, would you recommend that price stability be set forth as a specific goal in the Federal Reserve Act?

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

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

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

Senator MARTIN. Money is just a matter of convenience.

Mr. MARTIN. It is just a matter of convenience, and it seems to me that——

Senator MARTIN. As the Chairman says, it is very convenient to have.

Senator KERR. What a convenience. [Laughter.]

Senator MARTIN. I can remember, Mr. Chairman, in the United States when we did do a great deal of bartering. I lived out in the country, and when my father and mother needed some groceries, sugar, and salt, and so on, they took some chickens and some eggs in to town and they bartered.

Now, of course, it is so much more convenient to have a medium of exchange. But that medium of exchange, so people may understand our situation, ought to be stable; is that not correct?

Mr. MARTIN. It ought to be stable. I personally like the definition that money is a medium of exchange and a standard of value, and that its basic component is confidence.

And I think that is the definition we want to keep in front of us, at least the confidence aspect of it, all the time.

Senator MARTIN. I would now like to ask you some questions about the present, current inflation.

When did this current inflation begin?

Mr. MARTIN. Well, I cannot state it precisely, Senator. It is pretty difficult to say that it began at any precise point.

I think those of us in the System—and mind you, the System is not a one-man operation, for we have many varying views—I think we began to get worried about the current aspect of inflation in the middle of 1955.

Senator MARTIN. And that is when you began to recognize it as a——

Mr. MARTIN. We began to recognize it.

Let me go back just a little bit, if I may. In the inventory recession of 1953–54, we pursued a policy, and I think we were quite correct in our policy, in the early stages, of adjusting promptly, to make the inventory adjustment as orderly as possible, by easing money.

By the end of 1953 and the early part of 1954, I personally think that we were overdoing it a bit. We were using the phrase "active ease."

One thing you find out about this is that while your weapons may be more effective in inducing restraint than they are in galvanizing the economy, nevertheless it is more difficult to get people to recognize the need for action when it comes to restraint.

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And I think in retrospect that one of the errors we made was that, in 1954, when the adjustments that were being made by the market were culminating and the base was being laid for the recovery that we had, we got a little bit enthusiastic about increasing the money supply, and we lowered our discount rate in February of 1954 from 2 to 1¾ percent; and then we lowered it again to 1½ percent in April of that year.

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

Now, that is a judgment in retrospect.

The trouble in 1955, the place where I began to get concerned, was when it took us from April of 1954 until April of 1955 to move back from 1½ to 1¾ percent in the discount rate—a whole year—because the constant discussion in the System was, "Well, better not take a step, you had better not do anything to slow things down." You see, everybody likes expansion.

Then we went up to 1¾. We later moved up successively during 1955 in four notches. But it was from the middle of 1955 that we saw what was happening there was that a decline in farm prices was taking place on a supply-and-demand basis, but inflation in manufactured products, end products, some of which were affecting the farmer, was already beginning to take place.

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

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

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

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

Mr. MARTIN. No; I do not think we did. But there are differences of opinion on that within the System.

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

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

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

And at one point in 1956, in the summer of 1956, it was not very difficult to see that imbalances existed, and that the demand was so much greater then for certain items—certain types of steel, at that

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point, at the time of the steel strike—demand was so much greater than supply that additions to the money supply under those conditions could do nothing but run prices up.

It becomes more difficult later in the stage when the shortages disappear and the demand then changes. The demand is there, but at a price.

Senator MARTIN. What are you doing currently to curb inflation?

Mr. MARTIN. Our most recent action was merely a recognition of the money rates that had developed in the market.

The rate on Treasury bills has been higher than the discount rate for roughly 9 months. We work very closely with the Treasury on this problem; our purpose is always to assist the Treasury, but not to guarantee the Treasury a specific rate.

During this period, we have leaned over backward, I think, not to lead the market, but to keep in tune with the market. And our most recent step here occurred recently when, starting in late May, there was a conjunction of forces in the money market which were gradually adjusting upward that culminated in the Treasury's offering of a 1-year, 4-percent security, followed a little while ago by an increase in the prime rate by the banks.

And, merely as an adjustment to these pressures that we think were already here in the economy, we increased our discount rate at 7 of the 12 Federal Reserve banks.

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

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

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

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

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

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

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

Mr. MARTIN. It is our judgment that we have been trying to look at the whole economy—each time we have an open-market meeting. I would like to list, if I may, the things that we are looking at.

We are looking at the requirements of the Treasury. We are looking at the seasonal requirements of business. We are looking at a growth factor in the economy, and we think that growth factor should

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normally be in the neighborhood of 3 or 4 percent. In excess of that is, we think, too much.

We have let the money supply—of course, these figures sometimes are changed, because you add time deposits to demand deposits, but we usually eliminate time deposits from these figures—we have let the growth of the money supply slow down to about 1 percent.

We have let the balance of the 2 percent on our 3 percent growth take place out of the velocity of money, the turnover of money, and we have felt that that was about right, though I think sometimes we felt that perhaps we have erred a bit on the side of letting the velocity accumulate faster—it is very difficult to measure—than the situation warranted.

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

We consider ourselves as managers of the money supply. Congress has delegated to us the responsibility for managing this money supply. That means there should not be an oversupply or an undersupply.

Now, within the limits of human fallibility, that is what we are trying to gage.

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

So really, after all, it is our mistake, if you make one.

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

The CHAIRMAN. At least we will not send you to Siberia. [Laughter.]

Senator MARTIN. Mr. Chairman, you have referred to the cost-push effect on prices. The annual report of the Federal Reserve Board, page 5, in discussing wage and price movements in 1956, states, and I will quote:

> Wage increases were widespread, and increasing numbers of wage agreements covered a period of more than 1 year and incorporated cost-of-living escalator clauses and automatic annual wage increases.
>
> The increase in average hourly earnings in manufacturing, amounting to 6 percent in 1956, exceeded the rise in output per man-hour. About half of the gain in hourly earnings was matched by the rise in consumer prices.

Is there any reason, as things stand today, that this will not be true this year and in the years to come?

Mr. MARTIN. Well, that is a difficult question to answer.

Senator MARTIN. I know it is a very difficult one.

Mr. MARTIN. It is a very difficult question to answer, Senator.

I can only say I think if we can bring the nature of this problem to the attention of everyone, it is possible that we can get a little better relationship.

I will not say that any one of these things is the controlling factor in getting things out of line. But I think cumulatively we have a problem to deal with.

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Senator MARTIN. In fact, had not wage gains exceeded productivity gains since 1940?

Mr. MARTIN. I just do not know.

Senator MARTIN. I know that comes from another.

Mr. Martin, you have referred to monetary and fiscal policies as the two important anti-inflationary tools of Government. You have also said that industry, labor, and individual citizens must contribute their part.

Just what can anybody do about the income demand on the price, and spending by each of these? I would appreciate it if you would comment on the governmental side of it first.

Mr. MARTIN. Well, on the governmental side, I have already pointed out the necessity, under current situations, for a larger surplus, a larger budget surplus, than we have had.

I am not critical of anyone on the budget problem. I do not know enough about it. But I think what you have got to recognize here is that this is a rich country. We can support the programs we have to support.

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

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

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

Senator MARTIN. Have you given any thought to the effect this cutback in defense spending may have upon our economy? That it may cause unemployment in certain segments of our industry? Have you given any thought to that?

Mr. MARTIN. I would hope that, if it does, the employment could be taken up in other segments of the economy.

Senator MARTIN. That is what we all hope. Of course, there is now talk of decreasing the ground forces by at least 100,000 men. We are bringing many troops back from Japan and other parts of the world, and those men will be thrown out on the economy, and they must have jobs. Do you feel there are enough of them that it will have any serious effect on our economy?

Mr. MARTIN. I am not competent to comment on the military aspects of it, but so far as the economy is concerned, I think there is still, as I have said previously, unlimited opportunity here for development.

I think we have to recognize in this armament field, Senator, as you know as well as I do, that there are some people who think that armament is a great blessing, because if we cut armament we are going to collapse. I think that is a completely false thesis. I think that is part of the thesis that war per se is a good thing.

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We have to protect ourselves, to be sure, but the strength of our economy is not armament. The strength of our economy is the production of goods and services for individuals, apart from armament.

Senator MARTIN. I agree with you fully. But I think it is going to take men like yourself to sell it to the American public, because, just since this announcement has been made, I have had a great number of investors say to me, "Well, that is going to cripple certain industries, it is going to put men out of employment," and so forth. That is the reason I am asking you to comment on it. What you say will go out over the Nation much more than what a Senator will have to say.

Mr. MARTIN. No one likes cuts. Nobody likes to take a loss.

Senator MARTIN. I agree with you fully, and I hope the day will come when we do not have, when it is not necessary to have, anybody under arms, and I have done about as much soldiering as anyone. But war is destructive. It does not create anything.

Now I would like to get back to the wage end again, and I want to make this statement. I made the statement in an address last Saturday, that I wanted to see every American, who wanted to work, employed in gainful wages. I wanted to see the farmers have a profitable sale of their production. And I felt that men who invested in industry ought to have a proper return on their dollar. And I agree in all of those things.

But there are some of these things that are bothering a lot of us a great deal, and so I want to ask you some questions, because I feel you are better informed than anyone, to my knowledge.

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

Mr. MARTIN. They are; but I think wage increases must be related to productivity.

I think judging whether they are actually related to productivity or not is something that you cannot precisely come to an agreement on. Thatis one of the reasons you have collective bargaining in labor negotiations.

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

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

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

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

Senator MARTIN. Are not more and more contracts including escalator clauses?

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

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

Mr. MARTIN. They are.

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

Mr. MARTIN. I do not know whether it has been fully adequate to support them, but it is our intention to keep a steady flow of money, as steady a flow of money as we can have. And if that flow of money does not cover the increases that are unwarranted, there should be no pressure on us to increase the money supply just to validate some imbalance which occurs in the economy which is not warranted by productivity.

Again, I want to say I never want any recession. I do not want anybody to be unemployed. Certainly our job at the Federal Reserve would be much better and much easier if we never had to look at a decline of any sort. But, unfortunately, it is not made that way at the present time.

Senator MARTIN. It is true that, starting with about 1819, we have had the ups and downs in almost surprisingly equal cycles, I mean in equal number of years. It is amazing how that has worked out. And is it not true that most of the depressions followed too much borrowed money?

Mr. MARTIN. I think that is generally correct.

Senator MARTIN. Of course, in the early days, it was land speculation; and that was followed by railroad expansion, and different things. We had got too much productivity for our consumer capacity, and so on. But usually it was antedated by too much borrowing.

Mr. MARTIN. Borrowing is not the great blessing that some people like to make it out to be. Debt is not. We have tended to glorify debt in recent years, all out of proportion to the benefit that it produces. That is not to say that I do not recognize that debt is important, and certainly people should have access to borrowing.

But let us not forget the fact that the greatest slavery in the world is to have people owe for borrowed money to the point that they are just breaking their backs.

I have watched plenty of them just breaking their backs to meet the payments.

One of the interesting things is that people who are always advocating easier terms are the people who are the least forgiving when it comes to paying back a debt which has been contracted.

That is one of the human nature facets that I have observed a good many times.

The CHAIRMAN. Let me interrupt you to say that is one of the wisest statements I have ever heard. You are right.

Senator MARTIN. Personally, I feel——

The CHAIRMAN. And that applies to a nation as well as people.

Senator MARTIN. Personally, I wanted to make this addition to what you said, Mr. Chairman: That governmental debt is even more dangerous than corporate or individual debt. Individuals and corporations have the means of creating wealth. Government does not have.

Government is just created for the purpose of defending and rendering service. Take here in the United States, our first job was to arrange for our defense. That was against the Indians.

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And then, as we became an independent country, to defend ourselves against other countries.

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

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

Senator MARTIN. At one time, I thought I would put in the record, Mr. Chairman, the amount of debt owed by the 20 largest corporations in the United States. And, I will tell you, when you study it, it worries you a lot.

You referred yesterday to the dangers arising from expectations of inflation. When it is here, how are people to avoid behaving on the basis of expectation when it affects us, being felt daily and over a period of time?

I do not know whether I have made that entirely clear or not. The American people are rugged individualists. They want to take care of their own situation. And when we have this expectation of inflation, they are worried about it.

Magazines and commentators comment relative to it. Congressmen and Senators make speeches relative to it.

I would appreciate a little further comment on that from you.

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

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

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

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

Mr. MARTIN. I do not know as I do.

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

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

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

We in the United States, we the people, are still the Government, and I have always had, Mr. Chairman, great confidence in the American people when they understand the situation.

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I have great confidence in the labor groups in our country. I have great confidence in the agricultural groups. I have great confidence in the industrial groups.

And what I think, Mr. Chairman, will do more good in this investigation is if we get the real situation before the American people. That is why our questions may seem at times a little cruel, but we do not intend them that way, because you and your group are in position to understand these things, and people have confidence in you.

That is the reason I am asking them. I do not want my questions to seem cruel, and I do not want them to be that way, because I think probably you and I have the same ideas.

I want, again, to see every man and woman in America who wants to work, gainfully employed. And then I want a stable dollar so that, at the end of the year, if they are frugal, they have a little money in their savings account.

But a savings account is not worth anything if the dollar is not stable; is that not correct?

Mr. MARTIN. That is correct, sir.

Senator MARTIN. Can it be that the cost-push factor in the inflationary pressures will not subside until a better balance is achieved by negotiations of industry nad labor over wages and fringe benefits?

Mr. MARTIN. I just do not know on that, sir.

Senator MARTIN. All right.

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

Mr. MARTIN. Higher interest rates, in my judgment, are not a cause of inflation.

I pointed out in my prepared statement the relative problem. Interest is a wage to the saver as well as a cost to the borrower.

Now, no one deprecates more than I do the cost of carrying the national debt, and I do not favor high interest rates. I stated that yesterday, and I keep stating it, as I did when I was over in the House last week.

I favor as low interest rates as it is possible to have, without producing inflationary pressures.

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

Mr. MARTIN. The heart of the problem here is debt. And interest is one of the balancing factors, it is one of the governors, and I think that an increase in interest rates will encourage saving.

I do not agree with people that interest rates make no difference. They take a long time to operate at times. But as to interest adjustments—you have to pay more if you want to borrow more than is available out of savings; you have got to pay more.

The way to reduce interest rates is to reduce spending, and to see the level of saving go up in relationship to it: then you have a leveling-out process. And I know of no other device in a free society that can function better as the governor on the economic flywheel than the rate of interest.

Senator MARTIN. Mr. Chairman, I appreciate very much the answers to the questions made by Cousin Bill, but I would like the op-

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portunity of asking some further questions after he has made his answers to the questions which you propounded to him yesterday.

The CHAIRMAN. Every member of the committee will have that opportunity.

Mr. MARTIN. I would like to have them up here Monday morning, if that is all right, Senator.

The CHAIRMAN. I want to thank the Richmond group again for their fine presentation.

The committee will recess until tomorrow morning at 10 o'clock.

(Whereupon, at 12 noon, the committee recessed, to reconvene at 10 a. m., Thursday, August 15, 1957.)

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INVESTIGATION OF THE FINANCIAL CONDITION OF THE UNITED STATES

THURSDAY, AUGUST 15, 1957

UNITED STATES SENATE,
COMMITTEE ON FINANCE,
Washington, D. C.

The committee met, pursuant to recess, at 10 a. m., in room 312, Senate Office Building, Senator Harry Flood Byrd (chairman) presiding.

Present: Senators Byrd, Long, Gore, Martin, Williams, Carlson, and Bennett.

Also present: Winfield Riefler, Assistant to the Chairman, Board of Governors, Federal Reserve System; Woodlief Thomas, economic adviser, Board of Governors, Federal Reserve System; Elizabeth B. Springer, chief clerk; and Samuel D. McIlwain, special counsel.

The CHAIRMAN. The committee will come to order.

The Chair recognizes Senator Williams.

STATEMENT OF WILLIAM McCHESNEY MARTIN, JR., CHAIRMAN, BOARD OF GOVERNORS, FEDERAL RESERVE SYSTEM—Resumed

Senator WILLIAMS. Mr. Martin, in your opening statement, I notice in paragraph H you state:

> A monetary authority dedicated to promoting the public welfare must not relax restraints in the face of continuing inflationary pressures, since any efforts to relax merely add to the forces tending to keep the inflation in motion.

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

Mr. MARTIN. I do not think we can eliminate them completely, Senator, but I think we have it within our power to keep them within manageable proportions.

I do not think we can ever say we can precisely determine specific limits that will keep us on a straight line.

Senator WILLIAMS. But that is a part of the goal which you are trying——

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

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

Mr. MARTIN. They are.

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

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Mr. MARTIN. Not entirely. I think they have had some success. But I think, again, we must never exaggerate the influence of money and credit policy. It cannot do everything, and we have to recognize that fiscal policy and management of the debt also enter into it. They all have to work together.

We have not been completely successful in halting the present inflation, but I think it would have been a whole lot worse if we had not taken the steps that we have taken.

Senator WILLIAMS. You think this was one of the essential steps?

Mr. MARTIN. One of the essential steps.

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

Mr. MARTIN. I do not think you can state that, as each individual move has to be considered on its own. There may be circumstances where it would be desirable for the rediscount market, if we thought there was heavy pressure building up, to lead the market a little bit.

But generally speaking, we recognize that the market forces are the ones that are controlling—that we can influence the market. We never want to take the position that we do not have any influence at all—that market forces just produce all these changes. Otherwise, there would not be any reason for our existence.

We influence them. We lean against the wind when we can determine which way the wind is blowing. But we never try to usurp the function of making the wind. Whenever we think we can make the wind, we think we are in trouble.

Generally, in recent years we have tended to follow the market rather than lead the market. The last increase in the rediscount rate definitely followed.

Senator WILLIAMS. Was that the same situation a couple of years ago?

Mr. MARTIN. It was a moot point of judgment at that time.

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

Mr. MARTIN. That is right.

Senator WILLIAMS. That was part of the plan.

Was one of the factors that were giving you concern, the speculative activity in the stock market at that time?

Mr. MARTIN. Yes, that was one of the factors that concerned us, and that concerned us more in 1955 than in 1956.

The stock market was in better control in 1956 than it was in 1955.

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

Mr. MARTIN. We have not consciously attempted to influence——

Senator WILLIAMS. I understand that. But I mean, you were trying to put——

Mr. MARTIN. We wanted to minimize speculation.

Senator WILLIAMS. Minimize speculation.

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

Mr. MARTIN. No, I would not want to say that, Senator.

I say we are working with it every day, and we are trying to keep a flexible policy. We want to see to it that the legitimate needs of

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credit are met at all times. I would not want to make the specific statement that we have the situation under control.

I think that we are doing everything within our power to watch it and adjust to it as it develops, recognizing that it is a moving picture; it is a continuous operation.

And I think that, by and large, we have not been entirely unsuccessful; let us put it that way.

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

Mr. MARTIN. Well, I would say that the primary force since the spring of 1956 has been the plant and equipment expansion. We have had a constant pressure on the capital markets for long-term financing, some of which had been postponed for sometime in hopes that money would get easier or that they could use bank credit in place of long-term credit for financing.

I just happen to have some figures here which I would like to read into the record:

Corporate financing for the first 8 months of 1957 was $8.4 billion compared with $6.6 billion in 1956.

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

I had those figures here yesterday in hopes somebody might ask me that.

Senator WILLIAMS. You mentioned the fact that the control of interest rates was just one phase of the problem, and that budget was another factor, balanced budgets.

Do you think it is more essential today than perhaps ever before that we do maintain a balanced budget at this time?

Mr. MARTIN. I think it is extremely essential that we have a larger surplus as long as we have the spending impetus that we have, than we have had or presently have in prospect, because that definitely lessens the inflationary pressures.

I would like to comment on the ebb and flow of this, as I see it.

When I was in the House last week, I commented that the forces that we are dealing with here are very much like the tides. They are as large as the tides. We cannot stand, like King Canute, on the shore and tell the tides to stand back. We have got to adjust to them.

When the spending stream definitely exceeds the savings that are available for the economy, it is most unfortunate, in our judgment, to use bank credit to supply the deficiency.

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

Mr. MARTIN. I think that—I never favor deficit financing, although I recognize that it can sometimes have an impetus on our economy.

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

Senator WILLIAMS. How long have you been in the Federal Reserve System, Mr. Martin?

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Mr. MARTIN. I was appointed on April—I took office on April 2, 1951.

Senator WILLIAMS. 1951.

Well, since that time, we have had surpluses about half the time, have we not?

Mr. MARTIN. That is right.

Senator WILLIAMS. Do you think that the deficits prior to that time were—I will put the question this way: Do you think that the inflation between 1946 and 1951 could be attributed to the deficit, or partly to the deficit financing during that period?

Mr. MARTIN. That was a very difficult period, Senator, because we came out of the war period with a heavy backlog of latent pressures, and even though we had a balanced budget and a surplus—I was in the Treasury with Secretary Snyder in 1949 to 1951 before I came with the Federal, and I think he did an extremely good job on the budget, the surplus that he was trying to create.

But you had dammed up through the war years a very heavy backlog of demand and of money that had been kept in control by patriotic moves and by the specific controls that were then in existence, and I think you have got to be very careful on generalizing about those periods.

And I do not think, when you talk about the budget—I think it is always desirable to reduce debt. I refuse to join the group of those who insist that an increase in the debt is beneficial.

Senator WILLIAMS. I recognize the unusual circumstances at that time. The reason I asked the question was that beginning with 1953, and through 1955, we did have a rather stable dollar, and during that period we had a balanced budget.

Let me ask you this question: Do you think that the prospective large budget which was submitted to us this year was inflationary?

Mr. MARTIN. I think the impact of it was, definitely.

Senator WILLIAMS. Do you think that if it were approved as submitted, that it would be a major contributing factor toward inflation?

Mr. MARTIN. Under existing circumstances, yes, sir.

Senator WILLIAMS. You think it would.

Do you think that it is the responsibility of Congress and the Executive, working together, to trim that budget?

Mr. MARTIN. I do indeed, sir.

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

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

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

Mr. MARTIN. Well, it is, indeed. We have to gage it in terms of trends.

But whenever we get wedded to a theory, whenever we start riding a hobby, as I frequently call it, I think we are probably asking

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for trouble, because the nature of the problem we are dealing with requires us to be ready to admit mistakes, just as well as to accept its success in what we are trying to do.

Senator WILLIAMS. When was the last increase in the reserve requirements?

Mr. MARTIN. September 1954. That was a decrease.

Senator WILLIAMS. Decrease in reserve requirements.

Mr. MARTIN. The last increase, I am sorry, the last increase was in January of 1951.

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

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

The two reductions in reserves that were made in 1953 and 1954 have helped adjust them in that direction, but it is our objective always to see that the legitimate credit needs of the country are supplied.

Under no circumstances do we want to completely starve the credit stream.

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

Mr. MARTIN. No. I think the inflation today is in a little different category than that. It is hard to put your finger on it, but as I said yesterday in answer to Senator Martin, we were worried about it, certainly I was worried about it, from mid-1955 on.

I was not worried about it in the sense that I have been talking about it now. The spiral, the inflation spiral, it seems to me, seems to have begun about a year ago, in the summer of 1956. And there the important aspect of it was psychology, in the sense that there was general acceptance that gradually grew in the early stages of 1957, of the inevitability of inflation, and that is the most difficult thing to deal with, because now you are dealing with people's expectations.

I think the inflation which we had had previously did not have quite that spiral effect of expectation. It had the other elements in it, but the portion that has concerned me the most has had to do with this psychological aspect of the expectation of the inevitability of inflation.

It just seems to me we have got to stop that.

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

Mr. MARTIN. Theories, I think, are very difficult. I think unquestionably it was connected, and I do not know what point in time to place this, but it was connected with a conviction that spending was going to continue on an increasing scale, and a recognition of the fact that savings were not available in amounts to handle that level of spending.

Now, at what point that took hold, I do not know. I suspect it took hold in around the turn of the year, 1956–57.

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

Mr. MARTIN. I think that was one of the factors in it.

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

Mr. MARTIN. I think that that was a factor in it, yes. I think that you cannot—I think it is extremely difficult to analyze the transition from a controlled economy to a freer economy. It has to be taken in stages and in degrees.

My own judgment was, and I expressed it at the time to the Congress, we would have been a little wiser, much as I disliked regulation W, if we had not released regulation W and regulation X quite as quickly as we did in 1952, along with all the other physical controls that were being released at that time.

It is very easy to make statements about things that might have been done differently, but we did have an enormous buildup and increase in consumer installment credit as soon as those regulations were taken off.

Senator WILLIAMS. What year was that?

Mr. MARTIN. That was 1952. It was in June of 1952.

Senator WILLIAMS. What was your rediscount rate at that period?

Mr. MARTIN. In 1952, it was 1¾ percent.

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

Mr. MARTIN. I think you have to put that in perspective. I want to comment here, Senator, that the Treasury-Federal Reserve accord, which was adopted on March 4, 1951, was a transition to a flexible money policy.

One of the elements in that accord was an understanding that in view of the heavy Treasury requirements, the heavy financing needs of the Treasury for the balance of 1951, that except in a cataclysmic situation we would not change the rediscount rate.

When you are unpegging the market, you do not unpeg it in one fell swoop, and that applies to controls and everything else. You have to watch it.

We have the responsibility to see that markets do not go completely haywire. We do not want the law of the jungle prevailing in markets. And when we embarked upon the unpegging of the Government securities market, we faced for a couple of years the very difficult problem in which the ordinary criteria of money and credit policy that we are trying to apply today could not apply, because we had to take it by stages.

We had Government securities pegged at par and twenty-two thirty-seconds on the long end. They came down to about 99½, and then stabilized there for a while.

It was our hope that perhaps the demand would strengthen at that point, and they did strengthen for a little while, and then later they adjusted further, when the demand for credit constantly grew.

The point I am trying to make here is that, in the perspective of this period, I think probably we did not make a mistake in our dis-

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count rate. I think our agreement with the Treasury there—and we always have to have the requirements of the Treasury in mind—were such that it would have been unfortunate for us to have adjusted the discount rate.

And I think that understanding, which was a part of the Treasury-Federal Reserve accord, was an important part of it. I do not think you can apply the ordinary criteria to that period.

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

Mr. MARTIN. That is correct, sir.

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

Mr. MARTIN. That is correct, sir.

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

Mr. MARTIN. I was with the Treasury.

Senator WILLIAMS. When you speak of the accord you were able to reach, apparently referring to between Treasury and Federal Reserve, would you say that Treasury had more to say about determining the Federal Reserve policy then than they do today?

In other words, was that change in policy on the part of the Federal Reserve to suspend the supporting of the Government bonds a decision of the Federal Reserve alone, or was that done upon the insistence of the Treasury, or what?

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

Senator WILLIAMS. I am speaking about the accord, at the time.

Mr. MARTIN. That is when I am speaking about, too. The accord was brought together in March of 1951. Immediately prior to the accord period, I had nothing to do with that aspect of finance. I was an Assistant Secretary in charge of international finance. I consulted with the Secretary directly on the matter.

Now, what understandings there were between the Treasury and the Federal Reserve with respect to pegging the market is not a completely clear picture as far as I can see it.

But during the war period, an understanding had grown up between the Treasury and the Federal Reserve that, in the interests of winning the war, they would keep Government securities at a certain level.

As we came to the 1951 period, after Korea, the early stages of the Korean conflict, you had a rather wild, almost hysterical period of buying and readjustments of everything that went on, and the Treasury was very anxious not to have the Government securities market unpegged.

What those negotiations were with the Treasury and the Federal Reserve at that time, I am not in a position to say.

Senator WILLIAMS. I understand that. But I would be interested in hearing about the part with which you are familiar, because as I understand it, you were in on the negotiations in 1951——

Mr. MARTIN. I had a——

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Senator WILLIAMS (continuing). When they suspended the pegging of the Government market, and I was just wondering whether the influence of the Treasury was greater then than it is today.

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

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

Mr. MARTIN. They are still extremely good.

Senator WILLIAMS. In working out that agreement to suspend the Federal Reserve supporting of Treasury, as I understand it, a part of the agreement was, the Treasury Department was to call a previously floated bond issue of about $16 billion, 2½s; they were 25-year bonds, in which they were called and refinanced at 2¾, with a proviso that each bondholder would have an option to convert those bonds into a 5-year certificate.

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

Mr. MARTIN. Well, that was to face up to the fact that there was a persistent overhanging of Government securities that were pressing upon the market; the sales during the period were large, $15 million, $20 million a day, and they were growing in volume and intensity. As the demand for credit grew, it became apparent that the entire flood of these longer-term securities was going to come into the market.

So this convertible issue that you refer to was a device which we worked out in the Treasury-Federal Reserve accord, to remove that overhang from the market. In other words, to give an incentive to these holders of long-term bonds to stay in, give them a little better interest rate and stay in.

If the market had firmed up, they would have a longer term piece of paper with 2¾ percent instead of 2½ percent. If they wanted to get out at any time, they could convert into the 5-year security, and they would have a 1½-percent marketable issue.

It was a device to handle a specific situation that was overhanging the market.

Senator WILLIAMS. Well, what was there about that bond issue that made it any different from the other types of bonds which were outstanding? Because there were other 2½s outstanding at the same time, and just what was there about this particular issue that made it——

Mr. MARTIN. Well, the fact that you gave them a 2¾-percent interest rate and gave them the privilege of unlocking.

Mr. WILLIAMS. I understand that. But what was there about this issue which made it necessary for the Government to favor this particular issue more so than any other issue? It unquestionably cost the Government or substantially will cost the Government a substantial amount of money. You pay more for the extra carrying charges on this issue over a 25-year period than you would have done had they not called it.

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Mr. MARTIN. That was where the pressure was at the time. It was in the long end of the market.

Senator WILLIAMS. But there were other long-term bonds outstanding; were there not?

Mr. MARTIN. Let me ask Mr. Riefler to refresh my mind on that period.

Mr. RIEFLER. I think it was offered in exchange altogether for the four longest bank-restricted issues.

Mr. MARTIN. It was offered——

Mr. RIEFLER. They were the ones that were so large.

Mr. MARTIN. They were offered for the 2½-percent bonds.

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

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

Senator WILLIAMS. And where it was called prior to the 20 years, prior to the maturity, and voluntarily financed at a higher interest rate.

Mr. MARTIN. Mr. Thomas points out it was not actually a call. It was an optional conversion.

Senator WILLIAMS. That is true, but I would say that you had a 100-percent conversion. Anyone who had a 2½-percent bond would certainly convert it into a 2¾.

Mr. MARTIN. Oh, no, we did not get anything like 100 percent. We did very well on it. I do not have the precise figures, but I can get them for you. And we did very well, but we did not get all of them by any means.

Senator WILLIAMS. You mean there are still some of the 2½s outstanding?

Mr. MARTIN. Oh, yes, indeed.

Senator WILLIAMS. But they are exchangeable into these 1½s or 2¾s.

Mr. MARTIN. No. They were only at that time.

Senator WILLIAMS. According to the Secretary, I understood the bulk of them were transferred into 2¾s, and about $8 billion of them transferred into the 5-year certificates.

Mr. MARTIN. The transfers to 5-year certificates have been subsequent.

Senator WILLIAMS. That is right.

Mr. MARTIN. There were practically none——

Senator WILLIAMS. At that time.

Mr. MARTIN (continuing). At that time.

Senator WILLIAMS. That is correct.

Mr. MARTIN. But there are still some of those bonds trading in the market that were not converted at that time.

Senator WILLIAMS. But the conversion rights remained with them; even today they remain?

Mr. MARTIN. Oh, no.

Senator WILLIAMS. To convert into 5-year certificates?

Mr. MARTIN. Oh, no. If you did not take it at that time, you were not eligible.

Senator WILLIAMS. I am sure you would know, but I wish you would put that in the record.

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Mr. MARTIN. I will.

Senator WILLIAMS. Because that is not the information we received at the other hearing.

Mr. MARTIN. I will, indeed. But I am quite certain I am correct on that.

Mr. Riefler says you can convert the 2¾, if you converted them at that time, into notes. But if you did not convert at that time into the 2¾s, you have just the 2½ percent securities.

Senator WILLIAMS. That is true. But the 2¾s carries a continuing option.

Mr. MARTIN. Oh, yes, if you converted it.

Senator WILLIAMS. That is the point.

I wish you would furnish at this point, if you can, any previous instance wherein the Government called a long-term bond issue and substituted a higher interest rate.

Mr. MARTIN. I will check the records on that, Senator.

Senator WILLIAMS. On a voluntary basis. Because this was a voluntary calling of a bond issue.

Would you make any estimate as to the extra cost to the Government on that basis on that issue?

Mr. MARTIN. Well, I could take the amount that was actually converted at that time.

Senator WILLIAMS. Could you furnish us an estimate of that?

Mr. MARTIN. We will put that in a memorandum.

(The following statement was subsequently furnished by Chairman Martin:)

There have been two occasions prior to the offering of the 2¾ percent investment series B bonds in 1951 when holders of United States Government securities have been offered a conversion opportunity into higher yielding issues. These were the issuance of the conversion 3-percent bonds of 1946 and 1947 (dated 1916 and 1917) and the liberty loan convertible bonds put out during World War I.

CONVERSION 3-PERCENT BONDS OF 1946 AND 1947

Prior to the establishment of the Federal Reserve System, national banks had the privilege of issuing national bank notes collateralized by United States Government bonds deposited with the United States Treasury. United States Government bonds so utilized were those bearing the circulating privilege. With the establishment of the Federal Reserve System and introduction of a new circulating media, provision was made for a shift out of the national bank note circulation. To reduce national bank note circulation, Federal Reserve banks were authorized to buy the United States Government bonds bearing the circulating privilege and to use these bonds either as backing for Federal Reserve bank notes or to convert into other United States obligations without the circulation privilege.

In 1916 the Secretary of the Treasury issued a series of 30-year, 3-percent bonds and of 1-year, 3-percent notes. According to the Federal Reserve Act of 1913, the Federal Reserve System could buy 2-percent circulation privilege bonds from national banks at par plus accrued interest any time during the period December 13, 1915, to December 13, 1935. The Federal Reserve banks could issue Federal Reserve notes against these bonds or convert them, roughly one-half into the new 3-percent, 30-year bond, and one-half into 1-year, 3-percent notes. The Federal Reserve banks bought from the national banks $56,256,500 of the 2-percent bonds and converted them into $28,894,500 of the new 3-percent bonds and $27,362,000 of the new 3-percent notes. The new 3-percent bonds thus acquired by the Federal were then sold to the public at prices ranging from 94½ to 103½. This program ended with the outbreak of the war.

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CONVERTIBLE LIBERTY LOAN BONDS

The first and second liberty loan bonds of World War I, which were issued with coupon rates of 3½ and 4 percent, respectively, were each made convertible into bonds bearing higher coupon rates. The terms of these liberty loans provided for convertibility if any subsequent series of bonds bearing interest at a higher rate should be issued by the United States before the end of the war with Germany.

When holders of the 3½s, dated June 15, 1917, exercised this option, they received the first liberty loan converted 4-percent bonds of 1932–47, dated November 15, 1917. These converted 4's were, in turn, made convertible into any higher rate bond issues during the war. Conversions of these 2 issues were in turn converted into to first liberty loan converted 4¼ percent bonds during the period May 9, 1918, to June 30, 1925. Holders of the first 3½s were also permitted to convert into the first-second liberty loan converted 4¼ percent bonds of 1932–47, dated October 24, 1918.

The second liberty loan 4-percent bonds of 1927–42, dated November 15, 1917, were also made convertible into any higher rate bond issued during the war. This offer was good for the period November 15, 1917, to June 30, 1925. As a result, practically all of the second 4's were converted into second 4¼s during the period May 9, 1918, to November 9, 1918. As in the case of the first liberty loan bonds, this conversion privilege terminated June 30, 1925.

INVESTMENT SERIES B CONVERTIBLE BONDS

It may be of interest to note the circumstances under which the 2¾ percent investment series B convertible bonds were offered to holders of long-term 2½ percent Treasury bonds.

The fundamental problem which both the Treasury and the Federal Reserve faced in the postwar period developed out of the serious issue created by the existence of a huge public debt in a period of growing private demands for goods and services. Liquidation of Government securities on the part of holders was an important source of funds for current spending and for credit expansion. In order to give some assurance to investors that their securities would not be subject to severe declines in prices and encourage the holding of such securities and to aid Treasury refunding operations, the Federal Reserve had been following a policy of supporting the market for Government securities. In view of the recurrent heavy demands for funds during the period, these purchases had the effect of monetizing substantial amounts of Government securities, creating bank reserves, and laying the basis for excessive credit expansion.

Both the Federal Reserve and the Treasury recognized the dilemma presented by the conflicting problems of debt management and credit restraint in the inflationary situation which developed. Various measures were adopted through credit, fiscal, and debt management policies in an endeavor to restrict credit and monetary expansion, to retire debt, especially that held by banks, and to attract the investment of savings into Government securities, without withdrawing supporting pegs in the Government securities market. The problem came to a head during the Korean crisis and led to the accord.

The following joint announcement was made on March 3, 1951, for publication March 4, by the Secretary of the Treasury and the Chairman of the Board of Governors and of the Federal Open Market Committee of the Federal Reserve System:

"The Treasury and the Federal Reserve System have reached full accord with respect to debt-management and monetary policies to be pursued in furthering their common purpose to assure the successful financing of the Government's requirements and, at the same time, to minimize monetization of the public debt."

It was agreed that there were both immediate and long-run factors which had to be taken into account in arriving at an accord, and that the purpose of the negotiation was to reach agreement upon policies that would reduce to a minimum the monetization of the public debt without creating an adverse market psychology with reference to Government securities.

Consideration was given to the matter of long-term bonds overhanging the market and at the time being offered for sale daily in large amounts. It was agreed that a substantial portion of these bonds could be taken off the market by a Treasury offer to exchange for them a nonmarketable 2¾ percent, 29-year bond, redeemable at the holder's option before maturity only by conversion into

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a 5-year marketable Treasury note. The 2½-percent bonds were not called but were offered an optional exchange of this kind. The purpose of offering this new security, as announced by the Treasury was to encourage long-term investors to retain their holdings of Government securities, in order to minimize the monetization of the public debt through liquidation of outstanding holdings of the Treasury bonds of 1967–72. The Federal Reserve agreed to help the Treasury in explaining to large institutional investors the nature and purpose of this new issue. The extent of the acceptance of the offering testified to the success of this joint endeavor.

On March 4, 1951, the Treasury offered the investment series B long-term nonmarketable convertible Treasury bonds of 1975–80 in exchange for $19.7 billion outstanding 2½-percent Treasury bonds of June 15 and December 15, 1967–72. On April 1, 1951, about $13.6 billion of these 2½-percent bonds were exchanged into the 2¾-percent investment series B bonds of 1975–80. In May 1952 the investment series B bonds were reoffered for cash or for combined cash and exchange for a limited time for the June and December 1967–72 2½-percent bonds and in addition for the March 1965–70 2½-percent bonds and the March 1966–71 2½-percent bonds. The latter two 2½-percent issues were outstanding in amounts of $5.2 billion and $3.5 billion, respectively. Additional exchanges totaling $1.3 billion were made into the investment series B bonds from the June and December 1967–72 2½-percent issues and from the 2½-percent bonds of March 1965–70 and March 1966–71. In addition $450 million of the 2¾-percent bonds were issued for cash. The investment series B bonds are convertible into marketable 1½-percent 5-year notes at the owner's option. A total of $4.8 billion of the $15.3 billion 2¾-percent bonds originally issued have been converted into the 1½-percent notes to date. Three of the latter issues have matured and have been refunded into regular marketable issues.

Taking into account the interest cost of the 2¾-percent bonds, the 1½-percent exchange notes, and the issues into which 3 issues of the notes have been refunded, the additional interest cost to the Government through June 30, 1957, amounts to about $15 million. Interest saved in the 2½-percent bonds totals $2,279 million while interest cost on the convertible issues totals $2,294 million through June 30, 1957. These interest costs are divided as follows: 2¾-percent bonds, $1,978 million; 1½-percent exchange notes, $258 million; and issues exchanged for maturing exchange notes, $58 million.

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

Mr. MARTIN. No, I do not think so, Senator.

This was used as a device to handle a money market situation that was fast developing into one we could not handle. This was not a part of a plan to raise interest rates. It was a specific handling of a situation that, if the demand for credit had declined in the next 5, 6 months, or so, why, this would have been just something standing out.

It was merely an adjustment to a market situation at the time.

Senator WILLIAMS. When did your program become a part of a planned program to raise interest rates on the basis——

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

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

Mr. MARTIN. Well, the lead, whether we are leading or following the market, it was the market forces that were the determining factors.

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Now, it is my contention that if we lead the market and the demand for credit falls away, then we are out in front and we have to fall back after a time to adjust to the market.

Now, that is the fine line of judgment that we were discussing earlier with respect to these trends in the economy. But so far as consciously trying to promote higher interest rates, that has not been our aim at all. And I keep stating this for the record because I happen to believe it, that I favor as low interest rates as it is possible to have without producing inflation. I am not in favor of high interest rates.

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

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

Senator WILLIAMS. Do you believe that the current inflation is due to causes which have developed since the end of the Korean conflict?

Mr. MARTIN. Yes; I think the current inflation is. After the inventory recession in 1953–54, we had a period toward the end of 1954 where mortgage financing and automobile purchases blossomed into a full-fledged period of prosperity; and I think a great part of what we have been having is prosperity, but the seeds of inflation, which we presently have, resulted from too much expansion and too much exuberance following that period and in that period.

Senator WILLIAMS. Would you say that the carrying over of the authority for issuing these 5-year amortization certificates was inflationary?

Mr. MARTIN. I think in retrospect that it was inflationary. It was certainly one of the contributing factors to the exuberance in the economy. I would think that it was perfectly sound to have a better depreciation schedule than we had; but that taken with all the other factors, it certainly was one of the factors that added to exuberance of the economy.

Senator WILLIAMS. Well, by the same token, do you think the fact that Congress had just recently repealed that authority, would be deflationary?

Mr. MARTIN. I think it will tend that way; yes.

Senator WILLIAMS. You spoke a moment ago about the wide expansion in the financing of automobiles and the financing of goods in general through small-loan companies.

In recent years, I noticed that many of our banks have established separate departments wherein they operate their own small-loan business and financing. Do you think that is a healthy trend to encourage that?

Mr. MARTIN. Yes; I think it is all right. But I think it has to be watched very carefully. What the terms should be, and the handling

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of it has been left to the individuals concerned. It seems to me that it is a perfectly sound business, provided it does not outrun the capacity of people to repay; and that at that point an element of judgment that has to be exercised.

Senator WILLIAMS. Are there adequate Federal controls over the small-loan departments at these banks as of today?

Mr. MARTIN. I think that the small loan departments of the banks are pretty adequately covered in our examination procedures. We don't use examination as a control, but we know what is going on in these operations. Our control of the banks is through reserves.

Senator WILLIAMS. You have no objections to the banks entering into this phase of operation?

Mr. MARTIN. None whatever.

Senator WILLIAMS. Do you think there is any danger in the existing trend of the extension of branch banking?

Mr. MARTIN. Well, that is a—branch banking, I personally——

Senator WILLIAMS. Let me put it this way: Do you think it is being overextended in mergers?

Mr. MARTIN. I think the merger trend ought to be watched pretty carefully. I don't think it is necessarily bad, but I think it has to be examined on an ad hoc basis, as we do with our supervisory authority, and I happen still to favor the dual banking system and believe that it is desirable to have as many small unit banks as it is possible to maintain.

Under certain circumstances, however, I think that mergers are perfectly appropriate. The States have supervision over branch activity and there is no question but there has been an activity in the expansion of branches in recent years. Some of it is because of the growing need for capital and the inability of the smaller units to handle it.

Senator WILLIAMS. I notice you called our attention to the fact that in small towns the banks are being absorbed through mergers by the larger banks. Do you think that is a healthy trend or do you think there is more value in local ownership?

Mr. MARTIN. I think there is more value in local ownership. It is not a trend that I welcome.

Senator WILLIAMS. Have you done anything about it, in your Federal Reserve System, to frown on it, or made any recommendations to your members?

Mr. MARTIN. Well, the Federal Reserve System is presently engaged in administering the Holding Company Act which the Congress passed, and we have struggled with section 7 of the Clayton Antitrust Act.

One of my first problems when I came to the System was the famous Trans-America case, which we lost in the courts. But that is a problem that is on our agenda at least every week, I would say, in some form or another. It is a problem that we don't have the complete answer to, but——

Senator WILLIAMS. Would you say the present inflationary trend was the result of shortage of goods?

Mr. MARTIN. At this particular stage, no. I think that a year ago that there were imbalances, taking steel as an example, where there were real shortages in certain types of capacity; and that those shortages contributed at that time to the imbalances which have come about.

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Now, I think that as we have gone ahead in this period, that those shortages are now—the only really basic shortage today, outside of certain types of skilled labor, is savings. I think that the principal shortage today is savings, and that some overcapacity has developed at the current levels for goods; but the demand for goods, at a price, is still substantially in excess of the supply that is available.

Senator WILLIAMS. Do you think that the recent increase in steel prices was inflationary?

Mr. MARTIN. I do not know, Senator. I have tried to study that a little bit and I do not know. I have been reading Mr. Blough's recent speech. It is a little bit of a question of which came first, the chicken or the egg.

Senator WILLIAMS. That is what I was going to ask you first.

Mr. MARTIN. Well, I just do not know. I simply say that when prices are rising, it does not make too much difference which came first, the chicken or the egg; the end result is that we have a higher price.

Senator WILLIAMS. I noticed that the steel companies attributed the rise in prices to labor, and labor attributed their demands to the rise in prices, and each say there is no relationship between the other, and I was wondering if you would——

Mr. MARTIN. I am just not competent to solve that one.

Senator WILLIAMS. Do you think that the escalator clauses in wage contracts are constructive?

Senator BENNETT. The Senator has agreed to yield to me, so these are words I am putting in his mouth.

If we had not been in an inflationary situation, would either the wage increase or the price increase have been made so readily in the steel situation?

Mr. MARTIN. I don't think so.

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

Mr. MARTIN. There again, I do not know. I have no objection to escalator clauses, but I would say if the escalator clause in the long run contributes to inflation, it is bad for the worker, and it does not achieve its objective.

Now, it is a device to recognize an increase in the cost of living; but if the overall cost of living gets away from us, I think that the person benefited by the escalator clause suffers also.

Senator WILLIAMS. Now, I am not sure I quite followed you. Did you agree with me? Do you think they are good for the economy or not?

Mr. MARTIN. I did not say—if they make inflation, I think they are bad for the economy. I am not certain that they do always make for inflation.

I think that they have to be related to the individual industry and to the cost-price factors in that industry.

Senator WILLIAMS. In your opening statement, I understood you to say that you felt that escalator clauses and cost-plus contracts were both inflationary and should be avoided. Am I in error on that? Did I understand that to be——

Mr. MARTIN. I said they could be factors in inflation. I did not mean to take the categoric position that they always are.

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Senator WILLIAMS. I notice in your statement beginning with paragraph 3, under B:

The widespread existence in the economy of escalators which act automatically to transfer rising costs or prices into rising prices and costs—

and so forth.

Now, that is listed as one of the inflationary causes, and——

Mr. MARTIN. I have here under B:

The tempo of interaction between rising costs and rising prices will be speeded up if the situation is characterized by:

Senator WILLIAMS. That is right.

Mr. MARTIN. I think that is one of the factors that can speed it up. I did not mean to say that it always speeds it up. But it certainly is one of the factors that can speed it up.

Senator WILLIAMS. That was the reason I was asking the question.

Mr. MARTIN. Right.

Senator WILLIAMS. Because it was my understanding that you had stated that.

Do you anticipate a climb of Government expenditures in 1958 or 1959? Of course, that is out of your department, if you would rather pass on it.

Mr. MARTIN. I would rather pass on it, Senator. I do not know enough about the——

Senator WILLIAMS. I will go back into your department. Do you anticipate a climb in business activity in 1958 or 1959?

Mr. MARTIN. Well, 1958–59 is too far off for me to make any calculation; but I would say that the longer range outlook for business is still quite good.

Now, there may be some dips from time to time, but I am quite confident on the longer range outlook for business.

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

Mr. MARTIN. I think it would be very helpful; yes, sir.

Senator WILLIAMS. Would you say that it would not only be helpful—I mean necessary—but it would be practically essential that we do?

Mr. MARTIN. Yes; I think it is practically essential; yes.

Senator WILLIAMS. Do you think one of the methods of doing that would be to maintain the present ceiling on the national debt?

Mr. MARTIN. That is out of my field again, the management of the debt. I do not know what the answer is. There are some real problems with the way taxes come in and the management of the debt, but I certainly favor keeping the debt down.

Senator WILLIAMS. Well, based upon your experience in the Treasury Department, and, of course, your experience with the Federal Reserve System.

Mr. MARTIN. I think a limitation on the debt is a very salutary thing, generally speaking.

Senator WILLIAMS. And a limitation is not any good unless it is maintained as a ceiling; is that correct?

Mr. MARTIN. That is corrcet.

Senator WILLIAMS. If it is going to be moved every time we approach the ceiling, then there is, in effect, no limitation?

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Mr. MARTIN. It certainly trends that way.

Senator WILLIAMS. Do you think that the fact that in France inflation has reached the point where they have had to recently devaluate the French currency should be interpreted as a warning signal not only to us but to other countries at this time?

Mr. MARTIN. I most certainly do.

Senator WILLIAMS. Do you think there is any danger that this devaluation will extend beyond France?

Mr. MARTIN. Well, I would not want to comment on that. I think that any country that spends more than it has is faced with a real problem, that sometimes the chickens come home to roost. I would not want to make any comment on any foreign country.

Senator WILLIAMS. I think you are correct on that, I will not push the point. But the effect, when one country is placed in a position where it must devaluate its currency, it inevitably has an effect on other countries; is that not correct?

Mr. MARTIN. That is correct.

Senator WILLIAMS. Do you not think that the fact that the Canadian dollar has been in recent months selling at the highest premium over the American dollar should likewise be interpreted as a warning signal to America?

Mr. MARTIN. It should certainly be interpreted as a warning signal in the sense there is an imbalance there.

Senator WILLIAMS. Do you not think it would be just as appropriate to say that the American dollar has declined 5 or 6 percent below the Canadian dollar as it is that the Canadian dollar is 5 or 6 percent above it? I mean maybe it protects our ego a little more to say that it is higher; but, in effect, is that not what happened, that the American dollar is worth less than the Canadian dollar by 5 or 6 percent?

Mr. MARTIN. I think that is what the effect of it is, yes; without getting into the technicalities of it.

Senator WILLIAMS. It is only in recent years that that situation has prevailed?

Mr. MARTIN. Has prevailed. There are reasons for that on the investment side. But the effect is as you have stated.

Senator WILLIAMS. Would you care to give us some of the reasons in order that we might have them in the record here at this time?

Mr. MARTIN. Well, I think the reason is primarily the tremendous opportunity for investment in Canada and the confidence in the opportunity for developing raw materials and minerals up there that has attracted a persistent flow of American capital to Canada. That is the basic cause of it. It has been almost an overwhelming flood at times. The volume up on their stock exchanges and in their securities markets in relation to ours has been proportionately greater, and that unquestionably has been the major factor in causing the disparity in the two currencies.

Senator WILLIAMS. Canada has done a relatively good job of balancing their economy, too?

Mr. MARTIN. They have done a relatively good job; yes, sir.

Senator WILLIAMS. Their tax rate is lower than ours, too; is it not?

Mr. MARTIN. That I do not know.

Senator WILLIAMS. At least they have been reducing their taxes in recent months. I know that is the case.

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Mr. MARTIN. I would be glad to have a little memo prepared on the Canadian situation and put it in the record.

Senator WILLIAMS. I wish you would.

Would you also prepare for us—never mind.

I wish you would do that.

(Mr. Martin subsequently supplied the following:)

RECENT CANADIAN BUSINESS DEVELOPMENTS

During the last few years, economic developments in Canada have been roughly similar to those in the United States. The business adjustment of 1953–54 was even more limited in Canada than in this country, but the recovery there came several months later, in the spring of 1955 rather than mid-1954. In both countries, the recent boom has been dominated by unusually heavy investment in business plant and equipment; in Canada, exploitation of natural resources—oil, iron ore, waterpower, uranium, and nonferrous metals—has attracted capital from all over the world. In addition, Canada has experienced a higher population growth, with heavy immigration supplementing new births. This has generated a strong demand for housing and public services.

Canada's rapid growth has led to record imports, especially since the fourth quarter of 1955. These imports, which have come principally from the United States, have provided capital and consumer goods for the Canadian expansion and have moderated inflationary pressures in Canada.

Despite the heavy excess of imports over exports, the Canadian dollar has moved to the highest premium in recent history. A sustained inflow of capital from abroad, mostly long-term in character, has been more than sufficient to offset the trade deficit; under the Canadian policy of letting the exchange rate fluctuate freely, in response to demand and supply on the exchange market, this inflow has boosted the value of the Canadian dollar in the foreign-exchange market.

There have been three principal sources of capital flowing into Canada: (*a*) Direct investment by foreign interests in Canadian firms; (*b*) new cash issues floated in New York by local governmental authorities and Canadian businesses; and (*c*) purchases of outstanding Canadian securities by foreigners. In the 18 months between October 1955 and March 1957, Canada showed a current account deficit of Can$2,046 million offset by the following capital movements: Net direct investment, Can$639 million; net new security issues, Can$701 million; trade in outstanding securities, Can$300 million; other capital flows, Can$390 million. Canadian official holdings of gold and United States dollars rose by Can$16 million. Appendix table 1 shows the quarterly movements in this flow of funds into Canada since 1954.

Since 1954, the Canadian authorities have made use of flexible monetary, fiscal, and debt management policies to promote economic stabilization. In early 1955, both monetary and fiscal measures were designed to aid business recovery. Credit expansion was encouraged by a policy of monetary ease and bank rate was reduced from 2 to 1½ percent in February. The budget for 1955–56, introduced in April, provided for a treasury deficit at the national income level existing at the time.

With the rapid recovery of business activity in the second quarter of 1955, Canadian monetary policy changed from encouraging to moderating credit expansion. The discount rate was gradually raised to 3½ percent, and the Bank of Canada persuaded the chartered banks to adopt a minimum level of secondary reserves equal to 15 percent of deposits and to restrict certain types of long-term lending. The banks' loan expansion came to a halt in May 1956, but not before general loans had increased by 40 percent over their February 1955 level; this was the most rapid sustained bank-loan expansion in Canadian history. In addition, the volume of corporate, and local and Provincial government borrowing through the issue of new securities swelled to record proportions, reaching Can$1.2 billion net of retirements in 1955 and Can$2.3 billion in 1956.

In November 1956, a policy of tying the discount rate to the weekly Treasury bill tender rate was adopted. As market interest rates continued to rise, the disccount rate rose correspondingly, reaching 4.28 percent on August 15, 1957.

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At the present time, market interest rates in Canada are at postwar record levels and range from 0.4 to 0.8 percentage points above those in the United States.

Fiscal policy has had a less active role in recent Canadian stabilization efforts than monetary policy. After the Korean boom, there were significant tax reductions for fiscal years 1953–54 and 1955–56. The tax reductions for 1953–54 consisted mainly in eliminating a surcharge on individual income taxes and a reduction in the corporate profits tax. Similar but small reductions characterized the rate changes for 1955–56, introduced when the extent and timing of the economic recovery was still unknown. For 1957–58, there were smaller cuts in indirect taxes, reducing aggregate tax revenues by about 1 percent and still leaving an increased budget surplus. (See appendix table 2.)

Because of differences in tax bases, exemptions, and income categories it is not feasible to compare directly Canadian and United States tax structures. Comparison of the percentage of GNP absorbed by Federal taxes is more meaningful. In Canada, this percentage has averaged 17 percent for the past 2 years compared to 19 percent for the United States. It must be remembered, however, that the United States has felt it necessary to spend more than 50 percent of its budget on national defense compared with about 40 percent in Canada. The share of total tax revenue derived from individual and corporate income taxes is smaller in Canada than in the United States; in turn, however, excise and sales taxes are heavier.

Prices in the recent boom in Canada have been much more stable than in the immediate post-World War II and post-Korean war periods. From 1952 to mid-1956, consumer prices remained virtually unchanged; however, in the 13 months from May 1956 through June 1957, they increased by 4.3 percent, compared with an increase of such prices in this country of 3.6 percent. Wholesale prices have also increased in the past few years but at a slightly slower rate than in this country.

In recent months, several soft spots have appeared in the Canadian economy—in particular, in housing, automobiles, and lumber products. The percentage unemployed has been slightly greater than in 1956, and the index of industrial production, seasonally adjusted, has declined slightly from its high point in February of this year. Nevertheless, consumer prices and wage rates have continued to rise in the face of monetary restraint and a budget surplus.

TABLE 1.—*Canada: Selected balance-of-payments statistics*

	Current account deficit	Financed by—					
		Net direct investment	Net new security issues	Trade in outstanding securities	Other capital flows	Changes in official reserves[1]	Net capital flow
1954:							
I	−177	+92	+149	+20	−80	−4	+177
II	−195	+80	−9	+37	+124	−37	+195
III	+20	+47	−14	0	−15	−38	−20
IV	−80	+102	−19	+13	+29	−45	+80
1955:							
I	−185	+74	+21	−19	+38	+71	+185
II	−163	+103	−51	−1	+168	−56	+163
III	−85	+92	+8	−18	+10	−7	+85
IV	−265	+74	−27	+36	+146	+36	+265
1956:							
I	−363	+55	+39	+61	+179	+29	+363
II	−435	+164	+153	+53	+95	−30	+435
III	−204	+96	+151	+80	−118	−5	+204
IV	−370	+170	+183	+40	+4	−27	+370
1957: I	−409	+80	+202	+30	+84	+13	+409

[1] Minus denotes increase and plus a decrease in official reserves.

Source: Dominion Bureau of Statistics.

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TABLE 2.—*Canada: Selected Federal budget estimates*

[In millions of Canadian dollars]

	Estimated receipts at previous year's rate	Estimated amount of tax reduction	Estimated receipts after tax changes	Planned budget expenditure	Planned budget surplus (+) or deficit (−)
1953 to 1954	4,710	−237	4,473	4,462	+11
1954 to 1955	4,500	−36	4,464	4,460	+4
1955 to 1956	4,350	−148	4,202	4,362	−160
1956 to 1957	4,775	−12	4,763	4,650	+113
1957 to 1958	5,225	−55	5,170	5,018	+152

Source: Budget speech of the Minister of Finance.

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

Mr. MARTIN. I am convinced, Senator, that it is the little man that bears the brunt of inflation.

The man who has small savings, small income, the white-collar worker, and the men at the older ages, with the pensions—those are the people who are almost defenseless.

Now, as to the bigger operators, in the long run, of course, as I have tried to outline in this paper, everybody suffers from inflation. But in terms of its immediate impact, I think the primary sufferer is the small man.

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

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

Mr. MARTIN. That is correct.

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

Mr. MARTIN. That is correct.

Senator WILLIAMS. As they are invested in those fixed-income items?

Mr. MARTIN. That is correct.

Senator WILLIAMS. That is all the questions I have.

Senator LONG. Looking at these factors which you said contribute to inflation, I think it might be well to look at the labor supply. During the first 6 months of this year, we averaged more than 4 million unemployed. In the years 1950, 1952, 1955, and 1956, there was less unemployment and less inflation.

On this basis, would you say that we have too much strain on our labor force, or too much employment?

Mr. MARTIN. Could I get those figures again, Senator?

Senator LONG. Here is a tabulation that I made. Do you have a copy of Economic Indicators here?

Mr. MARTIN. The most recent figures we have—I see.

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Senator LONG. I will supply for the record here a tabulation of unemployment as a percentage of the civilian labor force for these years: 1952, 1953, 1956, and the first half of 1957.

(The tabulation is as follows:)

Here is a tabulation of unemployment as a percent of the civilian labor force:

Year:	Percent
1952	2.7
1953	2.5
1956	3.8
1st half of 1957	4.1

Mr. MARTIN. I would say that the record is quite good during this period. I am a little bit surprised at the 4.1 percent in the first half of 1957. I do not know what the precise figure on unemployment ought to be; and I am sure I agree with you that I do not want anyone to be unemployed.

But by and large it is my view that we have had during these periods, 1952, 1953, and so on, that you cite here, what I would consider full employment.

Senator LONG. Do you have Economic Indicators available to you?

Mr. MARTIN. Yes.

Senator LONG. If you will look at page 11.

Mr. MARTIN. I have got it.

Senator LONG. You will see that, on the third from the last column, allowing for seasonal adjustment, unemployment during the first half of 1957 has been more—has averaged more than 4 million. There is some improvement in the next succeeding month, I understand. Even so, this is a higher rate than we had in these other years which I have mentioned, when there was much less inflation.

The question I have in mind there is: With approximately 4 million people unemployed, do we have any strain on the labor force that could be regarded as an inflationary pressure?

Mr. MARTIN. Well, I have not analyzed these figures, but I feel, generally speaking, we have had full employment during this period. I do not mean everybody has been employed, but the level of employment has been extremely high.

Senator LONG. Well, to illustrate what I have in mind, let us take the year 1952. We had about 1 percent inflation during that year, and we had 2.7 percent unemployed, which was about 50 percent less than the current figure, that is, there is about 50 percent more unemployment today than you had at that time. Or if you look at 1953, which was a year in which there was very little inflation—there was less than 1 percent inflation that year—and then you had 2.5 percent unemployed, which again would indicate about 50 percent more unemployment, at least, now. Or if you look at it the other way around, unemployment then was about one-third less than today.

Would that at all indicate that we have any inflationary pressures today, as a result of shortage of the labor supply?

Mr. MARTIN. Well, you have to recognize that we had a—we have gone through a transition period in which there has been a lot of shifting of labor, and the removal of controls and shifts in the military program, and one thing or another, have caused a lot of shifts in employment of one sort or another that cannot be taken up quickly in figures of this sort.

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But the principal labor shortages that I would see at the moment are all in skilled types of labor. I do not think there are too many of them, but I think that there are certain areas where the only way you can get certain types of technicians is to bid them away from somebody else.

Senator LONG. Have we had, would you say, in any general sense, any inflationary pressure as a result of the shortage of labor supply, very recently?

Mr. MARTIN. I would think that in skilled labor there is, Senator, some.

Senator LONG. Would you make that statement in a general sense with regard to labor, that there is a shortage of the labor supply today which is creating an inflationary pressure?

Mr. MARTIN. I would think so.

Senator LONG. Well, can you support that statement, as compared to previous years, when we had 1 percent or less inflation, when the labor supply was as short as 2.5 percent unemployed, or far less unemployment than we have now—in other words, here we have the first half of 1957 a percentage of unemployment of 4.1; in 1952 we had 2.7; in 1953 we had 2.5. So the percentage now is one-half greater than in those years. Those were not regarded as inflationary years. In fact, the administration has taken quite a bit of solace from those years, in saying those were years in which you had what might be called stability and that inflation was less than 1 percent during those years.

Mr. MARTIN. Well, I would say that as indicated on the chart we had yesterday, that from April 1951 to April 1956 we had a reasonably good record. I place this on a completely nonpolitical basis because that includes a year and a half of the previous administration.

Now, the point, it seems to me, on these figures is, that without quarreling with them, I think they do an awfully good job in putting them together——

Senator LONG. Well, you are perfectly free to make your own calculation.

Mr. MARTIN. No; I was not quarreling.

Senator LONG. You and I are looking at the same publication.

Mr. MARTIN. I was not quarreling with the figures at all. I was just making the point that in the shift that has occurred and the new opportunities that have developed with the advancing technology, that unquestionably it seems to me there are at the present time shortages in labor, as I say in my statement here, where employers face rising costs by having to bid employees away from someone else of a skilled variety in order to handle their expansion.

Senator LONG. Well, of course, have you not always had that problem with regard to training skilled labor? Did you not have it in 1952, in 1953, when we were developing new weapons and things of that sort? Did we not have the same problems then we have now in that respect?

Mr. MARTIN. Well, it is accentuated.

The period, the post-Korean period, the period right after Korea was, in my experience in the Government, the worst I have ever experienced. You had almost hysteria in the purchasing of goods because the public had in front of them the recent war experience, you

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see, and we were not adequately equipped to handle it so quickly after one war.

Now, the early part of the post-Korean period was a period where we had to use all the weapons in our arsenal. The Congress promptly granted authority to invoke the price control and wage control mechanism at that time. But the thing got a head of steam on us, and we had a very difficult problem handling things through 1950–51. And then gradually it turned out that the Korean war was a different type of conflict than we anticipated it would be when we started. And I think that some mistakes were made in that period, too, by all of us; and certainly I think that money could have been handled a little less freely than it was in the early stages of the Korean conflict.

Senator LONG. I would like to stay with this question of the labor force just a moment or two longer, because we always have a problem of training skilled labor. Even if we did not have any unusual situation, we would have somebody die, and we would have to replace him and have somebody to train and take his place. But as long as we have an ample labor force from which to recruit the laborers and train them, I would not regard that as being any inflationary pressure, certainly not in a general sense. We may have need of some particular type of technicians, but I do not see that we have an inflationary situation if we have enough unemployment, or enough labor available so that labor can be recruited and trained for the job. Certainly the laboring man is not in any position to make any excessive demands for wage increases in a general sense when we have a considerable amount of unemployment, is he?

Mr. MARTIN. That is right. I think it is just a matter of degree.

Senator LONG. Well now, the point I have in mind is that when you have a higher degree of unemployment now than you had in these years that were not inflationary, can we regard a labor supply with approximately 4 percent unemployed as having any genuine inflationary pressure upon our economy?

Mr. MARTIN. Well, I think it has some inflationary pressure at the present time arising from its origin of a year ago.

Now, this is a moving picture here. We have got from 1951 through 1956, I think from April of 1951 to April of 1956, we did have a reasonable stability. Then I think the situation got a little bit out of hand in 1956. And the impact of the very valid point that you are raising is one that we will see in the next year or so.

Senator LONG. I just have in mind at this moment the labor supply, and looking at the published figures in Economic Indicators, I see that we have had more unemployment during the first 6 months of this year than we had—that is, over the period—than we had over any year starting with 1952, with the exception of the 1954; and that year was regarded as being a recession era when we had 5 million unemployed.

Mr. MARTIN. That is right.

Senator LONG. That prompts the question from me as to whether we can regard the current labor supply as creating inflationary pressures. In January, you had 4.9 million; February you had 4.7 million unemployed; March, 4.3. Then down it dropped down to 4 in April and to 4 in May; then up to 4.8 in June. And I understand it

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is going to come down by several hundred thousand in the next month, when the next Indicator comes out.

I do not see how you can contend that we have inflationary pressures or a shortage of labor supply, when you compare this to the years which were not inflationary years, and when unemployment was a third less than it is now. It seems to me as though the labor shortage should certainly be regarded as being greater during those times, less available labor to employ, and I do not see how you conclude on this basis that you have an inflationary labor situation now, certainly not compared with years where you had little or no inflation but far greater labor shortages.

Mr. MARTIN. Well, now, I do not have the gross national product figures, but look at the increase in gross national product in the same period.

Senator LONG. It seems to me that the crucial point would be the percentage of unemployment as against the amount of civilian-labor force available. Now, those are the figures that I gave you for the record.

Mr. MARTIN. That is right.

Senator LONG. As to how productive these laborers are, that relates to the kind of machinery they have, or perhaps how long they are working, or how much overtime employment they are putting in, and I believe that the overtime is no higher now. We are not working people any considerable degree of overtime now, are we?

Mr. MARTIN. No. That has diminished, but the reason I introduced the gross national product was that you have a tremendous shift in the whole content of the economy during this period, and I think your point is perfectly valid, but I do not think it can be done on a comparative basis. You have got to relate all this to the achievements of the economy.

Now, the last year from 1955 to 1956, as I indicated yesterday, you have more than $10 billion of the increase in your gross national product that has been merely a markup in prices without any additional goods and services. And that is a factor to be taken into consideration also in this picture. And I still think, as to the labor force, that we are in a condition of full employment, and certainly in certain skilled lines there is a shortage.

Now, I agree with you that the availability of labor here and the educational—I think one of the great things in this country has been the educational facilities we have been providing.

Senator LONG. It seems to me, when one asks the question, what is causing the inflation that we have now, and what has been causing it for the last 6 or 7 months, you just cannot say that it is the shortage of labor. There may be a shortage in some particular skills, but in general, labor is in more full supply now than it has been for several years.

You have got to go back to 1954 to find a time when labor was in more full supply than now.

Mr. MARTIN. I am not contending for a moment that labor is the only factor at the present time.

Senator LONG. Aside from 1954, you have got to drop back to 1950 to find a time when labor was in more full supply.

You say—you do not contend that——

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Mr. MARTIN. I do not contend for a moment that labor is the primary inflationary factor, but I think it is one of the factors.

Senator LONG. You think that a shortage of labor is creating an inflationary pressure upon our economy at this time?

Mr. MARTIN. In certain skilled areas, yes; I think that they have to bid—I stated it in my statement here. I said:

this general pressure has been expressing itself particularly in rising prices for services as compared with goods. Despite the existence in some lines of reduced employment and slack demand—I recognize that—many employers now face rising costs when they seek to expand activity by adding appreciably to the number employed.

I think that is true, Senator.

Senator LONG. Well, in some instances, of course, you have to pay more. But did you not have the same situation back to the Korean war? We have been having a shortage of these skills. I have been on the Armed Services Committee, and the Air Force has been complaining they could not get these skilled technicians because industry was buying them away from them. And did not that same general situation exist all through these previous years?

Mr. MARTIN. Yes. But wages have been steadily going up during that period. So that the price factor, you see, has gotten into that. I am not criticizing the wages going up.

Senator LONG. Wages have gone up, but did they not also go up during years like 1950 or 1953 or 1954 or 1955?

Mr. MARTIN. I do not think they went up to the same extent.

Senator LONG. Let us keep this in mind: It is one thing for wages to go up because a labor union calls their men out on strike and insists on a pay raise in order to go back to work. That is something you and I cannot do much about with monetary policy.

Mr. MARTIN. That is right.

Senator LONG. But it is another matter for wages to go up because labor is in short supply, and to hire labor—and I do not mean just to hire a few skilled ones, but I mean to hire labor in a general sense—you have got to bid the price up because it is very difficult to get labor.

Mr. MARTIN. That is right.

Senator LONG. The point I am making is we had years where we had very little inflation; and the Administration, I think properly pointed to those years, and Secretary Humphrey in his testimony here, and I think he had a right to, pointed to those years as years of very little inflation. And during those years, there was a greater shortage of labor than there is now, and I am speaking of it in the general sense. There were times as low as 2.5 percent for an annual average for unemployment, which is a very low figure. And the point I have in mind that there is now no inflationary pressure with regard to a general shortage of labor, and there is no widespread shortage of labor as far as the availability of labor is concerned.

Mr. MARTIN. I will agree with you on a widespread basis, I agree.

Senator LONG. In fact, it seems to me that, in a general sense, it would be desirable to increase employment at this time, when you look at your June figure of 4.8 million unemployed. I understand that the July figure will bring that down by 600,000. Even that would be 4.2. And while there may be some adjustment made in the availability of labor, reducing or increasing the labor force in ways which

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might affect the figure, I should think that even at that figure it would be desirable further to reduce unemployment. Would you agree with that statement?

Mr. MARTIN. I would like to see unemployment reduced to the vanishing point, but I want the employment that occurs to be not of a temporary nature but of a permanent nature. And if you just get oversupply in some goods or temporary overcapacity—and it is only temporary, in the growth of the country as I see it today—you are going to have pressure then on profits, and there will have to be some reduction of prices or losses taken to remove inventory accumulated under those circumstances, and then you will be forced to some unemployment.

Senator LONG. I do not share your hope that we are going to reduce unemployment to the vanishing point, Mr. Martin. I think we are always going to have some unemployment, even if it is people who have left one job to try to seek a more desirable job. And it does seem to me that there are inflationary pressures, if you try to get unemployment down below a million. I should think, when we are above about 2.5 percent unemployed, if labor is fairly well adjusted to the areas where we need it, that we do not necessarily have inflationary pressures. And I say that is based on years when you did have 2.5 percent unemployed, a very low figure, and yet we had very little inflation. I have particularly in mind the year 1953 which had that effect. There was a year with less than 1-percent increase in prices.

Mr. MARTIN. Well, and by the end of the year 1953 you had an inventory recession underway, and then your unemployment rose to 5 percent in the following year.

Senator LONG. That is right; and that was the highest degree of unemployment that you had; that was regarded as a recession year. Certainly, no one is going to argue in that year that you had any inflation because of a shortage of labor supply. That was a year where you had an excess of labor supply, I would say. Would you not agree?

Mr. MARTIN. That was a year where the adjusting process resulted in an increase in unemployment.

Senator LONG. Well, it did not result in any inflation?

Mr. MARTIN. Oh, no.

Senator LONG. Yes. That is the point I have in mind, that we could operate with a smaller number of unemployed by a considerable degree than we have now without having inflation, based on our actual experiences.

I would like to look at production. Here is my tabulation, and I will hand you a copy of this.

Mr. MARTIN. This is from the President's economic report, page 124.

Senator LONG. Here is my tabulation of production increases, 1949 to date, inclusive, in terms of annual average percentage change over the previous year, measured in uniform 1956 dollars. I would like to put that tabulation in the record.

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(The tabulation is as follows:)

Here is my tabulation of production increases 1949 to date, inclusive, in terms of annual average percentage change over the previous year, measured in uniform 1956 dollars:

Year:	*Percentage*
1949 to date, inclusive (average)	+4.0
1949 to date, inclusive, but excluding 1951 (average)	+3.5
1953 to date, inclusive	+3.1
1956 to date, inclusive	+2.7
2d quarter 1956-2d quarter 1957	+2.7
2d half 1956-1st half 1957	+1.2

(See p. 124, President's Economic Report, also p. 2, Economic Indicators.)

Senator LONG. You could find that for all the years at page 124 of the President's Economic Report. That is my own tabulation of the percentage of change. I believe you can glance over that and check the accuracy of that calculation.

Mr. MARTIN. I will certainly accept your figures, Senator.

Senator LONG. I expect you to correct me if you find them wrong, Mr. Martin.

Mr. MARTIN. I certainly will.

Senator LONG. Because you have got some better calculators over there than I have in my office, and I am sure, when your people look it over, that they can correct it if it needs correction.

Here is what my calculations indicate: From 1949 to date, the average increase in production, measured in terms of uniform dollars, was 4 percent.

Now, during that period of time we had the Korean war, and we had a great increase during the year 1951. It would seem to me it might be well to drop out that year, if you wanted to arrive at what sort of increase you could expect in peacetime. And so if we drop out the year 1951, the average for 1949 to date, excluding 1951, would be 3½ percent increase; or 1953 to date, during this administration, the increase has been 3.1 percent.

Now, that accords with what you stated to be a desirable rate of growth, between 3 and 4 percent.

In 1956 to date, inclusive, the increase has been 2.7 percent, which is less than 3.

If you would refer to the Economic Report on page 2—pardon me, the Economic Indicators on page 2, the picture can be brought forward. If you allow for the degree of inflation which has occurred, which is about 3.5, comparing the month of this year as compared to last year, or is a 3-percent increase if you compare the first quarter of this year to the average of last year, my calculation is that from the second quarter of 1956 to the second quarter of 1957, your increase in real production has been only 2.7 percent.

Here is the final figure that I calculate. The second half of 1956 against the first half of 1957, the increase is only 1.2 percent.

Mr. RIEFLER. Is that annual, 2.4?

Senator LONG. Perhaps annual 2.4. Would this indicate any inflationary strain on our production facilities?

Mr. MARTIN. I would say it certainly shows we are reaching capacity. Our production index——

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Senator LONG. You say indications are we have reached our capacity?

Mr. MARTIN. We are over our capacity, we are straining against our capacity in that sense. What I am trying to relate are these—well, I cannot relate all of these items here, Senator. These are only manufacturing.

Mr. THOMAS. This is more comprehensive, his figures.

Mr. MARTIN. Well, we certainly have been straining against the limits of our production capacity. And do not forget, as I pointed out earlier——

Senator LONG. It seems to me quite the contrary, that we are not producing because we are not consuming.

We could produce a lot more houses, a lot more automobiles, a lot more consumer durables in things like washing machines or household appliances, which we are not doing; and we have 4 million people unemployed.

Mr. MARTIN. And we have got demand for them at a price. But at the price level we have gotten up to——

Senator LONG. Let us see what the strain is on our productive facilities now. That is the point I have in mind at this moment.

I attempted to calculate, for example, as against 1956, allowing for the price increases, where we stand in the first and second quarters of this year. It appeared to me, if you adjust your prices upward from the first quarter of 1956—looking at that, page 2 of the Economic Indicators, looking at what our production was at, say, $405.2 billion, do you see that second column there, first quarter 1956?

Mr. MARTIN. Yes; I have got that first quarter.

Senator LONG. $405.2 billion?

Mr. MARTIN. Right.

Senator LONG. Then compare that to the first quarter of 1957, compare that to $429.1 billion. Now to see where you stand, however, you would have to make a calculation of 3½ percent to allow for price inflation, which would cause you to add $14 billion to that first quarter 1956 figure, which would give you $419.7 billion, which would show a 2-percent production increase in real terms from first quarter 1956 to first quarter 1957.

Now during that year, with a 2 percent increase of production, we had a 1½ percent increase in our population. Would you call that a desirable rate of expanding our gross national product?

Mr. MARTIN. I would say that we are expanding our gross national product here—you are adjusting on prices there. You are taking 3½ percent; is that right?

Senator LONG. Yes. You certainly cannot say—I mean by the time you look at your gross national product to see whether you are increasing or falling off, you have got to allow for the change in prices.

Mr. MARTIN. Right.

Senator LONG. And if you had a 3½-percent price increase, and if your production figure in current dollars stays constant, your real production has declined. When you make that calculation, you get slightly more than a 2-percent increase in real gross national product in the first quarter of 1957, as against the first quarter of 1956; and you get even less increase if you compare the second quarter of 1957 with the second quarter of 1956.

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So that would show that our rate of increase in our gross national product has fallen off almost to a standstill.

You do not regard that as a desirable situation; do you?

Mr. MARTIN. Well, I want to see the gross national product expand, but I also—you have to recognize that business has to earn a profit, and that——

Senator LONG. You are not complaining about business profits at this time; are you? My impression is they are in good shape at the present time.

Mr. MARTIN. They are beginning to be squeezed, but the main point here is that you have got to have demand to take care of the products that are being turned out; it has to be there, and it has to be at a price that the consumer—who has money today; there is no question of the ability of the consumer to buy—that he will take. If you want to say you can produce—if you want to give away houses or if you want to give away automobiles, you can do that.

Senator LONG. I am not trying to give them away. I am not proposing that. All I am discussing at this point is whether there is any inflationary pressure upon our productive capacity in this country, based upon the average annual increase of 3 to 4 percent which you state is desirable, and a showing that the actual increase has been substantially below that, in fact, hardly keeping up with the increase in population so far as the expansion of our gross national product is concerned. Do you regard that as indicating any inflationary pressure upon our productive capabilities in this country?

Mr. MARTIN. Well, I cannot go on your statistical basis here. I do not think it is a statistical problem.

Senator LONG. Now, that is not my statistical basis. These are the facts presented for you and me to look at, and to attempt to see where we stand, and to help us in analyzing what is happening and where we are going and where we have been.

I am just attempting to convert these matters to constant dollars, just as the President's economic indicators do when they make them available. They make them available right up to 1957, but we have to calculate ourselves from the year 1956 into 1957.

Mr. MARTIN. Well, I cannot do more with it, Senator, than to say that——

Senator LONG. Well, there are the figures and they are published for that purpose, and they do not indicate that expansion; do they? They do not indicate that there is any pressure on our productive facilities that are exerting any inflationary pressures upon this economy?

Mr. MARTIN. Well, I just cannot concede that. I would have to——

Senator LONG. Well, you and I know what it is like to have inflationary pressures upon our productive capacity; do we not? You just take the year 1942, when we increased our real production by almost 13 percent in a single year, as against this 2 percent this year.

Now, that is what you would call real inflationary pressure, when you had tremendous pressures to produce, and that caused great price increases. We just do not have anything like that now; do we? In fact, we are well below, and I should imagine even distressingly below, what we would hope for, as far as our rate of expansion is concerned.

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Mr. MARTIN. If you had a planned economy, you would seek a higher level than is projected by these particular figures; but you have to recognize here that you are quite correct in saying that a year ago or over you had this constant pressure in which the supply of goods, where there were shortages—that is the easiest way to think of it.

Now those shortages do not exist today in that sense, but the consumer is not willing to take some of this supply at the prices at which they are being offered, and therefore you have temporary overcapacity coming into the economy that will only be absorbed by adjustments in prices of some sort or developing a market, marketing techniques to sell further products.

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

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

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

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

Senator LONG. I mean either.

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

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

Mr. MARTIN. I have never advocated recession at any time.

Senator LONG. Well, you used the word "recession." I did not use it. I suspect that is what it would mean.

Mr. MARTIN. I think you are quite correct. I do not quarrel with you as to the use of the word.

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

Mr. MARTIN. No; I do not think so. I think what we need today for plant and equipment expansion is more savings.

Senator LONG. First perhaps I should have prefaced that by this question: Do you believe it would be desirable that our gross national product in real terms should expand more rapidly than our population?

Mr. MARTIN. I do not think you can relate population and the gross national product that precisely. But certainly if productivity——

Senator LONG. Why not? Because in time you have more people, you have got more mouths to feed, more to clothe, more to house, more to put in automobiles. Why not? Why should you not be able to state the desirability of increasing the gross national product more rapidly than you increase your population, so that living standards can rise.

Mr. MARTIN. If it can be expanded on a business basis, it is desirable to do it. But if it is to be expanded without regard to whether

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the consumer will pay the price, without response to market conditions, I do not see how it can be done.

Senator LONG. I am just trying to understand your answer. You tell me on the one hand that you do not think prices ought to be reduced.

Mr. MARTIN. Oh, no, I have not said that at all.

Senator LONG. You said you did not think we ought to do anything to contribute to a declining price level.

Mr. MARTIN. I think the forces of the market produces that.

Senator LONG. Fiscal policy, monetary policy, or any other policy aside, do you think a declining price level is desirable at this time?

Mr. MARTIN. I do not say it is desirable. I say it is inevitable if the goods cannot be moved at current prices.

Senator LONG. You are the one who used the word "recession."

Mr. MARTIN. I will stick to it.

Senator LONG. Do you think it would be desirable for us to use any fiscal or any monetary policies that would head off a recession?

Mr. MARTIN. I do not believe you can—there is no way, there is no magic to this. You cannot just turn on a lever and prevent adjustments. You cannot turn on a lever and crank it up.

Senator LONG. Well, you testified here—and it took you some time to present it, a very learned statement—that you were using fiscal and monetary policies at the Federal Reserve Board level, which you as chairman——

Mr. MARTIN. We have no control over fiscal policy.

Senator LONG. You were using monetary policies then; is that correct?

Mr. MARTIN. Yes.

Senator LONG. Let us use monetary policies. You were using monetary policies in your effort to prevent inflation.

Should you use your monetary policies, in terms of your responsibilities as you interpret them, to prevent a recession?

Mr. MARTIN. Why, if we could, we certainly will. We want to prevent either. But the point I am trying to make is that inflation precedes the recession; and that is just the reason why at the present time we have to come to grips with inflation. We are always fighting inflation.

Senator LONG. Here is the thing we are discussing: We are discussing the fact that, as of this past year, we have had a very inadequate increase in our national production. And the question that I am attempting to get to is whether it is desirable that we should have a further increase in our national production, or our gross national product, so that it will increase more rapidly than we increase population? And I would like to see us increase it considerably more rapidly than we increase population. I would like to see us increase it around 4 percent on the upper end of the 3 to 4 percent that you say is desirable.

Now that being a desirable result, the question I have in mind is: Is it desirable for us to use any efforts at this time to reduce consumer spending or restrain it?

Mr. MARTIN. Well, we have to have more savings if we are going to finance the programs of Government—more savings if we are going to have to finance the State, local, municipal, county plans, if they are

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going to finance this education we both agree is so essential in terms of technology for the new type of skilled labor that is required. We have got to have——

Senator LONG. But now, on the other hand, if we are going to make more of the better things of life available—that is, in terms of more clothes, better food, better diet, better housing, more automobiles, more household appliances for our people—then we also need to increase our production, and in order to do that, we need to increase the consumption of consumer goods, do we not?

Mr. MARTIN. Well, the consumer has to have the wherewithal to buy the goods. We could not compel him to spend his money. He is the one who has to determine what he needs and what he wants, and we can not just force "X" added production on the market without regard to his wishes.

Senator LONG. Now, insofar as, and separating this item of inflation for a moment and looking at consumer spending only, insofar as a tight money situation, and a high interest rate situation, reduces consumer spending, is that a desirable thing at this time?

Mr. MARTIN. Well, I contend that there is no tight money situation that is reducing consumer spending at the present time.

The problem is that the consumer is spending at a colossal rate, and I think the phrase "tight money" is a misnomer. I think it is really loose money we have been having for the past year or so.

Senator LONG. Is the consumer spending at a sufficient rate to enable us to expand our production at the normal rate which you have advocated, between 3 and 4 percent?

Mr. MARTIN. It is not unless we have more savings that come into it—you have got to have plant and equipment.

Senator LONG. I do not think you need at this point to condition anything. It looks to me as if you can look right there at the facts before you, and see whether we are doing it or not. You can take the next column, consumption expenditures, and see the extent that it has increased during the past year.

Mr. MARTIN. I would say the consumer is spending quite adequately at the present time. The thing we have got to do is—we are not earning enough through our production——

Senator LONG. How do you account for the fact that we have had so little expansion in our gross national product, although we have built all these new plants and have tremendously increased production capabilities, and yet we are hardly expanding production more rapidly than the population is increasing? How do you account for that?

Mr. MARTIN. I account for part of it by inflation.

Senator LONG. Well now, we just got through calculating for inflation; that is how we found out that we have not gotten anywhere.

Mr. MARTIN. Well, Senator, the only comment I can make on that—and I come back to it—is that inflation is a process; it is not something that you can calculate here as 3½ percent and measure it from this point to the other point. This is a continuous process that is operating in a spiral.

If we can project production for a constant level of increase, 3 or 4 percent, without regard to the ebb and flow of markets, why then I think your thesis is perfectly correct; but I do not think you can.

Senator LONG. Let me go back to this question I tried to get answered sometime ago, and perhaps we are ready to get an answer

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to it now: On this showing—and these are the figures I have to show it, and I hope you can answer this question yes or no, but you do not have to—do these figures show any pressure on our productive capabilities of a genuine inflationary nature?

Mr. MARTIN. Now, in terms of prices, I think it does.

Senator LONG. Let us not talk about that just yet, let us talk about productive ability to produce to meet demand.

Mr. MARTIN. Well, the demand is at a price, though.

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

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

Senator LONG. That is all I am talking about at this moment.

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

Senator LONG. In a general sense, the answer is "No," is it not?

Mr. MARTIN. In a general sense, the answer is "No." But on prices, I want to come back to it.

Senator LONG. That is all right. I am not foreclosing you.

Mr. MARTIN. At a price. That is right. I know you are not.

Senator LONG. We will tackle this price issue. But as far as the production is concerned, there is no showing here that production is under any inflationary strain, is there?

Mr. MARTIN. I would say that you are generally correct at the moment.

Senator LONG. Now, I would like to discuss in somewhat greater detail consumer expenditures; and I have prepared a table, and I shall refer to how I calculated it, and here is one for the record.

This is my calculation of the trend in consumer expenditures, annual average growth rate in uniform 1956 dollars.

Trends in consumer expenditures, annual average growth rates in uniform 1956 dollars

Year	*Percent*
1953 to 1st half of 1957	+3.7
1955 to 1956	+3.3
2d quarter of 1956 to 2d quarter of 1957	+1.7
2d half of 1956 to 1st half of 1957	+1.4

I derived that from two sources: One is from page 124 of the President's economic report. That is where I derived the basic figures, and I calculated the increases, which I do not believe you will find substantially in error, if at all, in terms of personal consumption expenditures. You will see that as the second column.

Senator LONG. On that page—that indicates that from 1953 on through the first half of 1957, our consumption expenditures increased at an annual rate of 3.7 percent in uniform 1956 dollars.

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Now, that is in line, I have always contended, with the fact that in order to produce, you have got to consume—you have got to have buying power in order to have production.

Now, there you have an average of 3.7 percent, which is within the range that you referred to as desirable, between 3 and 4 percent.

Take the average from 1953 through 1956, where the average is 3.3 percent. Then, referring to page 1 of the Economic Indicators, and adjusting for price change, it appears to me that if you compare the second quarter of 1956 with the second quarter of 1957, that the real expansion rate is about 1.7 percent.

Now, you can calculate that at some other time if you want to, but that is the information that is available to me.

Mr. MARTIN. All right.

Senator LONG. And I would ask you, assuming the substantial correctness of those figures, does that not indicate that our consumption expenditures are not increasing at the level that would be desirable?

Mr. MARTIN. No, not a bit, Senator.

I think that it shows that the savings trend is in the right direction, and that if we can continue to reduce those expenditures and increase our savings, we will be able to finance this plant and equipment expansion that will lead to a sound expansion.

Senator LONG. It is not going to do us any good to have a lot of plants, if they do not have somebody to buy the stuff they are producing.

It takes both; does it not?

Mr. MARTIN. They have got to have the earning to pay, and you cannot just manufacture savings, you know. We cannot use bank credit to produce these buildings and plants.

Senator LONG. Let me ask you—over here on about page 11 of the Economic Indicators, in terms of income, I think it ought to be there—just one second. Let us find disposable personal income in your Indicators.

No, it is not on page 11. On page 6, there is a figure that I know is not satisfactory from your point of view, and it is not a desirable figure from mine. If you will look at the second to the last column, per capita, compare the second quarter of 1956 with the second quarter of 1957, you will see in the second quarter of 1956, per capita disposable income was $1,713.

The per capita disposable income for the second quarter of 1957 was $1,705, and I would like for the reporter to put this particular column in the record.

That is in terms of uniform dollars, which indicates that income after taxes for the average person on a per capita basis is $8 less this year than it was last year.

Now, that is not desirable, is it, for this quarter?

Mr. MARTIN. Is there an adjustment of prices in that, Senator?

Senator LONG. That is in terms of constant dollars, in order to allow for the inflation of the dollar during that period.

Mr. MARTIN. Well, that is an $8 loss, then, as a result of inflation.

(The table previously referred to follows:)

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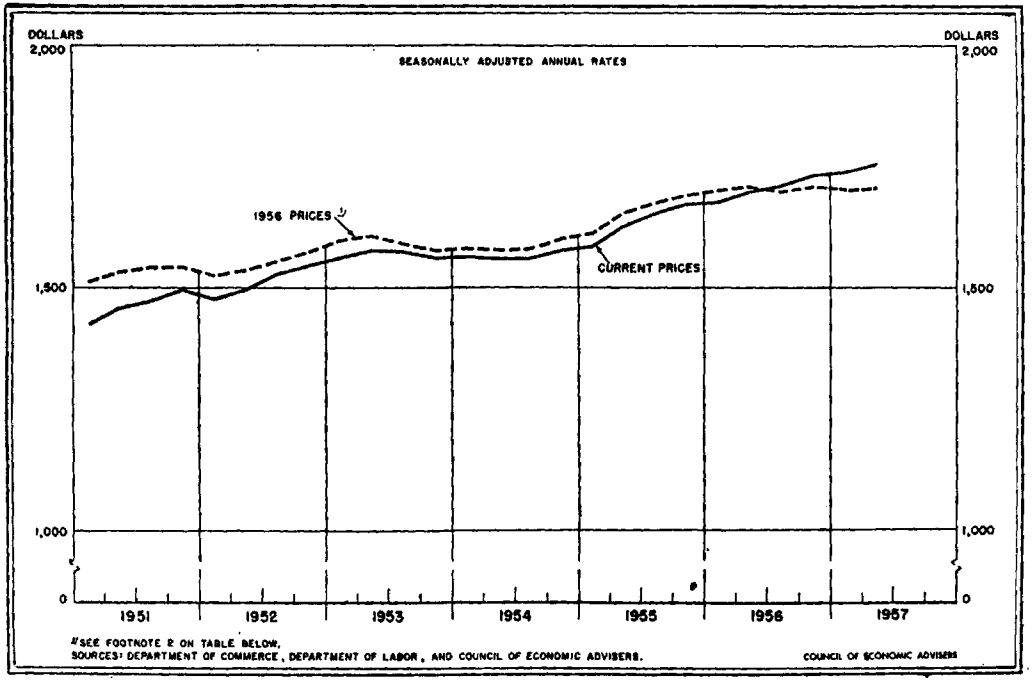
PER CAPITA DISPOSABLE INCOME

Per capita disposable income, measured in both current and constant prices, rose from the first to the second quarter of 1957.



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Period	Total disposable personal income (billions of dollars) [1]		Per capita disposable personal income (dollars) [1]		Population (thousands) [3]
	Current prices	1956 prices [2]	Current prices	1956 prices [2]	
1939	70.4	137.9	538	1,053	131,028
1948	187.6	212.0	1,279	1,445	146,631
1949	188.2	214.8	1,261	1,439	149,188
1950	206.1	232.9	1,359	1,536	151,683
1951	226.1	236.7	1,465	1,534	154,360
1952	237.4	243.0	1,512	1,548	157,028
1953	250.2	254.0	1,568	1,592	159,636
1954	254.5	257.6	1,567	1,586	162,417
1955	270.2	274.3	1,635	1,660	165,270
1956	287.2	287.2	1,708	1,708	168,174
	Seasonally adjusted annual rates				
1956: 1st quarter	279.6	283.6	1,673	1,697	167,150
2d quarter	285.8	287.5	1,703	1,713	167,824
3d quarter	288.8	286.8	1,713	1,701	168,594
4th quarter	294.0	289.9	1,735	1,711	169,416
1957: 1st quarter	295.5	289.4	1,737	1,701	170,158
2d quarter [4]	299.7	291.3	1,754	−1,705	170,859

[1] Income less taxes.
[2] Dollar estimates in current prices divided by consumer price index on a 1956 base.
[3] Includes Armed Forces overseas. Annual data as of July 1; quarterly data centered in the middle of the period, interpolated from monthly figures.
[4] Preliminary estimates by Council of Economic Advisers.

NOTE.—Series revised beginning with 1954. For details, see Survey of Current Business, July 1957.
Sources: Department of Commerce, Department of Labor, and Council of Economic Advisers.

Senator LONG. Well now, you say as the result of inflation; but we have had some years of inflation, when the real per capita income nevertheless increased very greatly. In other words, we both increased our real income and had the inflation all at the same time, because the increase in dollar income ran way ahead of the increase in prices.

That occurred all during the years 1939 on up, in fact, almost up to the present time.

For example, let us just take—if you take the years during this administration, under President Eisenhower—let us give credit to the Eisenhower administration here—in terms of real dollars, every year starting in 1953, with the exception of 1954 when there was a slight falloff that year and we did not regard the recession as being desirable—but going forward then, 1950, 1951, 1952, 1953, 1955, we had increases. Then it increased in 1956 until we got to the latter part, and then it started falling off.

This year we find, comparing one quarter to the other, here is a year we are just spinning our wheels so far as making any progress. That is not because of inflation, Mr. Martin, that is because of failure to produce; is it not?

Mr. MARTIN. No, I cannot agree with you, Senator.

Senator LONG. Well, suppose we had produced substantially more. We would have had more to share and more for everybody to buy.

Mr. MARTIN. We have to come back to our price. If you could ignore prices it would be, perhaps——

Senator LONG. Suppose it had been a case of spending more and producing more. Suppose the automobile producers had more output, and the producers of household appliances had more, suppose we produced more automobiles, household appliances, homes, clothing, any particular thing you might want to mention in terms of consumer

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goods, and the people, having produced them, had proceeded to purchase them. We would not have this kind of showing of a falling off in real terms, inflation or no inflation; would we?

Mr. MARTIN. Well, you are completely ignoring the necessity though for using a portion of our income to come out of savings for the production of these items.

We cannot use bank credit or borrowed money for that type of productive——

Senator LONG. Let us get around to that in a moment, because you have discussed that at considerable length here, and you have enlightened us on that, perhaps, not enough, but I will learn more about that, I am sure.

But, for the moment, I want to talk about where we are going and whether we are making any headway.

Here we have a showing that during this last year, without any tax increase, mind you, income after taxes did not keep up with the increase in the population; did it?

That is, comparing this quarter to the same quarter of last year, is what I am talking about. That is the figure. I do not make those figures. Those figures are made by responsible people who are doing their job from day to day as conscientious Federal employees, I assume?

Mr. MARTIN. Absolutely. They do an excellent job.

Well, I think the cause-and-effect relationship which you cite and that I cite are just the opposite. That is the point.

Senator LONG. Let me ask you this: Does not that, plus what I have been saying about the gross national product, indicate a desirability of more consumer spending?

Mr. MARTIN. Well, but under the present demands for capital, I earlier this morning mentioned——

Senator LONG. Let us just leave the demand for capital out of it for the moment, because that might change the answer—and if so, why you are entitled to prove that. [Laughter.]

But if we just leave the demand for capital out and say, based on these facts, separating the demand for capital at the moment, does not the slow increase of gross national product and the actual reduction of per capita disposable income, without any tax increase—and that is the only calculation you make to find out what your disposable income is, you say, "How much did I make? What are my taxes, and how much have I left after taxes?" and that is disposable income—now, without any tax increase, with disposable income going down rather than up, and with our gross national product hardly expanding fast enough to meet the increase in population, does not that indicate that there is a desirability for more consumer spending?

Mr. MARTIN. No, not under present conditions, because you are taking out of this wheel——

Senator LONG. I asked you to separate this thing, that you want to explain, that makes all the difference, this price matter.

Mr. MARTIN. Well, the only point——

Senator LONG. This industrial expansion that you want to talk about, let us separate that for a moment. Let us just say that, based on those facts, without any reference to other things, standing alone without any reference to the industrial expansion problem, these trends are not desirable.

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Mr. MARTIN. Well, if I accept your hypothesis, yes.

Senator LONG. That it is desirable to have more consumer spending?

Mr. MARTIN. That is right, if I accept the hypothesis.

But again, the point I am trying to make is, where we disagree is, that we cannot stop it at a given point and isolate these things. This is a circle, you see, this turning around.

Senator LONG. Mr. Martin, it seems to me that you feel you are being led to an answer you do not want to give, and that you are afraid these facts add up to it.

Mr. MARTIN. No.

Senator LONG. Later on, as far as your argument about the industrial expansion and the inflationary pressures that that creates, we can look at these other factors, and I think we should. But here are the facts before us, and it does seem to me the answer is fairly clear and obvious, as far as this particular point about consumption is concerned.

I know you are not going to say it is desirable in peacetime to have a reduction in per capita consumer expenditures unless there is some major factor to account for that.

Mr. MARTIN. I think it is desirable.

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

Mr. MARTIN. Well, there again you are taking the wheel—if you could take any isolated point and project——

Senator LONG. You are the man who told it to me first. You are the one who told me here that you have less production because of people not being willing to buy, you say, at these prices.

I say, "Is it desirable to reduce prices?" And you say, "No."

"Is it desirable to increase prices?" And you say, "No," if I understand you correctly.

Mr. MARTIN. No. I think you are misquoting me a little.

Senator LONG. Let me ask a second question.

Do you say it is desirable to increase prices?

Mr. MARTIN. To increase prices?

Senator LONG. Yes.

Mr. MARTIN. No; I have not said it is desirable.

I say that the market forces are the ones that are going to control ultimately these price adjustments, and that neither you nor I can make them; that there you are up against the operation.

Now, if we could plan the economy in its entirety and ignore this problem of saving and investment, we could unquestionably just try to produce more goods, but the people want them at lower prices all the time. I just do not think you can do that in this production, consumption, and distribution scale.

Senator LONG. We will be through by 10:30 here if you will just give me the correct answer. [Laughter.]

All I am trying to get from you is just the answer as to whether or not it is desirable, one, to have a reduction in normal times of per capita disposable income where no tax increase has occurred from one year to the other; that means, after taxes.

Mr. MARTIN. Senator, would you object to letting Mr. Riefler comment on this?

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Senator LONG. That is all right with me, provided you will claim the answers as your own. It is all right with me, Mr. Martin.

Mr. MARTIN. I will claim it as my own.

Mr. RIEFLER. This is a computation of per capita income in constant dollars.

Senator LONG. That is completely correct.

Mr. RIEFLER. They take the total income and divide it by per capita. Then they take out estimated price change, and get per capita.

What it shows, if the figures are correct, and these are difficult things to get within fine margins——

Senator LONG. You are not going to accuse me of falsifying that thing, I know that. [Laughter.]

Mr. RIEFLER. No; but what it shows is less output per capita this year than last.

Senator LONG. You mean less income per capita.

Mr. RIEFLER. Less output.

Senator LONG. Both ways.

Mr. RIEFLER. So that would mean that productivity has fallen off.

Now, that would be a very serious thing. I really think that you probably will find the explanation in the difficulty of making these adjustments so finely.

But to say that productivity has fallen off during the last year, that is what it shows——

Senator LONG. It does show that.

Mr. RIEFLER (continuing). That would be a very serious thing, because it is our productivity increasing that all these growth trends we are talking about are based on.

Senator LONG. You are saying that if that is correct, it is not a desirable thing?

Mr. RIEFLER. If productivity is falling off, then we will not have growth trends. That is not due to lack of demand. I mean there is a general thesis that inflation impairs productivity. I do not really think that when you carry it all through——

Senator LONG. Well, we have had some of our greatest increases in production during some of our greatest periods of inflation.

Mr. RIEFLER. When you had slack resources.

This one starts with—well, you quoted 1942. There were slack resources.

Senator LONG. Take the years like 1942. By that time you had——

Mr. RIEFLER. Slack resources were still in existence.

Senator LONG. You had 14 million men in the armed services.

Mr. RIEFLER. But you were——

Senator LONG. And you started the war with 9 million unemployed, so you had to increase your labor force by about 5 million at the same time you were taking 5 million men more into the Armed Forces than you had in the unemployed when the war started.

Mr. RIEFLER. And you released an enormous volume of labor from the sheer process of distribution.

As the Government became the sole buyer or more nearly the sole buyer, there was a terrific release of personnel there.

Senator LONG. You also had tremendous increases during the year after that and the year after that, but you had inflation——

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Mr. RIEFLER. Yes.

Senator LONG. You had inflation, but you also had tremendous increases in your production at the same time.

Mr. RIEFLER. Yes.

You see, that is productivity—when you get into multiplying military items by millions of times, the productivity factor can come in quite fast, but that World War thing is a very different kind of business.

Senator LONG. This thing of having an inflationary year, a year of inflation, where you had so little increase in production, is a very unusual thing; is it not?

Mr. RIEFLER. Well, it is something that accompanies——

Senator LONG. Can you tell me when it happened before?

Mr. RIEFLER. It is characteristic of a hyperinflation, and it is a phenomena of a hyperinflation.

I would be very surprised if the final figures when they all get corrected, if they would bear this out, because what this seems to show is a decrease in productivity during the past year, and at a time when so much plant improvement has come in.

Senator LONG. It is a threatening sign; is it not? It is a bad sign.

Mr. RIEFLER. It would be a sign inflation was more widespread than I think it has been.

Senator LONG. Can you point to any other year when you had inflation and a reduction, a falling off of production at the same time?

Mr. RIEFLER. Oh, yes. That is usually true of all extended periods of inflation.

You see, people are not interested in producing the most efficient things. They are interested in making inflation profits, because when you actually get a reduction in productivity, there is an inflation profit involved.

Senator LONG. I am just trying to get the answer to this question, and so far I cannot seem to get it, which seems to me obvious enough, and we wander all over the lot, but there is never a direct answer to this question.

All I want to know is this: With 4 million people unemployed, our production increased——

Mr. RIEFLER. Three.

Senator LONG. Well, the last figure——

Mr. MARTIN. It is 4 percent you are quoting. It was 3 million.

Mr. RIEFLER. The number was 3 million.

Senator LONG. Let me now see whether it is 3 million. I am just referring to the last published figure. I understand it came down last.

Mr. MARTIN. Yours would be 3.3 million, then.

Mr. RIEFLER. 3.7 million.

Senator LONG. June 1957, 4.8 unemployed, seasonally adjusted, 4.5.

Did I say million, or percent? I thought I said it was 4 million unemployed.

4.8 percent unemployed, as of now?

Mr. RIEFLER. Yes. It is 4.2 in July.

Senator LONG. I do not have the July figure. I only have the published figure here.

I have been asking for it, but I have not been able to receive it; 4.2 percent unemployed, which works out to 3 million.

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Four and two-tenths percent unemployed, an increase in production slightly more than the increase in the population, and an actual drop, an actual decline in disposable personal income, would it be desirable to have additional consumer spending if that meant additional production?

Mr. RIEFLER. Well, those figures do not exactly jibe. They are a little inconsistent there.

Mr. MARTIN. I still come back, Senator, to the point that under current conditions, the real need is for savings, not for consumer expenditures.

Senator LONG. You are familiar with Prof. Sumner Slichter, are you not? You either know of him or you know him, one or the other?

Mr. MARTIN. Yes.

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

The figures—

which I assume refer to these figures we are discussing here—

The new figures show that the weak spot in the economy is now consumption, especially consumption of durable consumer goods—

and I assume that relates to automobiles, household appliances, and things of that sort—

and that this weakness exists in spite of a fairly good increase in personal incomes.

For more than 6 months the American economy has been merely marking time. Physical production in the second quarter of 1957 was virtually the same as in the first quarter, and between the last quarter of 1956 and the first quarter of this year there was only a negligible rise in physical output.

As a result, total physical production today is only about one-half of 1 percent greater than it was in the last quarter of last year. Industrial production is even less today than it was 9 months ago and is not even 1 percent greater than it was in the spring of 1956—in spite of large outlays by factories and mines on new plant and equipment.

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

But the fact that the American economy has made virtually no progress in increasing production for over 6 months shows that the number one economic problem is not inflation—it is the problem of restoring expansion to the economy by persuading individuals to increase their spending, thereby creating markets for a larger volume of production.

Do you agree with that statement?

Mr. MARTIN. No, I do not agree with it. He has got a billion dollar error in there. That is not terribly important, but it is true, but I do not agree with the statement at all.

There is an answer to it from a life-insurance president today that I think is rather good. He says:

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

Senator LONG. Let me ask you this question: Do you think a life-insurance president can be an unbiased witness?

Mr. MARTIN. This is from an economist.

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Senator LONG. I thought you said he was a life-insurance president.

Mr. RIEFLER. He was an economist and a professor of economics a few years ago, and he has become the president of this life-insurance company.

Senator LONG. He is president now. He is not their economist; he is their president.

Well, I repeat the question, do you think that the president of a life-insurance company can plead from a position of an unbiased witness in this situation?

Mr. MARTIN. I think so. I think he has got——

Senator LONG. Do high interest rates substantially increase the income of a life-insurance company?

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

Senator LONG. Nor has anybody more concern about the increased rates, do they?

Mr. MARTIN. No, I do not think that follows, Senator. I think the No. 1 problem for a life-insurance company, is making good——

Senator LONG. You say the witness would not be biased; that the increase in his income would not relate to his judgment?

Let us go ahead and hear the rest of it.

Mr. MARTIN (reading):

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

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

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

Senator WILLIAMS. May I break in for a moment?

Senator LONG. Yes.

Senator WILLIAMS. I would just like to make the observation that this letter was written by one of Delaware's outstanding economists.

Senator LONG. That may very well be.

I know the cigarette people hired themselves a mighty fine doctor to testify that cigarettes cannot give you lung cancer—and he said it was not conclusive, after he made a study of the findings.

I would like to put Dr. Slichter's letter in here.

(The letter from Dr. Slichter follows:)

[New York Times, August 8, 1957]

FALL IN CONSUMPTION NOTED

STIMULATING SPENDING DECLARED OUR PRIMARY ECONOMIC PROBLEM

The writer of the following letter is professor of economics at Harvard University. He is the author, among other works, or What's Ahead for American Business?

To the EDITOR OF THE NEW YORK TIMES:

The figures on the state of the economy in the second quarter of 1957, recently released by the Joint Economic Committee, show important changes that should be of interest to businessmen and Government policymakers. The new figures

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show that the weak spot in the economy is now consumption, especially consumption of durable consumer goods, and that this weakness exists in spite of a fairly good increase in personal incomes.

For more than 6 months the American economy has been merely marking time. Physical production in the second quarter of 1957 was virtually the same as in the first quarter; and between the last quarter of 1956 and the first quarter of this year there was only a negligible rise in physical output.

As a result, total physical production today is only about one-half of 1 percent greater than it was in the last quarter of last year. Industrial production is even less today than it was 9 months ago and is not even 1 percent greater than it was in the spring of 1956, in spite of large outlays by factories and mines on new plant and equipment.

ACCOUNTING FOR LULL

The present lull in business was originally brought about by the wise decision of many enterprises to reduce their inventories. But this cause does not explain the continuation of the lull through the second quarter of 1957.

The unsatisfactory production record in the second quarter occurred in face of the fact that industry was producing more than it was selling, with the result that the physical volume of inventories rose in the second quarter by $1.5 billion a year.

The crux of the difficulty has been the reluctance of consumers to spend their growing incomes. Personal incomes after taxes rose by $4.2 billion a year between the first and second quarters. But personal consumption expenditures increased by only $1.1 billion a year and buying of durable consumer goods actually dropped by $900 million a year.

The small rise in consumer expenditures was not enough to offset the rise in prices, so that Americans actually consumed a smaller physical volume of goods in the second quarter than in the first.

INDUCEMENTS TO BUY

Sooner or later Americans will undoubtedly spend nearly all of the increase in their growing personal incomes. But at the moment, many consumers are evidently paying off old debts while waiting for industry to offer better goods at more attractive prices.

The job of getting individuals to spend a larger proportion of their incomes, and thus ending the present stagnation of the economy, is obviously not one that the Government can do. Only business firms can persuade people to spend a larger proportion of their incomes.

But the fact that the American economy has made virtually no progress in increasing production for over 6 months shows that the No. 1 economic problem of the country is not inflation—it is the problem of restoring expansion to the economy by persuading individuals to increase their spending, thereby creating markets for a larger volume of production.

SUMNER H. SLICHTER.

MADISON, WIS., *July 31, 1957.*

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

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

Senator LONG. Since you mentioned that subject of increased savings, do you believe that it would be desirable to increase consumer savings even in order to finance plant expansion, even though this means a considerable reduction in consumer spending resulting in a considerable reduction in production of consumer goods at a time when we have a large amount of industrial expansion, that is, industrial facilities, to spare?

Mr. MARTIN. I do not think we have a large amount to spare. I think you have got to recognize the size of this economy.

Senator LONG. Let us consider this.

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Here we are producing 2 million automobiles less than we are capable of producing. We are producing far less than we are capable of producing in terms of household appliances.

We are producing 20 percent less houses than we are capable of producing, and real income is not increasing because the public is not buying, and you pointed out yourself that seems to be one of the reasons it is not increasing.

Do you really feel that, even if it means that there should be a further reduction in real income—that it, income after taxes, income of the individual—we should nevertheless try to take from consumer spending additional savings, even though that means a reduction in production and a reduction in personal income?

Mr. MARTIN. I do not think it would mean either of those, Senator.

I think that the problem here is the turn of this wheel that we are talking about. Now, I put down here in my statement, and I will stand on it, that the volume of savings and investment permits continued expansion of productive facilities at a rate consistent with growing consumption demands.

Now, this population is growing——

Senator LONG. Let us just refer to that statement for a moment since you want to use that.

You say you are talking about permitting us to expand our plant and equipment, as I understand it, relative to consumption demand; is that correct?

Mr. MARTIN. Well, your problem here is that people have to—there is a time element in it, with a growing population and a growing consumption demand——

Senator LONG. That is just it. There is no growing consumption demand. You are the one to say that here it is lower than it was on a per capita basis, and it ought to go still lower.

Mr. MARTIN. No; we are talking now about real income.

Senator LONG. That is right, because if you use the inflated figures, it looks as though it might have increased, but it has not.

Here we are at a standstill, showing the actual reduction in per capita income in terms of real dollars—that is, in terms of constant dollars—and here you are saying that it would be good to further reduce it and that this would meet growing consumer demand.

I do not understand that. There is growing consumption demand, I believe is the term you used. Well, it is not growing; I mean, it is getting less rather than more, according to this.

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

Senator LONG. Well, now, let us just look at this for a moment.

If you make additional funds available for the expansion of these plants and facilities, then you must have more funds available to purchase more goods and commodities than are being produced today; must you not?

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

Senator LONG. Let us take it step by step.

Mr. MARTIN. There is no other way to do it.

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

Mr. MARTIN. No.

Senator LONG. Didn't you?

Mr. MARTIN. No, I have never said that.

Senator LONG. Did you not make this statement here that this failure to expand our gross national product to any considerable degree, and this failure to increase our per capita total income, related to the fact that consumers were not willing to buy at present prices?

Mr. MARTIN. Do you want to comment on this, Mr. Riefler?

Mr. RIEFLER. Yes.

He brought in the fact that when you talk about a specific line, like automobiles or appliances, or something where you have more capacity than current demand, you must remember that there the consumers were not buying that larger output, potential output, because possibly of a price factor. But, for the total situation, not at all. The point, in general, is that the labor force, employed labor force, is very much larger than ever.

We do have output at capacity. Now, some of these things are curious.

One of the things that has happened this last year apparently is a tremendous or a very appreciable shift in demand toward services.

If you look into the employment figures, it is the service sector where the growth of employment is.

If you look at the price series, it is the service component where prices are going up faster. So that it looks as though there is a shift toward the services in what the consumer is demanding at the present time.

Now, it may be that that helps explain your other dilemma also.

It may be true—and I do not know this—it may be true that productivity has not increased in the provision of services as much as it has in the output of factories. It is in the output of factories that you get the effects of the new machines, increasing productivity.

Senator LONG. Well, productivity has fallen off because of lack of demand for the product.

Mr. RIEFLER. No.

Senator LONG. Lack of money to buy it, one way or the other.

Mr. RIEFLER. The consumer is spending his money, and prices are going up. There is no question that prices are high. Prices could not go up unless they were spending.

Senator LONG. You are producing 20 percent less homes.

Mr. RIEFLER. But the prices are up.

Senator LONG. At their peak.

Mr. RIEFLER. The prices are up.

Senator LONG. I know prices are up.

Mr. RIEFLER. That shows that people are spending their money. Prices could not go up if people were not spending their money.

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Senator LONG. But they are buying less.

Mr. RIEFLER. Because the prices are higher.

Mr. THOMAS. They are buying less in constant dollars.

Mr. RIEFLER. They are buying less in constant dollars, but not less in actual dollars. It may be that these figures that show a decrease in productivity, after correction for price changes, may represent a shift of demand to an area where there has been less increase in productivity. The thing you were bringing up earlier about 1952 or 1953, and the last part of 1951, where you had this abnormally low percentage of unemployment at a time when prices were not rising, that was a period in which you were getting a very rapid increase in the efficiency of merchandising, that was the period in which the discount house was coming in, and that sort of thing, cutting the distributive margin, and part of the fact, part of the explanation, of that period that you could have rapidly rising wages without a reflection in prices, was the increase in the efficiency of distribution that was taking place.

Now, at the present time, these figures sort of seem to indicate that you are getting a reverse effect in the efficiency of distribution; that as demand shifts toward services from factory output, you get—when you divide through you get a general productivity factor, you get a decrease in per capita income in constant dollars. That may be an explanation.

Senator LONG. Well, you can answer this question if you want to, or your assistant can, but my impression is, perhaps, we are talking about a different definition of productivity.

To me, when you have got the ability to produce 20 percent more houses than you are producing, the definition that I would ordinarily use of our productivity would not cause me to think——

Mr. RIEFLER. Physical output per capita.

Senator LONG. You are not able to sell them or move them. But you certainly have the ability to produce them.

Mr. RIEFLER. People are always shifting their demands, according to what it costs. They could buy houses or vacations. This year they are buying more vacations than ever before, even though they are buying less houses.

Senator LONG. If you look at the overall figures, they are very revealing. The overall figures are, so far as personal consumption is concerned, show that it has not expanded the way that you would expect it to, even when you include your increased purchase of personal services in there.

Mr. RIEFLER. Well, the necessity for increasing savings to finance these larger capital expenditures, must necessarily be reflected in a decrease in the rate of expansion of personal spending. That is just mathematics.

Senator LONG. Well, the hour of 12:35 having arrived, Mr. Martin, I assume——

Mr. MARTIN. I have plenty of time.

Senator LONG. I was hoping we would be through at this time, but I still have several things I had hoped to get to, and I hope we will be able to cover them tomorrow in, perhaps, a half hour or so.

Mr. MARTIN. I will see you at 10:30?

Senator LONG. We will recess until 10:30.

(Whereupon, at 12:35 p. m., the committee recessed to reconvene on Friday, August 16, 1957, at 11:25 a. m.)

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INVESTIGATION OF THE FINANCIAL CONDITION OF THE UNITED STATES

FRIDAY, AUGUST 16, 1957

UNITED STATES SENATE,
COMMITTEE ON FINANCE,
Washington, D. C.

The committee met, pursuant to recess, at 11:25 a. m., in room 312, Senate Office Building, Senator Russell B. Long presiding.

Present: Senators Byrd (chairman), Long (presiding), Carlson, Bennett, and Jenner.

Also present: Winfield Riefler, assistant to the Chairman, Board of Governors, Federal Reserve System.

Elizabeth B. Springer, chief clerk; and Samuel D. McIlwain, special counsel.

Senator LONG. The committee will come to order.

Mr. Martin, I would like to talk a little bit about the independence of the Federal Reserve Board. You made the statement in your prepared statement that the Federal Reserve Board apparently had an obligation to follow the administration with regard to administration policies, and that it was not independent of them, but that it nonetheless exercised its own independent judgment with regard to the way that those policies should be implemented. Would you elaborate upon that, as to your understanding of the degree to which the administration fixes its policy with regard to employment, and with regard to direction of our economic and fiscal policies, and the degree to which the Federal Reserve Board exercises its judgment?

STATEMENT OF WILLIAM McCHESNEY MARTIN, JR., CHAIRMAN, BOARD OF GOVERNORS, FEDERAL RESERVE SYSTEM—Resumed

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

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

Mr. MARTIN. That is right.

Senator LONG. To adopt policies that may not be the policy of the administration itself?

Mr. MARTIN. That is right.

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

Mr. MARTIN. Well, I wouldn' say that—we will discuss it at considerable length.

Senator LONG. You have the right to disagree with them?

Mr. MARTIN. Exactly.

Senator LONG. And you believe that the Federal Reserve Board, if it does disagree, has the right to pursue a policy that is completely contrary to the policy that the administration proceeds to follow, not meaning that you are doing this or that you have done it, but that you feel that under the law you do have that right?

Mr. MARTIN. Under the law we feel it is our prerogative; yes, sir.

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

Mr. MARTIN. That is right.

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

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

Senator LONG. Yes. Has the administration of recent date, the spokesmen for the Treasury Department or the President in any other capacity, been urging you to take a position or adopt a policy contrary to the one that you have been pursuing?

Mr. MARTIN. Well, over the last year there has been no pressure, Senator, such as saying, "If you do not follow this policy, we will drop you out of office."

They have tried on a number of occasions to persuade us that we should not take action which we did take, but it was a perfectly friendly discussion and honest disagreement, not about broad policies so much as about timing and judgment with respect to whether it was a wise course for us to pursue under present conditions.

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

Mr. MARTIN. Well, I think the most glaring instance of that was in April of 1956. Pursuing our method of cooperation, I began discussions with Secretary Humphrey. In February of that year Governor Balderston and I had a meeting with Secretary Humphrey and there was a disagreement as to the nature that the economy was developing. We were so convinced; we discussed it with various people, and in a series of meetings from about the middle of February until the last week in March.

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By the last week in March the position in the Federal Reserve—which was not a 1-man operation; you see, the 12-bank directors were considering all aspects of this—was that it would be wise for us to go up in the discount rate.

I think Secretary Humphrey subsequently testified that his judgment, at that time, was that the timing was poor, but that he was not opposed to the long-run objective.

We finally reached a point where there was no meeting of the minds that could be had, and there was nothing for the Federal Reserve to do except to go and act. And we acted.

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

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

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

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

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

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

Senator LONG. As of yesterday, the Government paid more than 4 percent interest on their 90-day indebtedness?

Mr. MARTIN. That is correct. The rate was 4.17.

Senator LONG. 4.17?

Mr. MARTIN. Yes.

Senator LONG. Can you tell me when was the last time that the rate on a 90-day indebtedness was that high?

Mr. MARTIN. To be correct, it should be noted that this 4.17-percent issue was not for 90 days—it was 237 days.

Senator LONG. 237 days?

Mr. MARTIN. Right. We will have to look up the "last time." It has been a number of years.

Senator LONG. Do you have any off-hand recollection, just an impression that you could give us, for the moment, how long back it has been since you paid that much?

Mr. MARTIN. It would be probably in the 1930's. Mr. Riefler says the newspaper account said 1933. We haven't checked it. We will check it and give it to you for the record.

(The information referred to is as follows:)

On March 6, 1933, a 93-day Treasury bill was auctioned at an average interest rate of 4.26.

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Senator LONG. That is an extremely high burden for this Nation to assume, to pay interest at that level, is it not?

Mr. MARTIN. It is a high rate; yes, sir.

Senator LONG. And if we had to refinance our entire national debt, recognizing that the long-term bonds draw higher rates than the short-term obligations, do you have any idea as to how much that would increase the cost, so far as the interest charges on the Government debt are involved?

Mr. MARTIN. I haven't, Senator. You see, you cannot say that the long-term rate will be or become the overall rate, but what we are dealing with here is a rate that may well be the high for a long time to come. It also may not be. But by and large if you are talking about refinancing the whole debt and making an estimate of the cost, you are making a projection of a rate of activity and a flow of spending in money that just may not be in existence a year from now.

Let me just close on that by saying that this particular rate was not set by the Treasury. It was bid for in the open market.

Senator LONG. Let us just return to some of the matters we were discussing yesterday, with regard to this item of inflation. I didn't expect the point to be made yesterday, when I said that per capita personal disposable income has declined in the second quarter of 1957 as against the first quarter of 1956, and when you suggested that Mr. Riefler should comment on that subject, that the slowdown of production might be explained and that the actual decline of per capita income might be explained on the basis of a decline in productivity. I do not think that was the cause in any respect, and if you are at all under that impression I believe we ought to nail it down right here and now.

I have prepared a statement on that subject, which I think it might be well for you to read. You might read it, and then I will read it to you, because I think it analyzes this subject matter. I do not believe it leaves any doubt whatever, and I have the facts here to prove it, that there has been no decline whatever in productivity.

Productivity is the output per man-hour worked, and therefore productivity is a measure of efficiency or technology. If the slowdown in total output and the corresponding decline in per capita consumption was due to cessation of growth in productivity, then we would not have the steep increase in unemployment, the virtual abandonment of the overtime worked, and the greatly excess plant capacities in almost every major line.

All of these trends show that productivity is continuing to increase.

But total production is not increasing accordingly, with consequent unemployment of manpower and of plant, because consumer demand is not growing rapidly enough to make full utilization of the increasing productivity.

It is just because productivity is increasing that we have the economic power to continue to raise the standards of living, and it is just because productivity is increasing that the only alternative to a corresponding expansion of production and consumption is rising unemployment, unused plants, and ultimate recession.

I cannot understand the confusion on the part of the Federal Reserve Board as to the distinction between productivity and production.

Is there any inclination on the part of Federal Reserve to believe that there has been, or is a decline in productivity?

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Mr. RIEFLER. I think I stated I doubted whether it was that. What I said was that there had been a shift toward services in the expenditure of disposable income, and it might be that that would have that effect in the aggregate.

It might be that services had not been increasing their productivity over the past year. I questioned the validity of the whole position in using statistics quite so finely as they were being used. Statistics actually show that there was a very big increase in money demand over the past year, even on a per capita basis. It increased from $1,703, did it not, to $1,754?

Now, that is an increase in money demands. It showed that money demand was much larger even on a per capita basis than last year.

Senator LONG. First, let us settle this matter of productivity.

Mr. RIEFLER. I think I said I doubted whether productivity had decreased. I doubted if the figures showed that.

Senator LONG. You suggest that might explain——

Mr. RIEFLER. I said——

Senator LONG. That that might explain the fact the disposable income on a per capita basis has declined. I would like to ask Mr. Martin.

Mr. RIEFLER. Disposable income is not down. It is only when you divide it by the price index that you find a decline. The figures say here disposable income, per capita income, has increased from $1,703 to $1,745. That is what the figures show.

Senator LONG. We will have to go back to page 6 of the economic report.

Mr. RIEFLER. Disposable income, second quarter 1956——

Senator LONG. Do you want to take credit for the inflation—I take it?

Mr. RIEFLER. Disposable income has increased.

Senator LONG. Disposable income?

Mr. RIEFLER. On a per capita——

Senator LONG. Measured in terms of constant dollars?

Mr. RIEFLER. Then you are taking——

Senator LONG. Listen, just wait until I ask a question, and after I ask the question, answer. It is more difficult to direct a question toward Mr. Riefler because Mr. Riefler insists on talking while I am talking. After I get through asking my question, answer.

I am trying to examine the Chairman of the Board. If you want to comment on it, that is all right, because you are the one that suggested here that there was a decline in productivity. The Chairman said he would accept your statement.

It seems to me that is one of the worst misstatements you have made yet, but let me just nail this down. Here is page 6, where we have the computation of per capita disposable income, and those who prepared it in about three different places in the Economic Indicators have gone to the trouble of calculating it by making the correction to allow for inflation, or deflation. So that you can look at the thing in terms of constant dollars.

That is why we have this second column on per capita, one in terms of current prices which can be completely misleading because it does not take into account inflation which has occurred or deflation that might have occurred in one period against another.

Then a second column is prepared for a very good reason, so you can see what happened in terms of constant dollars, what hap-

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pened allowing for the difference in purchasing power. There you have in the second column, which I put in the record some time ago, your second quarter figure of the personal disposable income—second quarter 1956, $1,703, second quarter 1957, $1,705, which is an actual decrease. That takes into account increase in population; it also takes into account inflation as it occurred during the last year.

Now, it was you who suggested, Mr. Riefler, and the Chairman adopted that as his answer, that perhaps this could be explained by a decline in productivity. I think that we better dispose of that to see if there is any decline in productivity. You suggested it. You did not offer any support of it, other than to talk about services. I think we had better get the facts in the record on productivity.

Here is one phase of it, but first I think we ought to put in the record the figures on productivity so far as labor is concerned. Here at page 148 of the report of the Joint Economic Committee, 85th Congress, 1st session, is the record of the output per man-hour in manufacturing. And I will make these figures available to you here: from an index of 111.6 in 1951, based on 100 as of 1947 to 1949 average, the index rose; 1952, 115.3; 1953, 119.7; 1954, 123.6; 1955, 130.0; 1956, 133.5. And the information I have is that from early indications in 1957—the figures are not yet available—it will show a continuing increase. There is a steady increase in productivity so far as man-hours in plants are concerned. Here is the record so far as production per man-hour in agriculture, which shows a similar increase.

And I will put these two tabulations in the record, and those are taken one from page 148 of the Economic Report and the other from the Department of Agriculture.

That indicates a steady rise in productivity per man-hour of labor, does it not?

(The tabulation referred to is as follows:)

Output per man-hour, manufacturing (Joint Economic Committee, June 1957, p. 148)

[1947–49=100]

1951	111.6	1953	119.7	1955	130.0
1952	115.3	1954	125.6	1956	133.5

NOTE.—Early 1957 figures indicate much faster gain than from 1955 to 1956.

Real output per man-hour (Department of Agriculture)

[1947=100]

1951	120.4	1953	132.9	1955	149.7
1952	125.7	1954	143.9	1956	154.8

NOTE.—Based on (1) agricultural private product, as appearing in President's Economic Report, p. 126; and (2) adult male workers in agriculture, appearing at various places in Department of Agriculture publication entitled "Agricultural Production and Efficiency."

Mr. RIEFLER. So far as these industries covered by the computation is concerned, yes.

Senator LONG. One covers "all manufacturing" and the other covers "all agriculture," and that I think pretty certainly indicates, so far as all manufacturing and all agriculture is concerned, there is a steady increase in productivity per man-hour.

Here is an article from Business Week, July 13, 1957, which is pretty current, which shows that "Output lags as capacity grows," with regard to practically every major industry. In fact, this general

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statement is made with regard to industry, and I would like to read an excerpt or two from it:

Industrial production is down, industry's productivity is up, and the growing gap between the two is made up of expensive manufacturing plant that isn't fully used, some of which may be obsolescent and expensive to operate, perhaps, but unused nevertheless.

In a few industries, the gap has been growing for more than a year. In most, it has increased largely in the last 6 months. Before the beginning of the year, the chief factor causing the growth in the gap was rapid addition of extra productive capacity. But, since the beginning of the year, while industry has kept adding to its capacity, production itself has slipped.

Is that in accordance with your understanding of the economic facts of today? I will ask Mr. Martin that.

Mr. MARTIN. That production has slipped? It slipped slightly on our index, but not on the longer run. We could put into the record our general index, but we have just readjusted our index for June, I think to 144, which is about 3 points higher than a year ago. It is about three points higher than a year ago.

Senator LONG. Is that after allowing for the price increase—that is after you allow for inflation, I take it?

Mr. MARTIN. That it is real?

Senator LONG. That is in terms of dollars.

Mr. MARTIN. It is in real terms—actual physical output.

Senator LONG. Let me just go forward with this:

Industry generally prefers to operate in normal times—periods other than war and similar emergencies—at about 90 percent of productive capacity. The extra 10 percent of its plant is normally under repair or in reserve. But since the end of 1956, industry's overall production has slipped from an estimated 85 percent to 81 percent of capacity.

Does that accord with your understanding?

Mr. MARTIN. Well, I do not know on the precise figures, Senator, but production has held at a very high level. I do not think that there can be any doubt of that.

Senator LONG. How about the unused capacity—do you have the impression at the present time we have more than a normal amount of unused plant capacity?

Mr. MARTIN. No, I do not think we have more than a normal amount of unused plant capacity. I think the situation is one in which the people are trying to spend more than they have, which means there is demand for more goods than in the aggregate is available. That is the controlling factor. Otherwise, we would not have the constant price rises that have been going on.

Senator LONG. I think we should make this correction, between discussing a genuine classic inflationary situation such as occurs in wartime, and the type of situation that we have now. In wartime, we have business requiring funds and making expenditures, we have Government requiring expenditures, enormous expenditures for war purposes, and we also have consumers requiring funds and making expenditures.

The demand becomes so excessive that you simply do not have enough production available to meet all of those requirements. And that is the situation such as we had back during World War II, where the productive facilities were simply not able and not capable of supplying goods to meet all of the enormous amount of purchasing

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power that was being turned loose, and we made every possible effort to build up savings on that basis, consumer savings, to postpone purchases until the time when the productive facilities were available to meet consumer demands.

By contrast, this situation that we have now is one where the requirements of business, and I can include all industry in that, consumers and Government, are not in excess of productive capacity, in fact, are far below our productive capacity. And the figures are here to demonstrate it. Can you appreciate the difference between those two situations?

Mr. MARTIN. I appreciate the difference between the two situations, but I cannot agree with you in your analysis of the current situation.

I think we have obviously a situation where the cost of living has risen for 10 consecutive months, and where prices are moving upward.

Senator LONG. Right.

Now we are trying to explain that. We are trying to see what is causing it.

Yesterday we did dispose of one thing. I hope we are going to dispose of all of them. But yesterday we did dispose of one. The current inflation is not caused by shortage of labor, that is, by a general shortage of labor. And I thought we disposed of that.

What I am trying to settle now is whether the inflation is being caused by any shortage of productive capability or productive plant and facilities, plant and equipment. And here is a general statement from Business Week. Let me read specifically, and see if this accords with any of your understanding of any of these industries:

> Steel mills worked at about 87 percent of capacity through the first half of the year—

that would mean, I take it, this year—

> though the rate has been around 80 percent lately. (The preferred rate: 96 percent.)

There they are producing at 80 percent, when the preferred rate is 96 percent. Is that in accord with your understanding?

Mr. MARTIN. I do not know enough about the steel industry to know what the optimum rate of production would be. But, of course, it takes—it costs more money to increase your production, and in terms of a situation that we are dealing with today, there is no inadequacy of purchasing power. The inadequacy is this: demand, the total demand, including the demand for new plant and equipment capacity—that is part of the spending stream here, is above our available rate of savings.

Now, the money supply we have kept rising.

Senator LONG. Let us check this answer as you make it.

You have made a statement here with which I find myself in disagreement. You say there is no inadequacy of purchasing power. Let us apply that to the steel industry.

They are operating at 80 percent of capacity. Their preferred rate is 96 percent. Do you contend on that basis that there is adequate purchasing power to move from the market the articles for consumer use that the steel industry is capable of producing?

Mr. MARTIN. Unless you increase the prices across the board. You cannot get away from the fact that the cost of living is persistently

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rising, and disposable personal income made a new high, I think, this last month. I have not checked it.

Senator LONG. You say "disposable income." Well, did it make a new high in real dollars?

Mr. MARTIN. Well, one of the problems is that the dollars do not buy as much as they did before. I do not know the figures, but that is really what the problem is, and——

Senator LONG. Per capita disposable income has not increased. I do not think you want to take credit for any increase in disposable income based on inflation that has occurred, when the fact of the matter is that in terms of constant dollars the income has actually gone down.

I do not think you would want to give the public the impression they are better off, when they are actually worse off, would you?

Mr. MARTIN. I certainly do not; that is why I am so against inflation.

Senator LONG. So if we look at it in real terms, it is down as of the last figures we have; and if you have any figures which would indicate in real terms it is now up above, to an all-time high, I would like to have those figures available. I have not seen them.

Mr. MARTIN. We will get you the last figures on disposable personal income. But the overriding problem that we are dealing with is one where prices persist in rising, where there is adequate purchasing power, in my judgment, unless you want to say that people should just borrow—this is borrowed money we are talking about here in large measure.

Senator LONG. Here is the point we are trying to settle at this moment: Whether there is any inflation—whether inflation is in any degree being caused by the inability of this country and its factories and labor to produce sufficient goods to meet consumer demand.

Now, we have gone over the labor situation. There is adequate slack in the labor supply. Now we are looking at the steel industry, which is capable of producing, in fact prefers to produce, at 96 percent, and is now producing at 80 percent.

The question is, Can you say with regard to that industry that there is any inflationary pressure because of the inability of the steel industry to produce to meet the demand of consumers?

Mr. MARTIN. Well now, a year ago there were definitely shortages in some lines of steel, and this thing has been going on for about a year.

Now, I cannot accept completely the statement that there is no labor shortage. We discussed skilled labor yesterday, and I think the labor situation is better today than it was a year ago. But I do not think you can completely say you can get all of the labor you want, if you want to increase production, or plant and equipment capacity, unless you want to bid that labor at a price away from someone else, today.

Senator LONG. You are the person who made the statement that, with regard to the housing industry, production was down 20 percent; but that, looking at the overall situation—and you said that the Board had to look at the overall situation—that construction as a whole——

Mr. MARTIN. That was in the building industry.

Senator LONG. It was down. Yes. You were looking at the overall problem. You said it was your responsibility to look at the overall problem.

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Is it not your responsibility equally to look to the overall problem as far as employment is concerned? On the whole, you have got more slack in employment than you have had for quite a while, and you certainly have got more slack in employment than you had back during noninflationary years or when the inflation was 1 percent or less.

Would not your statement about looking at the overall have the same logic applied to the labor situation that it would have applied to the construction industry?

Mr. MARTIN. I just would like to make one comment on the low level of unemployment with stable prices. That is one of the points, it seems to me, that confirms the view that I have expressed here, in my opening statement—that unemployment is not necessarily the alternative to stable prices, as is frequently said by some people.

I think we can have the two, but we have to recognize both job opportunities and the situation of fixed-income people, and we have got to have a stable dollar so that the saving-investment process can be continued.

Now, the plant and equipment expenditures are still going ahead at an amazingly high rate, and it is the inadequacy of saving to finance those that is causing us our basic trouble at the moment.

Senator LONG. I do not want to just wander off into these fields, before we pin each point down. I find if we do not watch out, we never solve anything, and never get the information that we are seeking, unless we stick to each point until we settle it.

And the question—perhaps you have attempted to answer it, but I do not believe you have given me a direct answer to the question—is whether, with the steel mills operating at 80 percent of capacity as against an optimum rate of 96 percent, which apparently seems to be the most desirable rate for operation of the steel industry, there is any general or even any considerable inflationary pressure with the steel people operating that far below their capacity.

In other words, can you say that we have inflation in the steel industry because the steel people cannot produce enough steel to meet the demand at a time while they are operating at 80 percent of capacity?

If you want to say that, go ahead and say it, and we will pass on to the next point. But I just do not see how you can make that conclusion.

Mr. MARTIN. I do not know what, as I said before, the optimum rate of steel production is, but——

Senator LONG. You know it is well above 80 percent, do you not?

Mr. MARTIN. No, I do not. I think you have got to relate it to the market for their products, and to the cycle. When I point out that a year ago or a little over a year ago there were any number of steel items that it was virtually impossible to acquire, and then——

Senator LONG. Did you not say in your statement that bottleneck had been broken?

Mr. MARTIN. Why, certainly that bottleneck has been broken, but let me point out we lost over $10 billion in inflation in the interim. That is one of the adjustment problems we have to deal with.

I was just coming back to the point that I think it is very significant that from 1955 to 1956, we lost over $10 billion in a mere markup of prices, without any additional goods and services being supplied to anyone, which seems to me quite a serious situation.

Senator LONG. That is not the question I asked, Mr. Martin.

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Mr. MARTIN. But it bears directly on the question, in my judgment.

Senator LONG. It perhaps bears on it, but the question I asked was: As of this date, with the steel industry operating at 80 percent, and assuming the correctness of this Business Week statement here that the desirable rate is 96 percent of capacity, do you see any reason there to believe that there is any inflationary pressure upon our economy——

Mr. MARTIN. Well, now, Senator——

Senator LONG. In the steel industry?

Mr. MARTIN. Yes. Let me say this: I do not want to appear evasive or to be ducking your question. That is not my point at all here. But I really do not think you can pinpoint a given point in the business picture and say that as of this point a given industry is not operating to its full capacity.

It has got to be related to the whole business cycle, the whole business principle.

Senator LONG. We are getting ready to do that, but it seems to me we first have to settle this one. In fact, the steel industry is so important that it is the one on which the Government keeps productivity figures, and attempts to keep them in terms of constant dollars and for various analysis purposes.

That is the reason, perhaps, why Business Week leads off with the steel industry. The Government tries to keep figures on it, so does Business Week, because this is one of the principal industries, one of the basic industries, and one of the largest, which is oftentimes the bell cow as far as the trends in employment, industry, and financial conditions are concerned.

Mr. MARTIN. Right.

Senator LONG. So that is the reason I asked you about the steel industry first.

I have some information about some of the others, but I would first like to get your answer with regard to the steel industry.

Mr. MARTIN. Well, I can only say——

Senator LONG. That, standing alone. You say it would not be safe to generalize. Let us just take that one and recognize it is not safe to generalize.

Mr. MARTIN. All right. I say I do not know what the capacity situation in the steel industry is at the moment in relation to the business cycle.

Now, steel was subjected to terrific pressure in late 1954 and early 1955 by the upsurge of automobile and housing expansion, along with all the other demands.

Senator LONG. But during those times—there you say you had great pressure on the industry, and during those times we had no particular inflation, did we, in 1954 and 1955? The steel industry apparently met that demand against considerable pressure, but we had no general inflationary situation did we?

Mr. MARTIN. Well, it is pretty hard to pinpoint—I think we certainly had an excess that was created then.

You must remember that we had an expansion. We had not only the wage-cost-price push, but we had the record levels of consumer credit and mortgage credit going on coincident with that. We had full employment.

And then, on top of that, we superimposed an unprecedented expansion of plant and equipment, and as that gathered momentum it

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developed this spiral that we have been discussing here. Otherwise, we would not have any problem.

Now, I think it would be nice, I mean if you want to take this thing, and say in 1953–54, if the Government just kept cranking out money, we would not have had any recession in 1953–54.

The point I have been trying to make is that it would be nice if we had some magical formula or device by which we could crank this thing up or crank it down. We would have discovered it a long time ago if we had it.

But when waste and extravagance and incompetence and inefficiency come into the picture, they have to be adjusted for from time to time. To just increase the money supply when you have rising prices—and the cost of living is our major economic problem, in my judgment, at the moment—when you have that cost of living going up, to suggest that you just add to the money supply just compounds the problem, as I see it.

Senator LONG. Mr. Martin, were you an attorney before you went with Government?

Mr. MARTIN. No, I am not an attorney, and I am not an economist, Senator. I just have worked, as you have——

Senator LONG. I just asked that question because I sometimes gain the impression it is more difficult to get a direct answer from an attorney than almost anyone else that you have testifying before committees, especially if you just ask a simple question where you want a simple answer.

And if you are in position to supply the facts, and all I am asking you to answer is just the question of whether there is any inflationary pressure—and I would be satisfied with a general answer from you—assuming the correctness of these figures that steel is operating at 80 percent capacity with 96 percent being their preferred rate, if there is any inflationary pressure in any general sense because of the inability of the steel industry to produce to meet consumer demand?

Mr. MARTIN. To produce at a price so that the consumer will take it, yes, I think there is still inflationary pressure in steel.

Senator LONG. Well, I have been trying to analyze that statement.

Mr. MARTIN. Could Mr. Riefler——

Senator LONG. On yesterday—let me just make this statement.

On yesterday, you understood to explain the failure of consumption to expand adequately in real terms by saying that there was not enough buying power at current prices.

This is another way of saying that there would have been enough buying power, but not in an inflationary amount, if prices had not risen.

If this is the case, why did prices rise? This illustrates the very point I was making, namely, that prices did not rise because of excessive consumer expenditures or consumer buying power. The Federal Reserve Board introduced the price factor in a way that put the cart before the horse.

The fact is, and it is the only point that I was making and am making now, that prices rose although consumer buying power at the lower level was not imposing an inflationary strain upon productive capability, and consumer prices are still rising even now, when consumer buying power at the current price level is far short of productive capabilities.

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I thought that over sufficiently so that I thought, after I dictated it, I decided to read it back a time or two for my own purposes, and I would like for you to read that statement, and Mr. Riefler can read it, because that, to me, is a problem that we are facing, it seems to me. You are finding a different way of saying the same thing I am saying, and thus giving the answer I am seeking to obtain from you.

Mr. MARTIN. Could he make a statement first?

Senator LONG. If you do not mind, I would like for you to answer that, and if you want to, you can consult with Mr. Riefler. He talks in much more technical terms than you do, and he talks while I am talking, which makes it very difficult when I seek to get information through Mr. Riefler.

Mr. MARTIN. All right.

Well, you cannot take consumer buying alone—what we are talking about is total expenditures, business and consumer expenditures, and total spending has exceeded the limits of availabilities now for a good many months.

That is the point that I make.

Senator LONG. Let us analyze this statement I have handed you here. What I am saying is that prices did not rise and are not rising now because of excessive consumer expenditures beyond the ability of our plants to produce.

Now, you say that the plants could produce a lot more, you concede that, I believe. And if not, we will go into more figures on it. And you say that the public will not buy at these particular prices, these high prices.

To which I ask the question: Then why did the prices rise? The point being that they did not rise because of any inability on the part of our plants to produce more consumer goods.

Mr. MARTIN. Well, the shift from consumer goods for some time——

Senator LONG. I thought——

Mr. MARTIN (continuing). For some time, soft goods have been in growing supply, but the plant and equipment, the expenditures for plant and equipment, have so far exceeded the bounds of available savings that pressure has been for rising interest rates all through this.

Senator LONG. We can get around to that latter factor later on, you see. You have not been here testifying contrary to what I am seeking—the answer I am seeking to obtain from you. You have not testified here that industry cannot produce these goods to meet consumer demand, and I am not seeking to obtain from you any answer in conflict with what you said in your prepared statement.

All I am seeking to do, at a time when you say that the inflation occurs because of this investment boom, is to nail down the point that it is not occurring because of excessive consumer buying.

You did not say it is in your prepared statement, so far as I know. Perhaps you did, but I did not find it there. And I am attempting to nail that point down, that it did not occur because of excessive consumer buying or because of inability of the American economy and its productive facilities to meet consumer demand.

Now, can we agree upon that statement?

Mr. MARTIN. Well, do you include in "consumer buying" purchases for plant and equipment? To what are you limiting it?

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Senator LONG. Oh, no. I am talking about things that ordinary people buy, that consumers buy for their use, things like food, clothing, automobiles, transportation, household appliances, consumer items as against industrial items.

Mr. MARTIN. Well, there has been a shift that we pointed out here, from buying toys in the corner drugstore to taking vacations and services. The service industry has expanded enormously, and that is all——

Senator LONG. That is all fine.

Now perhaps we are prepared to get the answer to the question—in other words, if people are buying more vacations and spending more time buying things other than the manufactured articles and farm articles, more vacations, more recreation, more luxury items, spending more on haircuts and beauty parlors and things of that sort, that even highlights the point I have in mind, that we are not having any inflation because of the inability of the plants of America to produce the manufactured articles that the people of this Nation want.

Now, can we agree upon that?

Mr. MARTIN. Well, I will agree with you that there are no specific shortages of consumer goods at the moment, that I know of. But I will not agree with you that people are not spending. They have to earn this money, mind you, and they have to keep this.

You have had this terrific increase in consumer installment buying, and in mortgage borrowing, and it is earned money; we want the people to be able to have these goods and to retain them.

But I insist that, as I see it, they are spending more than they have earned in order to try to buy more goods in the aggregate than are readily available, goods and services in the aggregate.

Senator LONG. You just got through making a statement that you want to explain inflation based on two things: One, that there was an excessive expenditure for plant and equipment; another, that people tend to be shifting expenditures more to services as against manufactured goods, meaning that they would spend less on manufactured goods than they had in the past.

Here you have a showing, here you make the statement that people will not buy manufactured goods at these high prices, which is an apparent explanation of the fact that you have a vast amount of plant capacity idle.

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

Mr. MARTIN. Now, I have great respect for Business Week. I have read it for a long time. But if you will take Business Week over the last 4 or 5 years, and pinpoint the times they have stated that a given industry was in a state of oversupply or undersupply, and then see what happened in a period of 6 months, you will find that their errors of judgment have been pretty high, also, as will all of us in this.

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

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Senator LONG. Mr. Chairman, I will be glad to discuss this boom in plant and equipment at great length——

Mr. MARTIN. I am not against the boom in plant and equipment at all.

Senator LONG (continuing). At the time when we get around to that, but it seems to me there is too much difficulty in agreeing on certain specific items, where I think all the facts and figures are available to establish what I have in mind or what you have in mind. It seems to me that we ought to be able to settle some of thse simple things before we get around to perhaps some of those more controversial things,

You just got through telling me you knew nothing about the steel industry, had no idea what their productive capabilities might be or should be. And now you proceed to tell me that Business Week, which does think it knows something about the steel industry, does not know what it is talking about.

Mr. MARTIN. No, no. I am talking about—that is the point they make at a given time.

Now, the point I am trying to make on figures, let me just make that on figures, and then I will stop on this.

Senator LONG. Yes.

Mr. MARTIN. When I first went to Wall Street, I lost my shirt all the time because I studied figures too hard, and I am not a figure expert today. I do not pretend to be.

But I say they can be extremely misleading. What you have got to do is to apply your commonsense in terms of the overall picture. I am not challenging the validity of any of these figures, but I say this is a moving operation, this business cycle. This business movement that we have does not stop at a given point, and therefore you cannot say at this given point there is overcapacity, and at this point there is undercapacity.

All of these factors are coming into the aggregate.

Senator LONG. It sems to me, Mr. Martin——

Mr. MARTIN. I am not criticizing your use of the figures at all, but I am simply saying that from my point of view, as I learned early in my experience, that you can certainly lose your shirt in business if you depend too much on that type of analysis.

Senator LONG. Let me just see if we are going to get anywhere here.

So far as I can see—I do not object at all to your elaborating on your answer, because I would like it to be an answer that you are satisfied with, but I would like also to feel that you have given a responsive answer to the question I have asked.

Now, I have asked the same question several times here this morning, and you have discussed a great number of things which, so far as I am concerned, are not at all important as an answer to the question I had in mind. Perhaps you want to stay by the only commitment you have made to the question asked, and I think it is wrong if that is your answer. But I do want to ask this question, and I will limit it to this one specific situation based on what I quoted to you:

In the steel industry, with that industry operating at 80 percent capacity as against—and assuming that 96 percent is a desirable rate for the operation of that industry—an optimum of 96 percent, could

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it be said that we at this time have any inflation because of the inability of the steel industry to produce to meet consumer demand?

Mr. MARTIN. Well, I am not trying to invoke the fifth amendment, Senator——

Senator LONG. I would suggest that you commit yourself one way or the other.

Mr. MARTIN. I do not know.

Senator LONG. And even if it is wrong, let us get on to the next one. I think we ought to settle that one way or the other.

Mr. MARTIN. Well, I can only answer that I do not know.

Senator LONG. Very well. You do not know. All right.

I would like to ask about the petroleum industry, and here is a statement made in this July 13 issue of Business Week:

> Petroleum refiners generally aim to run their plants at about 95 percent of capacity. This time last year they were ahead of that mark, running at about 96.1 percent. But since this year's first quarter, they haven't been able to keep going at this preferred rate. In the last 2 months, after a series of refinery cutbacks, the rate has been dipping steadily until today refiners are producing at about 88 percent of capacity.

Would your answer be "I don't know" with regard to that same question again? In other words, if I asked you the question whether or not there is any shortage with regard to the petroleum-refining industry, and any inflation resulting from the inability of the industry to meet consumer demand, would your answer in that instance also be, "I don't know"?

Mr. MARTIN. My answer would be "I do not know."

Senator LONG. Now, the same thing is the case with similar statements made with regard to the machinery industry, the electrical-machinery industry, the fabricated-metal industry, the nonferrous-metals industry, the rubber-products industry, the chemicals industry, the paper and pulp industry, autos, trucks and parts, textiles, and I assume that your answer would be, "I don't know," with regard to those?

Mr. MARTIN. We have a review of all of these at at least every 2- or 3-week period; we are going to have one on Monday in the staff of the Board, and these things shift in the periods that we have reviews.

Now, obviously there are periods when they are moving up. Then there is a dip. We do not go up in a straight line; we do not go down in a straight line, as a rule.

The point I am trying to emphasize is that at a given point, I do not believe it is a profitable thing to say positively that there is no shortage or that there is.

Senator LONG. Well, all I am pointing out to you—and I would suggest you take a look at this article, because I have been referring to it——

Mr. MARTIN. Yes; I would be very glad to.

Senator LONG (continuing). Is that insofar as industry is concerned, both specifically with regard to those industries and generally with regard to manufacturing industry as a whole, there is a widening gap, demonstrated by Business Week, as to industry's ability to produce and actual industrial production.

In most instances, there is shown to be a reduction in the production of those industries, although their productive capabilities are continuing to rise.

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Mr. MARTIN. Right. And this is something that we are watching very carefully, and reviewing each week in the Board.

Senator LONG. Yes.

The point I am making here—and as to whether you agree with it, I understand your answer to be that you do not know—but whether you agree with it or not, the point here is that here are the facts and the figures available are analyzed by Business Week, which I regard as being one of the better economic publications——

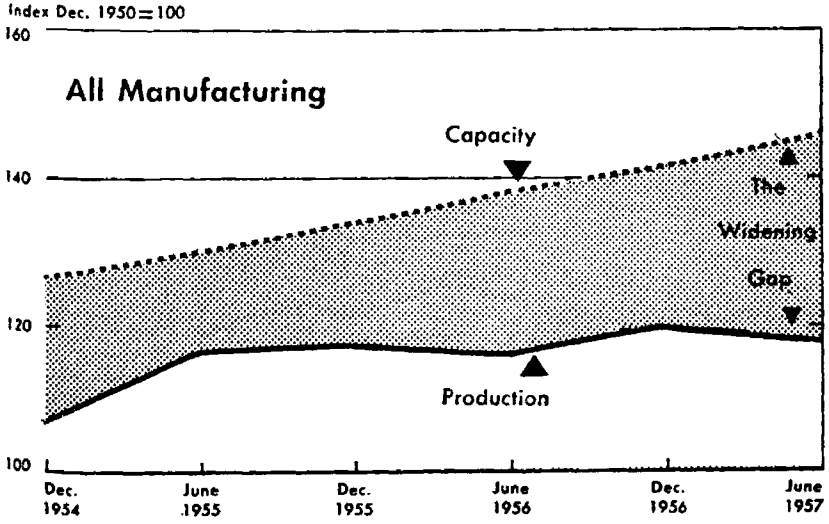
Mr. MARTIN. A fine publication; I agree.

Senator LONG (continuing). Pointing out quite clearly that there is no pressure of an inflationary nature as a result of the inability of American industry to produce to meet consumer demand. I would like to ask the reporter, if possible, that this article be reproduced at this point in the record, with the charts insofar as the Printing Office can reproduce those charts.

(The article referred to is as follows:)

[Business Week, July 13, 1957]

OUTPUT LAGS AS CAPACITY GROWS



Data: Federal Reserve Board, BUSINESS WEEK Estimates

On these pages you see the evidence of what's to be one of industry's major problems through at least the next several months. Industrial production is down, industry's productive capacity is up, and the growing gap between the two is made up of expensive manufacturing plant that isn't fully used (some of which may be obsolescent and expensive to operate, perhaps, but unused nevertheless).

In a few industries, the gap has been growing for more than a year. In most, it has increased largely in the last 6 months. Before the beginning of the year, the chief factor causing the growth of the gap was the rapid addition of extra productive capacity. But, since the beginning of the year, while industry has kept adding to its capacity, production itself has slipped.

Industry generally prefers to operate in normal times—periods other than war and similar emergencies—at about 90 percent of productive capacity. The extra 10 percent of its plant is normally under repair or in reserve. But since the end of 1956, industry's overall production has slipped from an estimated 85 percent to 81 percent of capacity.

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Not since 1954's dip in production and employment has industry had to face a situation like this.

PROSPECTS

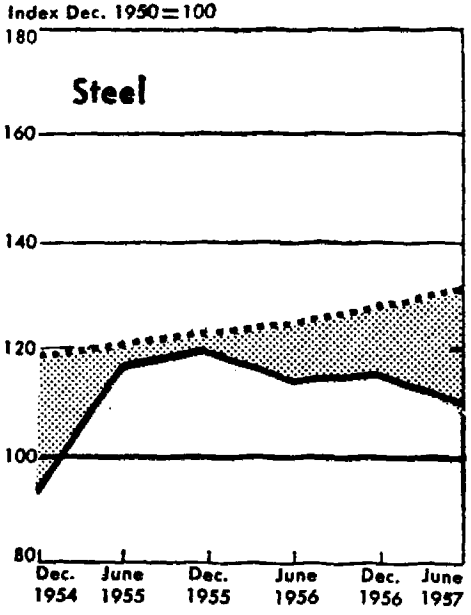
How long will this gap between capacity and production be one of the major zones of anxious attention for United States economists? From industry to industry, often from company to company, the answer varies. Say some: "The gap will diminish and the proper balance between production and capacity will return by the end of this year." Others guess the gap will remain until the early 1960's. "We're in an interim period. There'll be a slowing of growth until new products appear, and the enlarged markets that are expected to grow from the rapidly increasing adult population, arrive in the 1960's."

NEW RATIO

Supplementing these views, economists for congressional committees in Washington have noted the recent rise in the ratio of capital investment to output, and they're wondering if it's becoming a trend, and whether that trend is dangerous for the economy. They supply no answer.

Meanwhile, business is preparing to learn the answer by experience.

What follows is a report on how the major industrial groups are faring.



Steel mills worked at about 87 percent of capacity through the first half of the year, though the rate has been around 80 percent lately. (The preferred rate: 96 percent.) But the gap isn't worrying the industry as a whole. Though their mills have more often than not run at 100 percent of capacity in the last 17 years of war and inflation, steel's leaders still hail this year's production rate.

The dip, they say, is part of the price they're paying for the 3-year no-strike contract they signed last year with the United Steelworkers. That contract freed steel's big customers from the need to build inventories against the threat of a strike before 1959. Tight money and the weaker 1957 auto market helped customers reduce inventories, too.

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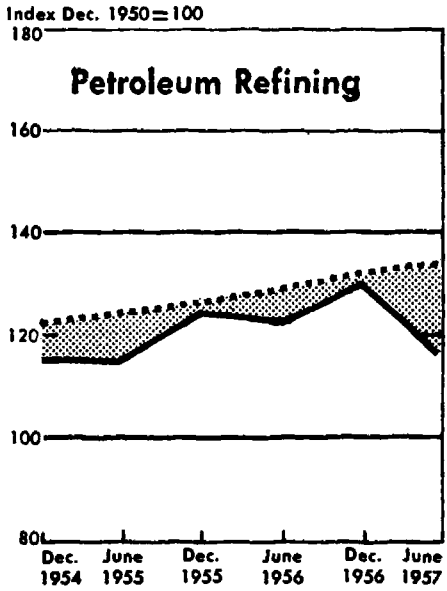
IN BALANCE

Now steelmen guess their customers have cut inventories about as far as they can. Until late next year, when a new inventory buildup is likely in anticipation of a strike in July 1959, steel production should correspond closely to general business activity.

In short, steel guesses its dip is short-term, and it doesn't regard it as serious.

While it lasts, steelmakers are still pressing their expansion plan, which call for 15 million tons capacity to be added by 1960.



Petroleum refiners generally aim to run their plants at about 95 percent of capacity. This time last year they were ahead of that mark, running at about 96.1 percent. But since this year's first quarter they haven't been able to keep going at their preferred rate. In the last 2 months, after a series of refinery cutbacks, the rate has been dipping steadily until today refiners are working at about 88 percent of capacity.

Their perennial problem, the heavy wintertime growth of gasoline inventories, has caught up with them to a greater degree than usual this year. Outside factors have helped oilmen to reduce those large start-of-summer inventories in most postwar years: the Korean war demand, closure of the Abadan (Iran) refinery, the Suez crisis, and strikes in United States refineries. This summer there have been no such upheavals.

SHORT TERM

Rising costs have forced the industry to increase prices, but now leaders are wondering if they can make the increases stick. Refinery cutbacks could help: Total demand in June was estimated at 8.8 million barrels a day; refinery runs totaled 7.9 million barrels a day.

The refiners see their troubles as strictly short-term. By next year, industry economists say, the capacity-production equation should be closely enough balanced to let refineries run at near preferred rate.

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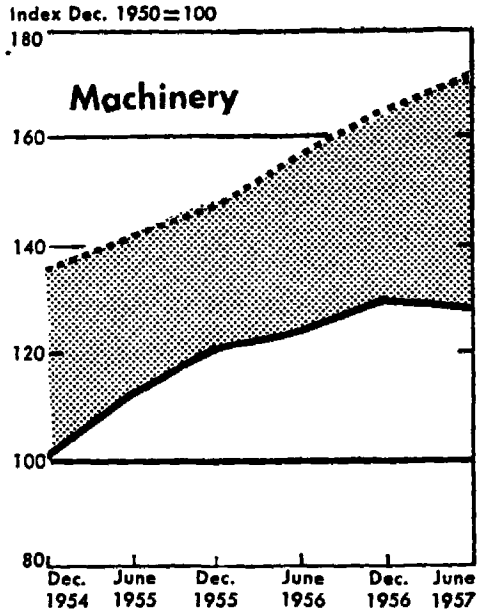

There's little room for generalizing about this broad industrial category. Its products vary from machine tools (production high so far this year but new orders dwindling), to construction machinery (production up but far below expectations), and office machinery (production close to capacity).

It's also difficult to judge capacity for this group. Machine-tool makers, for instance, can add heavily to capacity in a few weeks by calling in subcontractors.

But it is possible to estimate that machinery makers as a whole are working at more than 5 points under their preferred operating rate of about 89 percent of capacity. Machine-tool makers, in particular, are caught in a decline that threatens to last through 1958. They blame part of the dip on a slowdown of expansion in the auto industry, hope for gains as the auto makers begin to retool their plants for 1959 model production.

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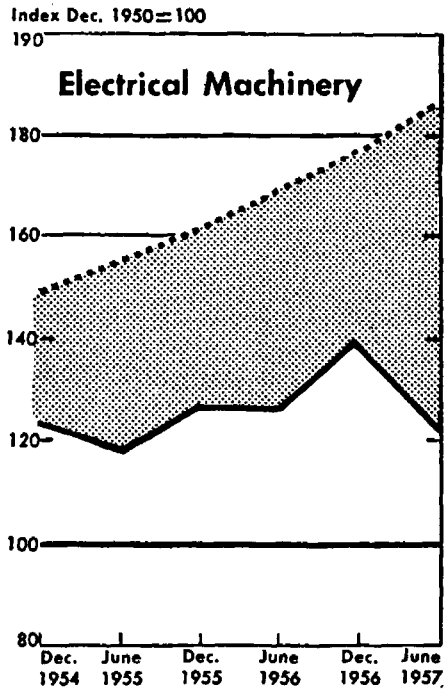

Two groups of products—vastly different in size, cost, and sales performance—make up this industrial category: appliances and the major electrical apparatus that's sold to utilities and to industry. Appliances are lagging about as far as they ever have; the makers of major electrical machinery are having their best year ever.

Overall, electrical-machinery makers have a preferred operating rate of about 90 percent of capacity. Today, due to slackening appliance production, their operating rate is close to 85 percent. There's no sure figure on appliance makers' operating rates alone. Rough estimates put the rate at between 60 and 70 percent of capacity.

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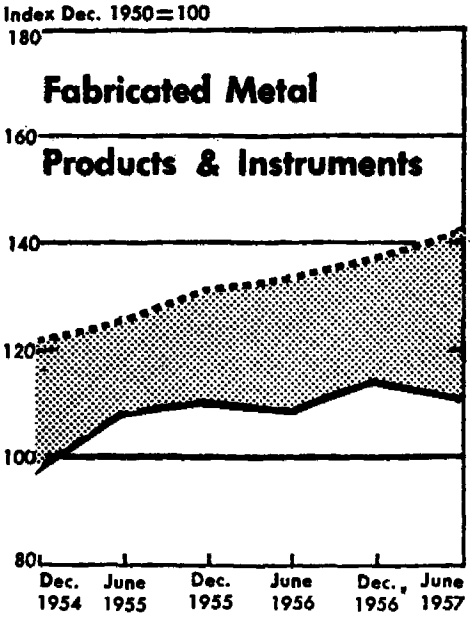
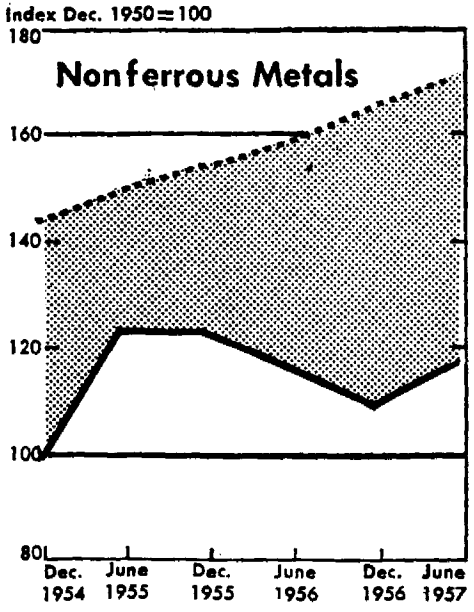


A vast range of products fills this industrial category, and some are booming while others are depressed. Instrument makers, for instance, have rarely had it better, new orders indicate the second half of the year will be just as good.

But business for fabricators of nonferrous metal products—tubes, pipes, wire, and so on—is down. In many brass mills a 4-day week is common. Producers put some of the blame for their lagging sales, and production, on the decline in housing starts, and appliance and auto production. But they reserve a good part of the blame for competition from lower priced imports from Europe.

Economists aren't guessing about the prospect of an upturn for nonferrous products. Many manufacturers of those products are pressing for steeper tariffs against European competition. That may mean that they believe the dip is likely to last more than 6 months.



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The four major products in this group are aluminum, copper, lead, and zinc. Through most of the year's first half, production of all but aluminum climbed above last year's rate. Now zinc has gone into a tailspin. Its trouble is overproduction.

Meantime, copper and lead producers turned out only between 2 and 3 percent more between January and June this year than in the first 6 months of last year.

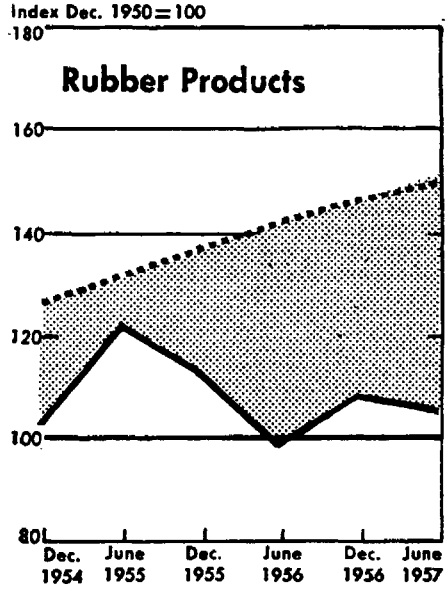
OVERSUPPLY

At midyear, aluminum production was 5 percent less than at the end of 1956. Simultaneously, aluminum's productive capacity has increased. So far, the industry isn't worried about the dip in production. The decline stems from temporary inventory reductions by customers, say the producers.

For the short term, the producers need not worry about oversupply. During the Korean war, the Government encouraged expansion by signing "put or take" contracts with producers. These contracts require the Government to buy certain percentages (up to 100 percent in some cases) of plant output if the producer can find no private market. A few outside economists foresee a rapidly growing gap between production and capacity. In the next 3½ years, almost 1 million tons annual capacity will come into production, raising 1960 capacity to 2.6 million tons. This, the economists believe, will be too much for the economy to absorb. Digestion of the extra aluminum capacity may be delayed a year or so.

In the 15 months since they began exercising their rights, producers have sold the Government 144,000 tons of aluminum under these contracts. Meantime, the Government slowed its direct stockpile purchases of aluminum, and 4 months ago decided to halt entirely purchases other than those made under "put or take" contracts.

In the next 2 years most of the "put or take' 'contracts expire.



The rubber industry isn't up to its 90 percent of capacity preferred rate of operations, but it's close to it. The backbone of its sales gains this year is auto tire manufacturing. In the first 5 months of the year, the industry shipped 14.9 million passenger-car tires to Detroit, turned out replacement tires at a record rate of 59 million a year.

This year's big replacement business stems from 1955's record number of auto sales. The average auto owner replaces tires when his car is 2 years old.

In the midst of all this, the rubber industry is little worried by the overall dip in its production. As of now, the industry is running ahead of the economy, and its economists say, "The dip is no more than a short-term readjustment."

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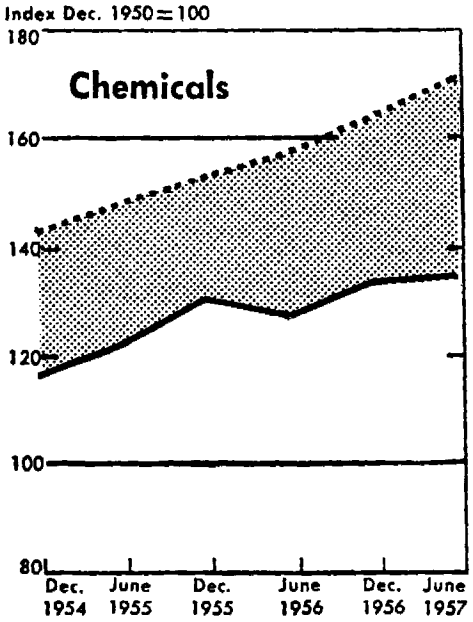
There's the prospect of 2 or 3 years of continuing growth in the gap between production and capacity in the chemical industry. Today, it's operating at about 83 percent of capacity.

This year and last, the industry budgeted a total of $3.3 billion for new and modernized plant. Next year, it will probably spend at about the same rate. Just about all that extra plant will be on stream by 1960. Then, say industry economists, there'll be excess capacity for perhaps 2 years.



Pulp and paper mills last month ran around 90 percent of capacity, compared with a rate of almost 90 percent at the same time last year.

Sales dipped in mid-1955 and though they gained again by the end of the year they didn't come up to expectations. Since then, the industry has been taking a second look at its expansion plans, which called for addition, by 1960, of 7 million tons. Now the plans aim to add 1.8 million tons annual capacity by 1960.

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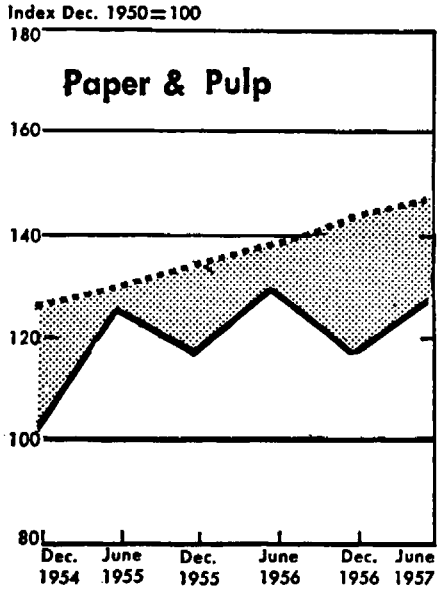
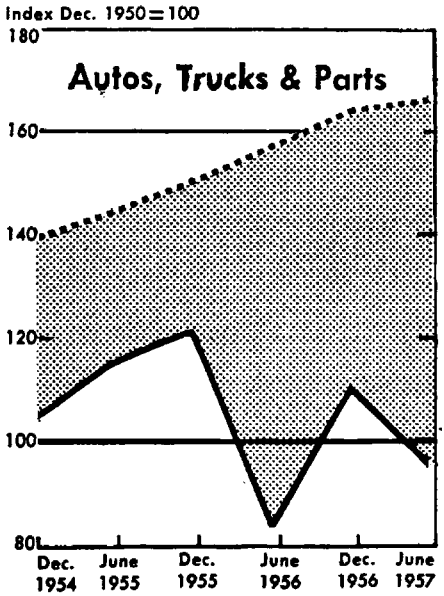


The auto industry (p. 28), just winding up its second-best 6-month production period, turned out 3,370,100 passenger cars from January to June this year. That was 5½ percent more than in last year's first half. But it was still about 20 percent below the 4¼ million cars produced in the first half of 1955, and that reduced number of autos was turned out by an industry whose productive capacity has been enlarged some 10 percent in the last 18 months.



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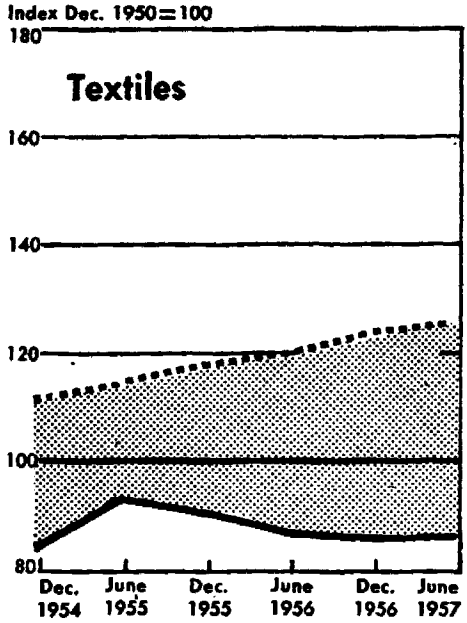

Textile companies had expected a sales gain in the first half of the year. It came, but it lasted only a few weeks.

The broader picture of the industry is one of long-term recession that started about 2 years ago and is persisting. Industry economists are not predicting when their market will undergo a real change. But they do argue that the industry has shrunk about as far as it should, that capacity is coming into better balance with demand.

Sentor LONG. With regard to productivity, perhaps I can find these figures, we have the industrial production index, both in the President's Economic Report and in the Economic Indicators.

What is your impression with regard to the industrial production indexes during the last several years? Do you believe that at the present time, as of this time, they are on the upgrade, or on the downgrade?

Mr. MARTIN. We have been pretty steady here recently, Senator. We reached our peak, I think, last December, last November or December, at 147, and it is now 144. It has been a plateau, more or less, for some time.

Senator LONG. So it is actually now below what it was during the last quarter of 1956?

Mr. MARTIN. During the peak. But higher than it was this time a year ago, you see.

Senator LONG. Let us check that and see what Economic Indicators shows. I will attempt to check that, and perhaps Mr. Riefler will find where that is in the Economic Indicators, to show where it is most recently.

Mr. MARTIN. Here we are, December.

Senator LONG. I am looking at page 16 of Economic Indicators myself. Does that accord with your figures? Those are your figures?

Mr. MARTIN. Yes; they are our figures.

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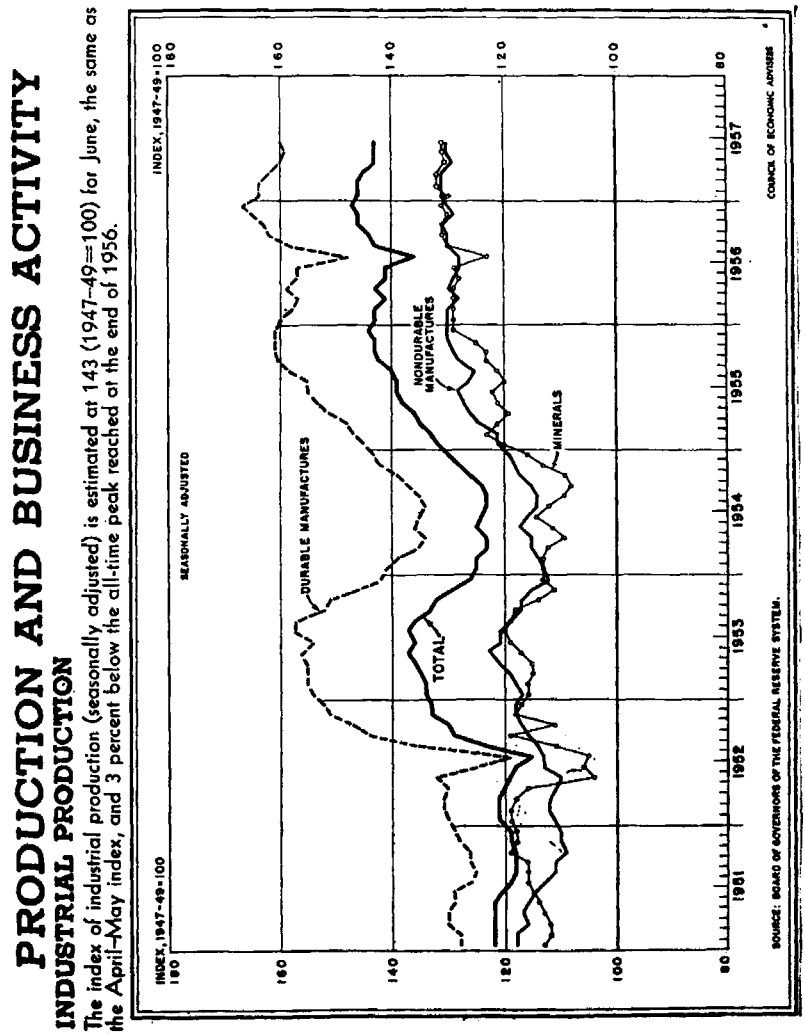
Senator LONG. And they are supplied for Economic Indicators, which I find reproduced in this publication of July 1957.

Mr. MARTIN. There is just one correction.

Senator LONG. Just looking at that column—and I will ask that that column, that the figure for 1956 be reproduced, that the remainder of that column as shown here be reproduced. That is on page 16 of the Economic Indicators. I would suggest it might be well to reproduce that entire column there, starting in 1939 and coming forward.

(The material referred to follows:)



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[1947-49=100, seasonally adjusted]

Period	Total industrial production	Manufactures			Minerals
		Total	Durable	Nondurable	
1939	58	57	49	66	68
1948	104	103	104	102	106
1949	97	97	95	99	94
1950	112	113	116	111	105
1951	120	121	128	114	115
1952	124	125	136	114	114
1953	134	136	153	118	116
1954	125	127	137	116	111
1955	139	140	155	126	122
1956	143	144	159	129	129
1956—May	141	143	157	129	128
June	141	142	157	128	129
July	136	138	148	128	123
August	143	144	158	130	130
September	144	146	162	130	131
October	146	147	163	131	131
November	146	147	165	129	130
December	147	149	167	130	130
1957—January [1]	146	147	164	131	130
February [1]	146	148	164	131	132
March [1]	145	147	162	131	132
April [1]	143	145	160	129	130
May [1]	143	145	159	130	131
June [1]	143	145	160	130	131

[1] Preliminary estimates.

Source: Board of Governors of the Federal Reserve System.

Senator LONG. That column shows that, with the exception of the recessionary year 1954, there has been a steady increase in industrial production, with the exception, with the possible exception of this year, which, of course, is not yet complete.

Now, we have a showing that the industrial production was at the level of 143 on the average for 1956. It reached 144 in September of last year, it reached 146 in October and November, 147 in December, and 146 in January and February of this year. Then it fell off in March to 145, in April down to 143, and in May to 143, and in June to 143.

So it is lower now than it was during the last 4 months of 1956, and during the first 3 months of this year.

Now, the question is ask is, Does that indicate again any inability of American industrial plant and facilities to meet consumer demand?

Mr. MARTIN. In my statement, I made clear what our thinking on it was, which is that there are no specific shortages or bottlenecks, but there is a broad, general pressure on all of our resources.

Senator LONG. There you are, you said broad, general pressure; and here is a fact, that far from expanding our production, we are moving in the wrong direction, we are contracting, and we should be able to expand our production at the rate of at least 3 percent a year, I should think that is a reasonable rate, it is the kind of rate you advocated. Yet here we are going backward, going downhill at the rate of 2 percent a year based on the figures here.

Mr. MARTIN. Well, the year is not over. And I would like to correct, if you do not mind, that June is 144 instead of 143, and July, which we have now got, is also 144.

Senator LONG. That should be 144?

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Mr. MARTIN. One hundred and forty-four in July, which we now have also, and 144 in June. I say there is a pretty good plateau at a very high level.

Senator LONG. In your prepared statement, you would have appeared to be one of those who believes in a steadily expanding economy, and one who would not be satisfied with a stagnating economy.

Now, I should not take it that you would be satisfied with a plateau of industrial activity in a Nation where the population is expanding. Would that be correct?

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

Senator LONG. Let me ask you this question: Can you tell me of anything that tends to provide the answer to inflation any more than the production of goods to meet demand?

Mr. MARTIN. Well, if you are going to——

Senator LONG. In other words, if you are trying to find a cure for inflation—we had a lecture here about the disease and the cure. Now, if you are trying to provide a cure for inflation, can you suggest to me any better cure than to increase production to meet the demand? It is certainly a better cure than rationing, is it not? It is a better cure than credit controls, or is it?

Mr. MARTIN. Well, you cannot cure inflation by supplying more money.

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

Mr. MARTIN. I know. But in order to supply more goods at the present time——

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

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

Senator LONG. Now, what you are saying is, if I understand it, you want to make a qualification, you want a qualified statement, and I would suggest that you make the statement and then qualify it, because how can I anticipate your statement by your qualification?

In other words, I am saying this: Do you know of any better cure for inflation than increased production, or the production of adequate goods to meet consumer demand?

I would suggest that first you give us the answer and then you provide the qualification that you would like to add to it, because to qualify without giving the answer makes a qualification rather mean-

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ingless. If your answer is yes, if people have the money to buy, or it is no, even if they do have the money to buy, why, that is all right, that is a satisfactory answer to me. But I would like to get the answer and then the qualification. Would you mind answering in that fashion?

Mr. MARTIN. Well, I want this production that you are talking about, and I think that there is——

Senator LONG. The question is: Do you know of a better cure for inflation than that of providing goods to meet demand in an adequate amount to meet demand?

Mr. MARTIN. Do you want Mr. Riefler to take that? I cannot answer that.

Senator LONG. I would suggest you answer the question. If he wants to consult with you, I would suggest that you consult with him.

Mr. MARTIN. All right, I will consult with him.

Senator LONG. Then you can answer the question?

Mr. MARTIN. Well, there is no limit—I have consulted with Mr. Riefler and I am not sure that he and I see eye to eye on it, so far as that goes.

Senator LONG. You see, that is a good reason why Mr. Riefler should not answer the question, because you would have been in a position of vouching for that answer with which you would have been in disagreement.

Mr. MARTIN. I understand that, but he is extremely valuable and I need any advice I can get.

Senator LONG. Let me say there: If there is any other man who can take us around in circles without answering the question, I do not know who it is, because he is supplying more technical information that leads contrary to the answer to a question I am trying to get than anyone I have examined here yet. He got us off on this productivity thing, and I think it took us about a half-hour to get back on the right track after that.

Mr. MARTIN. Well, I will say that I think that the production of consumer goods, is certainly one of the basic cures for inflation, provided it is not an inflationary operation which creates additional demand for goods, because demands are unlimited. I do not know anybody who does not—well, I will not say "anybody"—but people of my acquaintance always want to spend more and more and more.

The question is whether they can earn it, whether they have means of paying for it.

Senator LONG. The typical inflationary situation is a situation where you have the public with money that the public wants to spend, the purchasing power is there, and the public wants to spend that money faster than industry can produce goods. And against the classic inflationary situation which I think that would be, do you know of any better cure for it than to provide the goods in terms of additional production?

Mr. MARTIN. If you can provide the goods in a way that they can be paid for. If they are just provided by largesse, they just add to the spending stream, and you do not come out any differently than at the start.

Senator LONG. So that answer could have been prefaced by a question: if you can provide the goods that the public has the funds to pay for?

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Mr. MARTIN. That is right.

Senator LONG. All right.

So with regard to inflation, that happens as a result of rising prices, people wanting to buy more than there are goods available. The best answer to it is to increase the production of those goods and make them available for the public to purchase; is that correct?

Mr. MARTIN. Make it available for them to purchase in a way that they can hold, and we cannot by creating debt—debt is not the answer to the problem.

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

Mr. MARTIN. I am, and any other capital expenditures.

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

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

Senator LONG. Well, could you tell me why can we not have both? Why can we not go right on ahead producing additional consumer goods—in other words, anything from a face towel to an automobile—for the public and at the same time, knowing we have vast additional productive capabilities in all of these fields, and knowing we have more slack labor supply now than we have had for a considerable period of time, at the same time go on producing industrial items the industry wants, especially in view of the fact that our production now in the overall is below what it was 6 months ago?

Mr. MARTIN. Well, there is a plateau there, but what you have got is a situation in which the price level continues to rise. And against a rising price level, why, the expectation of additional price rises causes speculative activity; and more and more people, instead of looking at the sound holding of property and goods, look at it on a speculative basis and this wheel just goes on and on and on.

Senator LONG. Let me ask you this——

Mr. MARTIN. Printing money is not the answer.

Senator LONG. Why is overall production down as of the present time? Why is it down even when you look at this investment boom? Why is it down from what it was 6 months ago?

Mr. MARTIN. It is not down very much.

Senator LONG. But it is down, and it is down by 1 percent; and you are one of those who advocates that it should increase by 3 percent a year.

Mr. MARTIN. Now, there is no magical way, Senator, of increasing this 3 percent or 4 percent——

Senator LONG. Why is it down?

Mr. MARTIN (continuing). In X months.

Senator LONG. Why is it down?

Mr. MARTIN. Why is it down now? This is only manufacturing production, industrial production, and I doubt very much whether the overall——

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Senator LONG. Why is industrial production down? Let us just talk about what you have there.

Mr. MARTIN. Because we have been going ahead too fast. I think there has been a shift to services. And we have gone and developed plant capacity faster than we can absorb it.

Senator LONG. Now, did you not just answer the question I tried to get you to answer about a half-hour, when I asked you if there was any inflation because the plants could not manufacture to meet the consumer demand?

Mr. MARTIN. No, I do not think so, Senator. That is what I said in my prepared statement, and I do not back away from that at all. I think that we have no specific bottlenecks at the moment. But I do think that, as I stated here, causing prices of individual commodities to be bid up because of limited availability—rather it is a problem of broad general pressure on all of our resources, and I think that broad general pressure is there; otherwise I do not think prices would continue to go up and the cost of living would keep climbing.

Senator LONG. In your prepared statement, you say you had this broad general pressure upon all of our resources with regard to industrial plant and equipment. You make this statement, that we are below what we were producing 6 months ago because we built so much plant that we do not have enough consumer buying to keep those plants busy.

Now, that is the statement you made just a moment ago, when I asked, Why is industrial activity and industrial production down?

Mr. MARTIN. Well, I do not think it is down for that reason. I think it is down for financing reasons.

Senator LONG. Perhaps you would like to take back that answer you made just a moment or two ago.

Mr. MARTIN. No; I do not want to take it back, but I want to keep it in the perspective of the current situation, and I just do not think that taking X figures for 3, 4, or 5 months is relating it to the cycle that we are dealing with.

Senator LONG. I suppose we could deal with that subject in greater detail some time hereafter, but it does seem to me that the answer you made a moment ago is the obvious answer; and perhaps you might want to take it back: that we do not have any inability of the plants to produce far more than they are producing at the present time to meet consumer demand, and now——

Mr. MARTIN. At a price.

Senator LONG. And the fact is, again with regard to this statement you made about price, I thought about it enough to analyze the statement that I gave you. The question is: Why did the prices rise? They certainly did not rise because industry could not produce to meet the demand. Is that not correct?

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

Senator LONG. That is just fine. I am glad you made that statement, because I can ask the same question again. They did not rise because of the inability of the plants to produce. Here we have been 2 hours getting that answer; have we not?

Mr. MARTIN. No. Well, I just cannot put it in as simple terms as that.

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

Mr. MARTIN. Well, I assume at some point—we cannot compel consumers to buy or to save.

Senator LONG. Is that not what you said a moment ago? Did you not say, in fact, a moment or two ago, in fact, repeated it here, that there are plenty of goods available at a price, but that the consumers cannot pay that price——

Mr. MARTIN. No; I said——

Senator LONG. Or at least are not willing to pay the price.

Mr. MARTIN. There is plenty of demand for the goods at a price, not goods available at a price.

Senator LONG. At a lesser price?

Mr. MARTIN. At a lesser price——

Senator LONG. But that consumers are not willing to pay the present price?

Mr. MARTIN. In a number of instances. I have watched 1 or 2 plants this spring where a reduction in price stimulated demand.

Senator LONG. Let us just analyze that statement then. Assuming no reduction in prices, your answer would then mean, and could lead to, only one conclusion: that industry can produce more consumer goods than consumers are willing to purchase at existing prices; is that correct?

Mr. MARTIN. At a moment.

Senator LONG. At this time?

Mr. MARTIN. At a moment. But I do not think you can take a moment and isolate it. That is where we disagree.

Senator LONG. All right.

Would you care to say that the answer would be any different as of a week ago or as of a month ago?

Mr. MARTIN. I think it is changing every day. I do not think you can pinpoint it on a day.

Senator LONG. Well, now, do you think that—is there any time during the last 2 months when you would have said that the answer would have been different, that industry could not produce more goods than the public could buy at existing price levels?

Mr. MARTIN. Well, we are talking about industry in general, and I think that that is a pretty broad concept.

Senator LONG. That is right. But you are the man who came here with a prepared statement saying we should not talk about these things in specific examples, we ought to talk about them in general, because that is the way you feel you should exercise your responsibilities.

Mr. MARTIN. No; that is not the way I——

Senator LONG. Did you not say with regard to construction of housing——

Mr. MARTIN. I said with regard to housing——

Senator LONG. Did you not say with regard to the construction of housing that housing starts were down to a considerable degree but that on the whole the construction industry was up and that you felt that your responsibility had to be exercised by looking at the overall picture?

Mr. MARTIN. That is right. That is right.

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Senator LONG. Yes,

Mr. MARTIN. Overall building is up.

Senator LONG. So that the overall building was up?

Mr. MARTIN. Overall building was up.

Senator LONG. So therefore you did not feel you should adopt some policy that would encourage the addition of housing starts inasmuch as building activity as a whole is at a high level.

You made the general statement that the board had to look at these overall items and it could not be too much impressed by a specific wheel within a wheel?

Mr. MARTIN. That is right.

Senator LONG. Now, looking at the same situation with regard to consumer goods and industrial production, do you know of any time during the last 2 months when your general statement, which I think is a satisfactory general statement for these purposes, that industry could produce more and substantially more than the public would buy at existing prices, do you know of any period within the past 2 months when your statement in that regard would not be correct or any time during the past 2 months at which you felt that the statement should be the other way around?

Mr. MARTIN. No, I do not know of any time in the last 2 months or at the moment, but we are talking about a broad plateau.

Senator LONG. Good.

So here we are on a broad plateau, and not just on a pinnacle for 1 day. Now, that being the case, is not that statement tantamount to saying that industry can produce substantially more consumer goods than the public can buy at existing price levels?

Mr. MARTIN. Well, no; I do not think so, Senator.

Senator LONG. What is the difference?

Mr. MARTIN. Well——

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

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

Senator LONG. Well, the hour of 12:40 having arrived, I am willing to suspend at this time.

Senator Carlson, if you wanted to ask some additional questions, you are at liberty to do so.

I would suggest that we recess on call of the Chair. I would like to continue this examination because there are quite a few additional things that I would like to cover.

I regret, Mr. Martin, that I have such difficulty in getting the answers I want, or perhaps it is my fault that I do not put the questions so that——

Mr. MARTIN. It may be my fault, Senator.

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

Senator CARLSON. As I understand it from the session this morning, you would conclude and I was to follow.

Senator LONG. All right.

(Whereupon, at 12:45 p. m., the hearing was adjourned, subject to the call of the Chair.)

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INVESTIGATION OF THE FINANCIAL CONDITION OF THE UNITED STATES

MONDAY, AUGUST 19, 1957

UNITED STATES SENATE,
COMMITTEE ON FINANCE,
Washington, D. C.

The committee met, pursuant to recess, at 10:30 a. m., in room 312 Senate Office Building, Senator Harry Flood Byrd (chairman) presiding.

Present: Senators Byrd, Kerr, Frear, Long, Martin, Williams, Malone, Carlson, and Bennett.

Also present: Winfield Riefler, Assistant to the Chairman, Board of Governors, Federal Reserve System.

Elizabeth B. Springer, chief clerk; and Samuel D. McIlwain, special counsel.

The CHAIRMAN. The committee will come to order.

Senator Long is here, and will continue his interrogation.

Senator LONG. Mr. Chairman, I did not know we were meeting this morning. I just did not get the notice that you sent me.

The CHAIRMAN. I would like to state the program, so far as it is possible to foresee at this time. Senator Long will continue his examination, and I would suggest, Senator Long, that the record show that it is a continuation of your previous examination.

Senator LONG. That would be fine.

The CHAIRMAN. Then Senator Carlson; then Senator Malone, who has returned and desires to ask questions, which he thinks will take about 2 hours, and he has asked to have a meeting at 2 o'clock this afternoon.

Mr. MARTIN. That is right.

The CHAIRMAN. Should that program be followed, the committee will then recess to the call of the chairman.

Mr. MARTIN. Yes.

The CHAIRMAN. Senator Long, you may proceed.

STATEMENT OF WILLIAM McCHESNEY MARTIN, JR., CHAIRMAN, BOARD OF GOVERNORS, FEDERAL RESERVE SYSTEM—Resumed

Senator LONG. I hope I can get through here in a half hour this morning, Mr. Chairman.

I will say that to both chairmen, the chairman of the committee and of the Board.

In the testimony of Mr. Humphrey and Mr. Burgess, they both indicated that they felt this investment boom was going ahead too

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rapidly, and that it was not good that it should be going ahead that fast.

My impression from your testimony thus far is that you believe that the current rate is a good thing, and perhaps should be going ahead at this rate.

Do you agree with their point of view, or do you feel this investment boom should go ahead as rapidly as it is?

Mr. MARTIN. No. I think it is going ahead too rapidly at the present for the level of savings which we have.

Senator LONG. And do you believe it is desirable that it should be slowed?

Mr. MARTIN. I believe that the rate of investment ought to; that we ought not to be supplying bank credit to cover the deficiency in savings that I think is there.

Senator LONG. Yes. Now, the fact of the matter is that these high interest rates, and even this tight-money policy, have not prevented this rapid increase in investments in plant and equipment, and it seems to me that one of the main reasons is that, in most of the major industries, the interest expense is less than 1 percent of the expense of doing business. Do you agree with that statement?

Mr. MARTIN. That is a small percentage; yes, sir.

Senator LONG. We all know it is less than 1 percent of the cost.

Mr. MARTIN. Yes, sir.

Senator LONG. The conclusion I draw is that, since it is less than 1 percent of the cost, an increase in interest rates would have very little effect on major industry insofar as a decision to expand plant and equipment.

Mr. MARTIN. It has had very little direct effect that we can find to date, but I believe that there are a great many plans that you cannot put your finger on which have not only been sloved up but have actually been laid aside for the time being because of the expectation of interest costs rising, and a tendency toward wondering if it would not be better to wait until the financing situation was a little bit better. But it has not prevented——

Senator LONG. The facts are that this tight-money policy, which has been accompanied by high-interest rates, has not at all slowed the investment boom, as far as the figures would indicate. I have here a compilation—I will supply you with a copy of it—which I ask be placed in the record.

Senator FREAR (presiding). Without objection, it will be placed in the record.

(The table referred to is as follows:)

Investment in producers' durable equipment, annual average growth rates in uniform 1956 dollars

Year:	*Percent*
1953 to 1st half 1957	3.3
1956 to 1st half 1957	10.1
2d quarter 1956 to 2d quarter 1957	9.6
1st half 1956 to 1st half 1957	11.1

(Derived from p. 124, President's Economic Report, and August 1957 Economic Indicators.)

Senator LONG. This indicates the average investment in terms of constant dollars. I derived this from page 124 of the President's

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Economic Report and from Economic Indicators, which are my source materials.

The average annual increase from 1953 to date was 3.3 percent. That is the growth rate in producers' durable equipment. But from 1956 to the first half of 1957, the annual growth rate was 10.1 percent.

In the second quarter of 1956, as against the second quarter of 1957, it has increased by 9.6 percent, or, comparing the first half of 1956 with the first half of 1957, the increase has been an 11.1-percent increase, in terms of constant dollars.

That is certainly a very rapid increase. According to Secretary Humphrey, this rapid expansion of plant and equipment, more than any other one thing, has led to the inflation that we are having. Do you agree with that statement?

Mr. MARTIN. Well, I think that plant and equipment expenditures have been the primary move in the last——

Senator LONG. We have had these high interest rates and this tight-money policy during that period of time. The fact is that this rapid expansion has taken place in spite of that. How much more rapid do you calculate it would have been if you had not had high interest and tight money?

Mr. MARTIN. I have no way of calculating it, Senator; but I think it would have been substantially more rapid.

Senator LONG. It stands to reason that a decision to expand plant and equipment would also be hastened if the companies could take a more rapid depreciation allowance as a tax matter, would it not?

Mr. MARTIN. That is right.

Senator LONG. And the bill passed in 1954, which made it possible for people to take their depreciation more rapidly during the first year or 2 or 3 years that they had the equipment, undoubtedly did contribute to this rapid expansion of plant and equipment.

Mr. MARTIN. That is correct.

Senator LONG. If we were trying to think of what we might do that might slow it down, perhaps we might very well have made this depreciation law flexible, so that it could have been changed or so that it could have been terminated in the event the investment was going on too rapidly. That occurs to me as one thing that perhaps we could do even now; we could slow down the rate at which we permit people to take depreciation on equipment, if we wanted to slow down the investment boom. We have had a steady increase of interest rates during the last 5 years, although I believe there had been some instances in which there has been some slight downward fluctuation.

Can you tell me when the downward fluctuations have occurred, and how long those fluctuations continued, during the last 5 years?

Mr. MARTIN. I could prepare a paper for you and put it in the record. I could not do it out of my head, Senator.

Senator LONG. Very well.

Do you have that at the present time? Is there a chart available for it? Perhaps that could also be placed in the record.

Mr. MARTIN. Yes, sir; we could put the chart in the record.

Senator LONG. Yes. So there have been some motions in that, doubtlessly.

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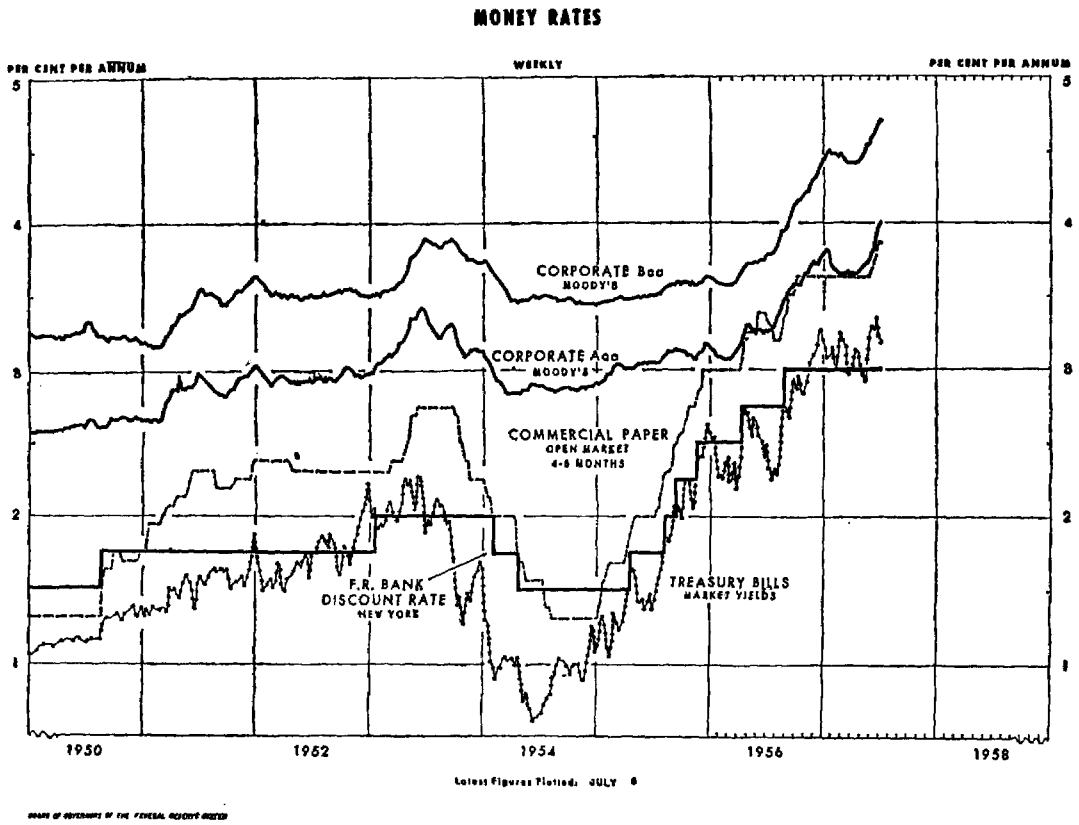
(The information referred to is as follows:)



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Senator LONG. I understand you do not believe high interest is good per se. You believe it is something that you have to put up with from time to time, but that it is bad for the Government and it is not good for the economy, aside from other factors.

Mr. MARTIN. That is right. I would like to see as low-interest rates as we can have without producing these inflationary pressures.

Senator LONG. That brings me to this point: The cost of Government is up more than a billion and a quarter dollars because of these increases in interest rates, and if we refinanced the entire national debt at the present level, it would increase the cost of Government by more than $4 billion.

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

Mr. MARTIN. I do not think we would have much trouble. Once the demand for funds declines substantially, you will find that the interest rate level begins to decline.

We would not be the slightest bit averse to using our powers, once deflation is clear, to ease money. We have got to make a judgment of when the time comes and what the right time is.

In 1953, we started easing money, and we got a little bit overenthusiastic about it, I think, toward the end of the year, but we actually pursued a policy of active ease during that period.

Senator LONG. How low did interest rates go during that time?

Mr. MARTIN. In 1954, to around one-half of 1 percent on the bill rate, Senator, in about the middle of 1954.

Senator LONG. Were you using an open-market operation at that time?

Mr. MARTIN. Yes. We were supplying funds by purchasing Government securities.

Senator LONG. The use of the open-market operation by the Federal Reserve Board can be used as a very powerful factor to bring interest rates down, can it not?

Mr. MARTIN. It is an extremely powerful operation. But it cannot make people borrow money if they do not see an opportunity for profit.

Senator LONG. The point is, that you have this supply-and-demand situation, you have competition for money, and you have the reverse of that, competition for securities. If the Federal Reserve Board were using its power to buy Government securities, it could tend to bring the general level of interest rates down by entering the field and competing with private lenders, could it not?

Mr. MARTIN. It can——

Senator LONG. So my question is, assuming that we get this inflation under control, do you then propose to use the powers of the Federal Reserve Board to bring these interest rates back to where they were?

Mr. MARTIN. Bringing them back to where they were——

Senator LONG. Back down, I mean, to a level of where they were several years ago——

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Mr. MARTIN. We would use——

Senator LONG (continuing). At a time when the interest rates were low.

Mr. MARTIN. We will use the power of the Federal Reserve to lean against either deflationary tendencies or inflationary tendencies.

Senator LONG. Here is another question I have in mind: Leaving out this matter of inflation, is it not true that high interest does increase the cost for a great number of people in this country? In other words, in many respects it increases the cost of living for many people, in and of itself.

Mr. MARTIN. It is one of the factors in increasing costs; as I pointed out earlier, it is a minor factor in relation to the cost of the goods and services that they are buying, but unquestionably it is one of the costs.

Senator LONG. The point was made by Under Secretary Burgess that for a major industry the interest cost was less than one-half of 1 percent, and therefore an increase in interest rates of 50 percent would only increase its costs of doing business by perhaps one-quarter of 1 percent.

On the other hand, let us see what it does to home building. Here is a tabulation that I have made to show, on a 10-year and 20-year mortgage—no, put it on a $10,000 and $20,000 mortgage based on the period of years for which that mortgage is outstanding—the difference in cost.

Now, I notice this: that the monthly payment and the final interest cost is almost 9 percent higher on a 20-year mortgage if you increase interest rates from 4 percent to 5 percent; the same 1-percent increase would increase the cost of buying a house on a 25-year mortgage by more than 10 percent, almost 11 percent; and it would increase the cost of buying that house, if bought over a 30-year period, by 12.4 percent.

I would like to make these available for the record.

(The information referred to is as follows:)

Effects of the increase of 1 percent (i. e., from 4 percent to 5 percent) on interest payments for mortgages of various principal amounts and maturities

Principal	Term (years)	Interest rate (percent)	Monthly payment to principal and interest	Total interest payment
$10,000	20	5	$66.00	$5,838.19
$10,000	20	4	60.60	4,543.28
Difference			5.40	1,294.91
Percent increase in monthly payments				8.9
$10,000	25	5	$58.50	$7,525.55
$10,000	25	4	52.80	5,831.51
Difference			5.70	1,694.04
Percent increase in monthly payments				10.8
$10,000	30	5	$53.70	$9,317.20
$10,000	30	4	47.80	7,167.42
Difference			5.90	2,149.78
Percent increase in monthly payments				12.4

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Senator LONG. That does increase the cost of living for those people buying homes, does it not?

Mr. MARTIN. Well, it certainly is a factor in increasing the cost of living to them.

But putting it against the cost of building supplies and building equipment—I do not have the figures here, but I would be glad to work up a table for you and show you that cost has gone up infinitely more than this cost.

Senator LONG. Well, if a person is buying a house, his cost is 10 percent higher than it would be if you had interest rates 1 percent less, is it not? There is his average monthly payment. Ten percent would be a fair average, depending on those figures.

Mr. MARTIN. I do not know—well, the increase in monthly payments here would be 10.8 percent more. Now, what the cost of the house would be on the higher cost, that would be——

Senator LONG. There it is, right there. There it is on the right-hand tabulation; you can see the final payment in interest, and that works out to about 10 percent additional interest costs.

Mr. MARTIN. Yes. But the point I am trying to make, Senator, is that you are neglecting the rise in building costs that is occurring coincident with this.

Senator LONG. I am just saying, in and of itself, let us leave out this argument about inflation for a moment——

Mr. MARTIN. Well, but I——

Senator LONG (continuing). And I am saying, how much does the additional interest cost increase the cost of buying a house?

Well, a 1-percent increase in interest works out to about a 10-percent increase in the monthly payment on the house, does it not?

Mr. MARTIN. Assuming that you can keep the cost of the house static.

Senator LONG. I got those figures from the Banking and Currency Committee, by the way. I did not compute them myself.

Mr. MARTIN. All right.

But that is assuming you can keep the cost of the house static. The point I am making is, you just cannot make the assertion in a vacuum that it costs this amount, an increase in this amount. It has to be related to what the cost of the house is.

Senator LONG. Well, if I want to buy a home, ordinarily, let us say there is a $10,000 house I want to buy. If I can get a 4-percent mortgage, then my payments would run about 10 percent less than they would if I have to take it on a 5-percent mortgage; would that not be correct?

Mr. MARTIN. Well, yes. But what about the $10,000 house maybe costing $12,000 because of the current inflation?

Senator LONG. What I am saying is, and I hope you will agree with this, that in and of itself, leaving out all other factors, an increase in interest cost increases the cost of living for a homebuyer as 1 is to 10.

In other words, every 1-percent increase in interest increases the cost of buying the house by about 10 percent.

Mr. MARTIN. Well, the point I am trying to make is that in and of itself, you cannot separate this price. I just do not think you can make a statement—I mean, I do not think I can agree that in a vacuum you can say that the cost goes up by 10.8 percent. There certainly

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will be an increase in costs; if you eliminate the factors of inflation and if current business factors were static, you would be correct. But I do not think that is so.

That is where you and I have a disagreement.

Senator LONG. Mr. Chairman, there is the tabulation, and if you are buying a house, you have got to think about the same thing I am thinking about, and that is, how much do I have to pay in total when I pay the mortgage off?

Even though I just computed how much my new mortgage is going to cost me, it is now going to cost us for the same mortgage $50 a month extra, or $600 a year more than we were paying before, because of the increase in interest costs on a $20,000 mortgage.

The same thing would be true of rent, would it not?

Mr. MARTIN. Oh, yes. Rent would fall in the same category.

Senator LONG. In other words, a landlord has to think in terms of the cost of money on his investment, and when interest costs go up, then of course it is necessary for him and all other landlords to advance their rents; is it not?

Mr. MARTIN. I doubt very much whether that is true in the present market, but it is certainly a factor that he has to consider, likewise.

But I think that a good many vacancies are appearing.

Senator LONG. Even in the supply of housing, if a person is trying to decide whether to build one of these large apartment buildings around Washington, or anywhere else in the country, to supply more housing, he has to think in terms of charging rents which will enable him to pay the interest on his money and to amortize his investment; does he not?

Mr. MARTIN. He does, indeed.

Senator LONG. This being the case, an increase in interest means that, certainly for rental new housing, the housing will not be constructed unless the landlord feels he is in position to get the interest plus a fair profit and an amortization of his investment.

Mr. MARTIN. That is correct.

Senator LONG. In and of itself, standing alone, the increase in interest rates also increases the cost of a small-business man doing business, and to a much higher degree, on the average, than the cost of large business; does it not?

Mr. MARTIN. No, I cannot say that. We have discussed that a good many times, and I am not at all certain of that. It increases the costs——

Senator LONG. You think that with businesses which have an equity investment, equity holding of, say, less than a quarter million dollars, that the interest cost is less than 1 percent of their costs of doing business?

Mr. MARTIN. Well now, rates on small loans have not gone up as much as on large loans.

Senator LONG. That is not what I am asking, though. I am just asking if an increase in interest does not increase the cost of doing business for a small-business man even more than it does for most of the large industries?

Mr. MARTIN. No; I cannot say I agree with that.

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For the marginal borrower and, it is not a matter of whether he is small, medium-sized, or large, it certainly makes it more difficult for the marginal borrower to obtain credit.

But I am unconvinced—we are going to make a careful study of this—but I am unconvinced yet that you can demonstrate that the small person has been discriminated against during this period.

Senator LONG. Can you undertake to get us some figures, some information, to show us what percentage of small business' expense is represented by interest costs? The figures were provided with regard to basic industries by Under Secretary Burgess.

I wonder if you might be able, either directly or through some of your interdepartmental committees, to provide us with material to show us what is the percentage of cost represented by interest expense for small businesses?

Mr. MARTIN. We will do our best on it, Senator.

Senator LONG. I believe that is just about all the questions I wanted to ask, Mr. Chairman. Thank you very much.

(The information referred to is as follows:)

SMALL-BUSINESS INTEREST COSTS

The latest detailed information on business expenses available is the Internal Revenue Service tabulations of corporate income tax returns for 1953. These tabulations indicate that interest is a relatively smaller cost for small businesses than for large concerns. Thus, interest payments as a proportion of total compiled deductions (total expenses allowed in computing net income) averaged one-half of 1 percent for nonfinancial companies with assets under $250,000, but amounted to a full 1 percent for corporations with assets of $50 million or more. Unfortunately, no comparable information is available from the tabulations of tax returns filed by proprietorships and partnerships.

The CHAIRMAN. The Chair recognizes Senator Carlson.

Senator CARLSON. Mr. Chairman, I appreciate very much the granting of this opportunity at this time. I will want to complete the statement, as you have just stated; otherwise, I would have been pleased to wait until Senator Long was present, because I talked with him Friday, and he had not concluded.

Mr. Chairman, I have appreciated your very frank statements in regard to our monetary policy. Your opening statement seemed to me to stress the fact that the Federal Reserve had but one goal, and that is to give this Nation a stable and sound monetary program which would provide our economy with sufficient money and credit to furnish high employment, expand production, and prevent inflation from robbing our people of their savings.

It is my intention to ask a few questions in regard to labor, the gross national production, and the effects of employment and unemployment on our economy.

My first question is going to be: Is there a shortage of labor?

Mr. MARTIN. The labor supply has fluctuated, Senator. In the last few years, as was evident in my colloquy with Senator Long, I think that in certain skilled areas today there is a shortage of labor.

A year ago, I think the shortage of labor was greater than it is today. But in certain skilled areas and in certain areas of the country, there is definitely, in my judgment, still a shortage of labor.

Senator CARLSON. I noticed just recently, I believe last week, where the Secretary of Commerce and the Secretary of Labor, Mr. Mitchell,

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stated that we had an alltime high, I believe, of 67,200,000 employed during July.

The question then gets to be, if we have a shortage of labor, do you think that we are faced, then, with the choice between price stability, a higher level of unemployment, and a slower rate of economic growth on the one hand, or creeping inflation and continued economic growth on the other hand?

Mr. MARTIN. Well, Senator, I am convinced that the alternative to inflation is not widespread unemployment. I think we can have—and that is evidenced, I think, by the years in which we have had lower unemployment than we have presently, and also less inflation than we have currently—we can have very high levels of employment without inflation.

The employment that we want is stable employment. It is employment that will be sustained and maintained, not temporary additions to the labor force which will be cut back as soon as excess capacity develops in the line.

And it is my conviction we can have the goals of the Employment Act in a country that has the growth potential of this country if we will recognize that if we try to do things too fast, we are going to have needless unemployment.

Senator CARLSON. And following that suggestion and statement, if it should develop that we had to make a choice between creeping inflation or some unemployment, which would you choose?

Mr. MARTIN. I think it depends on the point that you are in the cycle. I think that any employment which would develop as a result of a creeping inflation of the sort you are talking about would be very temporary indeed, and I think you cannot separate price stability and growth in the economy. I think that you have to recognize that they are very closely related. It is not possible to completely isolate one from the other.

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

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

Mr. MARTIN. You would have had, in my judgment, more inflation than we have had. You would have had inflation feeding upon itself in a way that it has not fed upon itself, and I am confident that you would have had greater demands upon our resources than we could have met without rather sharp further increases in prices.

The cost of living has gone up for 11 successive months, as it is.

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

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

Senator CARLSON. Are the decisions the free market makes about the allocation of savings, in line with the economic welfare of our people? For instance, is it consistent with our economic welfare for wealthy corporations like the A. T. & T., General Motors, and many others, to

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be able to borrow money, while school districts, housing, and other worthy enterprises have unsatisfied demands for credit?

That has been one of the problems, I know, which has been discussed for some time before this committee.

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

Senator CARLSON. Did I understand from that statement that the funds under this economy are determined or will be determined by savings?

Mr. MARTIN. Until there is a better balance between spending and saving, I am confident that it should be.

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

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

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

Mr. MARTIN. I think it is partially, because I think that spending, governmental and State and private spending, is a factor. There are the three factors here, money and credit policy, budget policy, and management of the debt, all of them working together, and I think that money and credit policy is just one of those three factors.

Senator CARLSON. We have been discussing some of these phases of employment and gross national production as it affects our economy as a whole. I want to get back to employment again.

Do you think employment is (*a*) over full? I mean by that, if we are employing 96 percent of our employable people or labor force, is that about as high as we can get?

Mr. MARTIN. I would say it is about as high as we can get. I would say we have had a condition of full employment for roughly the last 2 years.

Now, I would not want to be dogmatic and say that the degree of unemployment which is consistent with a stable price level is necessarily an accurate definition of full employment. But I think that you have to bear in mind that at all times when employment is rising at the expense of price stability, you are one step removed from deflation. And our battle should constantly be against deflation.

I think that is our objective in resisting inflation. First you have inflation, which is followed by deflation. When you have a strong, growing economy such as we have had——

Senator CARLSON. Well, now, with this inflation, is it the natural tendency for a shortage of labor to cause prices to rise?

Mr. MARTIN. Well, labor is just one factor in it. If you have to bid labor away from one industry to put it in another industry, and

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you are already straining against capacity, in a general sense, why, I think that in itself contributes to a rise in prices.

Senator CARLSON. You have just stated, I believe, that a shortage of labor is not necessarily the cause of a rise in prices, and that we do have, not necessarily full employment, but certainly very high employment. There are some people who do not agree with the policies of the Federal Reserve, and contend that your present policies are preventing full employment, increased gross national production, and increased inflation. I have here a clipping from the Washington Post of August 14, the heading of the article being "Economic Blundering Laid to Ike." It is dated "Chicago."

The AFL–CIO executive council today launched an all-out attack on Eisenhower administration economic policies with a charge that they were designed to hasten a recession.

The council, meeting in its summer session here, issued a legal-style statement condemning tight-money policies and accusing business and administration leaders of "blundering dangerously."

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

Mr. MARTIN. Well, obviously, I do not think the Federal Reserve Board is blundering dangerously. I think that to take the position that the way to cure an inflation is by additions to the money supply is just asking for more inflation, and I am convinced that the No. 1 economic problem today is to direct all of our energies to reducing spending and increasing savings. We have within our grasp, as I stated earlier, I think, a higher standard of living on a sound basis, if we just do not try to do too many things too fast, and if we give savings a chance to accumulate to be utilized in the way they should be, instead of depending upon the creation of bank credit to supply a deficiency in savings.

Senator CARLSON. Well, now, just following on in this same article, and I read:

The statement was hammered out last night at a meeting of the AFL–CIO's economic policy committee, headed by Reuther and attended by Keyserling. It was organized labor's most blanket indictment to date of Eisenhower economic policies.

They state here, and I read:

"A thorough reappraisal of all public policies and private actions that affect the stability and growth of the American economy is long overdue," it added.

The statement attacked decisions to raise interest rates by the Federal Reserve Board and the Federal Housing Administration and the offering of Government bonds at 4-percent interest by the Treasury Department.

Such actions, the statement said, were designed to hasten a recession.

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

Mr. MARTIN. There is no intention on the part of the Federal Reserve to hasten a recession. I do not want recession at any time.

I have pointed out that, if there are excesses which develop, corrections are necessary from time to time. The actions, the overt actions, we have taken—we influence the money supply, but do not control it—have been as a result of reflections of the demand, the terrific, overwhelming demand for credit that has occurred persistently in the economy for the last 2 years.

It seems to me that it is tantamount to a California gold rush in its intensity, and that the forces which we are dealing with cannot be

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equalized in any sense without the use of the price mechanism, and interest rates are merely a reflection of this operation.

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

Senator CARLSON. I have just read a recent article entitled "Cracks in the National Economy," by Leon H. Keyserling, which appeared in the July issue of the Progressive magazine, published in Madison, Wis. Leon Keyserling is a personal friend of mine, and I have listened to him on many occasions, but I want to read 2 or 3 statements from this article which appeared in this magazine.

The facts of our economic life show:

Our overall economic growth in real terms, which averaged 4½ percent a year for several years after World War II, has averaged only 2½ percent during the past few years, and even less during the past 15 months. This slowdown has caused almost $60 billion in lost production within 4 years. Total production during the past few months has been at an annual rate of about $25 billion below full production. By the first quarter of 1957, the true level of unemployment was 40 percent higher than in 1953.

First, I would like to ask you, what would have happened to our economy had we poured out $60 billion more in gross national production in the last 4 years?

Mr. MARTIN. You would have had an acceleration of the point that I have commented on, that between 1955 and 1956 we lost more than 50 percent of the increase in our gross national product in a markup in prices, without any additional goods and services, and I think that would have been accelerated substantially if what you said had occurred.

Senator CARLSON. Well, now, by the first quarter of 1957, and I am reading now—

By the first quarter of 1957, the true level of unemployment was 40 percent higher than in 1953.

I am not familiar with the figures in 1953, but I believe you stated that we have fairly high employment at the present time.

Mr. MARTIN. We do have fairly high employment. I had not prepared it for that purpose, Senator, but I have an analysis of current unemployment here, which I would be glad to put in the record. made by our staff recently, which, certainly, I think, would be at variance with those figures you read. I think you could analyze these figures a great many different ways, and I would not offhand want to—I would be glad to put this in the record.

Senator CARLSON. Mr. Chairman, I am going to ask that it go in the record. I have not seen it.

The CHAIRMAN. Without objection.

Mr. MARTIN. It is an analysis of the unemployment situation.

Senator CARLSON. I think it would be appropriate.

Senator BENNETT. Is it in such shape that it could be read for the information of the committee, to follow the questioning?

Mr. MARTIN. I will read this.

FACTORS ACCOUNTING FOR DIFFERENCES IN UNEMPLOYMENT; 1951 TO MID-1953 AND 1957

Current unemployment

First, in terms of perspective, it is worth while examining current levels of unemployment.

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In July 1957, unemployment totaled 3 million, or 4.3 percent of the civilian labor force, based on new definitions which were adopted starting January 1957. If old definitions were used—and data on the old basis are the only data comparable with earlier periods—unemployment in July would have been reported as 2.7 million, or 3.8 percent, of the labor force.

The summer months tend to be the high months in the year in respect to unemployment because of a large influx of students and graduates looking for summer jobs. As students leave the labor force in September and as the usual fall expansion in industrial activity gets underway, unemployment drops rather sharply.

Between July and October, unemployment can usually be expected to decline by 700,000 to 800,000. Thus, if only seasonal factors affect unemployment between now and fall, the number of workers seeking jobs in October of this year will be only about 2.2 million, under the new definition.

Since early 1955, seasonally adjusted unemployment has remained virtually unchanged, with the unemployment rate moving within a one-half percent range and with no consistent trend in either direction.

I just made this up for my own information.

During this period. over 3 million workers were added to the labor force, a much larger increase in the labor force than would have been expected on the basis of growth of the population of working age, reflecting the continuing strong demands for workers.

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

Other indications of the current low level of unemployment are that about two-thirds of the unemployed have been looking for work less than 6 weeks, and that only 500,000, or less than 1 percent of the labor force, were reported as having been unemployed for 15 weeks or more in July.

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

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

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

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

Senator CARLSON. That was certainly a very interesting statement.

If I understood it correctly, in July the unemployment had reached only 2 or 3 percent, less than 3 percent, of our national labor force.

Mr. MARTIN. I will continue this a little bit further, if I may.

I have here comparison of current unemployment with 1951 to mid-1953:

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In the first half of 1957, average unemployment was about 800,000 to 1 million more than in comparable months in 1952 and in 1953. The old definition was used in both instances for purposes of comparability.

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

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

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

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

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

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

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

Since 1953, there has been a reduction in manpower requirements in the railroad, mining, and textile industries which has resulted in some increase in longtime unemployment and is reflected in somewhat higher rates of unemployment among older workers now than in the 1951–53 period.

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

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

In 1957, while unemployment among automobile workers declined, reductions in residential construction, lumber, electrical machinery and more recently aircraft employment, have tended to keep the un-

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employment totals fairly constant, but probably slightly higher than if all activities were currently rising.

The unemployment series is based on a sample survey and has all the difficulties of such data including sampling error. A difficult factor to evaluate has been the improvement in unemployment data resulting from two changes in the census sample since 1952–53.

In 1957, census interviewed about 35,000 households in 330 areas each month. In 1952–53, only 21,000 households were interviewed in 68 areas each month. Sampling error for unemployment in 1952 was calculated as 190,000. In 1957, the sampling error is 100,000 for unemployment.

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

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

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

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

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

(Tabulation on unemployment and labor force submitted by Mr. Martin is as follows:)

Unemployment and labor force, July of each year

	1950	1951	1952	1953	1957 (old definition)	1957 (new definition)
Number unemployed (thousands)	3,213	1,856	1,942	1,548	2,686	3,007
Unemployment rate:						
Total all ages	5.0	2.9	3.0	2.4	3.8	4.3
14 to 19 years	12.0	8.1	8.8	6.6	10.9	11.8
20 to 24 years	7.0	3.6	4.2	3.2	5.5	6.2
25 to 34 years	4.5	2.2	2.3	1.9	3.4	3.8
35 to 44 years	3.3	2.0	2.3	1.8	2.3	2.8
45 to 54 years	3.6	2.1	1.8	1.5	2.5	2.7
55 to 64 years	3.8	2.4	2.3	2.3	2.7	3.0
65 years and over	3.6	1.7	2.2	1.4	3.0	3.3
Total labor force (thousands)	65,742	67,477	67,642	68,804	73,056	73,051
Armed Forces (thousands)	1,315	3,095	3,466	3,590	2,823	2,823
Civilian labor force (thousands)	64,427	64,382	64,176	65,214	70,233	70,228

Mr. MARTIN. I had that made up, Senator, because I wanted to go over the data on unemployment. It is not a completely scientific analysis, as you can see.

Senator CARLSON. Mr. Chairman, I think you made a very valuable contribution this morning, because it is one of the problems confront-

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ing this committee, the percentage of unemployment, and whether we have full employment.

The gross national production we have at the present time, which I understand is very high, is based on this 96 or 97 percent of full employment.

Then I would ask again—I still have this article before me of Mr. Keyserling's—who would have produced—and I am quoting now:

> Total production during the past few months has been at an annual rate of about $25 billion below full production.

Who would have produced those goods, $25 billion worth, with this employment?

Mr. MARTIN. Well, I do not know who would have, and I think it is perfectly obvious that prices have been rising during this period, and they would have risen more, if you had had further additions to debt, which is largely what we have been dealing with here: we never want to forget the fact that of recent additions to purchasing activity, a good percentage is accounted for by debt. I deplore the idea of spending more than you have to try to buy more goods than are available. The creation of money to add to the spending stream under such circumstances can do nothing but put prices up, as I see it.

Senator CARLSON. I want to read another section from this same article by Mr. Keyserling, and I do not do this because of anything personal against Mr. Keyserling, but it is a philosophy that he evidently has advocated, and there is a conflict between different views in this Nation, and I think we ought to analyze it a little, and I quote:

> The slowdown in economic growth has resulted largely from an even greater slowdown in consumption growth. Purchases by American consumers, measured in 1956 dollars, grew only 1½ percent from the fourth quarter of 1955 to the fourth quarter of 1956. The deficiency in this consumption now accounts for 70 percent of the deficiency in total production.

From that statement, may I inquire about the purchasing power of our American people. Do they have the funds to buy with, or what is our situation?

Mr. MARTIN. Well, purchasing power has been high; if you take disposable personal income, this last month it made a new high $302.5 billion—personal income was $345.5 billion.

I might read here what I have on consumer disposable income.

The assertion that consumer disposable income has not increased during the past year disregards the inflation which is our problem by stating it in terms of ex-inflation dollars.

This is the colloquy I had with Senator Long. I am sorry he is not here.

Consumer personal income available for spending has grown appreciably, both in absolute amount and on a per capita basis, during the past year.

It is the largest single component, by far, of the total spending stream that has sustained the continued rise, both in wholesale prices and in the cost of living. If consumers had saved a larger proportion of this income, which is the point I made earlier, it would have been available for the financing of schools, highways, and capital plant, without contributing further to inflation and the reduction in the value of their spending dollar.

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As it is, the inflation that has actually occurred has offset in large part the buying power of the increase in consumer disposable income. There is just no percentage in increasing disposable personal income if you are going to lose more than 50 percent of the increase from one year to the next in a markup in prices without any additional goods and services.

Senator CARLSON. In other words, a reduction of the dollar's purchasing power would not increase the amount of goods the consumer got, but he would pay more for them.

Mr. MARTIN. That is right.

Senator CARLSON. As I read this, I was concerned about it, because it states in this article, and I will read again now:

> The deficiency in this consumption now accounts for 70 percent of the deficiency in total production.

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

Mr. MARTIN. That is correct.

I have a comment on production here I would like to read, if you would permit it, Senator.

Senator CARLSON. You may.

Mr. MARTIN. Increased production per se does not cure inflation. Money income is generated in the process of production, and becomes part of the spending stream.

As was pointed out on Tuesday, one man's expense is another man's income. Consequently, increases in production in themselves add to the flow of spending as well as to the flow of goods.

Increased output to the full extent permitted by our capabilities is good, provided, of course, it is the right production and is financed in such a way as to promote continued prosperity.

However, if there is excess money demand present in the economy at a time when resources are actively employed, that excess will cause a rise in prices. Increased production under these circumstances will add to the spending stream as well as to the stream of goods and services.

It will not, therefore, eliminate the excessive money demand that is the cause of rising prices. For inflation to be curbed, excess money demand must be absorbed from the spending stream.

This may come about by the development of a budget surplus, by increased planned savings, by curtailed borrowing from banks, or by a slowing down in the growth of the money supply or in its turnover.

It does not result automatically from increased production.

No one would maintain that a cessation of production, the reverse of this proposition, would stop a deflation. Likewise, an increase in production does not in and of itself stop an inflation.

The unhappy condition of France today is a standing example of this fact. It sharply increased its production as well as its productivity, but it failed to take measures adequate to reduce the excess money demand that was necessary to avoid a crisis.

Senator CARLSON. Mr. Chairman, that is an answer to a question I expected to get into, because I am getting into productivity, so I will ask a question now that I feel you have answered:

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Do you consider the current inflation is due to increases in profits or wages greater than increases in productivity?

Which is about what you have stated in that statement you just read.

Mr. MARTIN. That is correct.

Senator CARLSON. I notice that Dr. Gardiner C. Means, an economist for the Committee for Economic Development, who invented the term, I think, "administered prices," has come up with a theory that the current inflation is an "administered" inflation.

As I read the statement, he contends that the sellers of commodities can administer prices to any level they choose, and labor, in view of its great bargaining power, can increase wages in any amount they care to, and that this is "administered" inflation rather than a monetary inflation.

Do you agree with that theory?

Mr. MARTIN. No, I do not agree with that, Senator. I have commented from time to time on administered prices, and I recognize that there are such things, and that they can be effective for periods of time.

But I insist that in the long run, you cannot get away from the fundamental forces of supply and demand, and that is what we are dealing with here. When we talk about inflation, it really does not make too much difference whether we are talking about cost inflation, price inflation, or how it comes about; the fact remains it is still inflation, and we have got to do everything within our power to stop it, or the expectation of further inflation will become one of the elements of psychology in the country in such a way that saving and investment, which is at the heart of a growing economy, will be eroded.

That, in essence, it seems to me, is where the problem lies.

Senator CARLSON. Then I believe your answer to that would be that, it would not be correct to state, rising prices cause inflation, but that they are the result of inflation?

Mr. MARTIN. That is correct.

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

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

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

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

Senator CARLSON. Would you indicate statistically or graphically the relative rates of increase in profits, wages, and productivity, in manufacturing, and such other segments of our economy for which

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figures are available, for the periods beginning in the year, for instance, 1900 to the present——

Mr. MARTIN. I would be very glad to have that prepared.

Senator CARLSON. Prepared, and put it in the record.

Mr. MARTIN. Prepared, and put it in the record.

Senator CARLSON. Do that, and then take 1930 to the present, 1940 to the present, 1946 to the present, and 1953 to the present, and 1956 to the present.

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

Mr. MARTIN. I do not think so.

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

Mr. MARTIN. I think so.

Senator CARLSON. Do you have figures there which would show the rate of increase in productivity since the end of 1945?

Mr. MARTIN. I will be glad to get them for you.

Senator CARLSON. If they are available, I would like to have them.

Mr. MARTIN. Why do we not get them and put them in the record?

Senator CARLSON. Place them in the record. And if you do that, would you get them since the end of 1954?

Mr. MARTIN. I would be glad to.

(The information referred to is as follows:)

QUESTIONS RELATING TO PRODUCTIVITY, WAGES, PROFITS, ETC.

It should be stressed that available data relating to output per man-hour (productivity) are subject to significant limitations. Furthermore, for 1957 the available data relate only to manufacturing, and these are as yet quite tentative.

In Chairman Martin's answers to No. 9 of the questions submitted by Senator Byrd, it was stated:

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

"In the nonmanufacturing sector, measurement of output per man-hour is subject to even greater qualification than in the manufacturing industries, because it is so difficult to measure output in physical terms * * *."

The committee staff of the Joint Economic Committee, in its productivity, prices, and incomes (published in 1957) has compiled a great variety of information relating to the above questions. The Joint Committee staff is fully aware of the difficulties engaged in measuring these variables and is careful to caution users about their limitations. Thus, on page XI of this report it is stated: "We submit these data with some hesitancy, since many of them are subject to all of the limitations and frailties of statistics in general. Data covering long periods of years collected by different agencies and for varying purposes must be

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used with great caution since concepts, coverage, consistency, and degree of accuracy make their interpretation uncertain and the drawing of inferences and relationships hazardous. On the empirical evidence of statistics alone it is, moreover, dangerous to ascribe casual relationships where correlations, no matter how close or how elusive, appear to exist." On page 5 it is stated: "The problems of measurement have been particularly troublesome in studies of productivity, prices, and incomes."

For the purpose of answering Senator Carlson's questions, some relevant data have been selected from this report.

The following table is reproduced from page 22 of this report:

Average annual percent increase in real private product per man-hour [1]

Period	Total	Farm	Nonfarm	Period	Total	Farm	Nonfarm
1910–19	0.7	0.4	0.7	1953–56	2.2	4.8	1.9
1919–29	2.5	1.1	2.5	1910–39	1.8	.8	1.9
1929–39	2.5	2.0	2.5	1910–53	2.1	1.8	2.0
1939–47	2.2	2.3	1.6	1947–56	3.0	4.0	2.8
1947–53	3.6	3.7	3.4	1910–56	2.2	2.0	2.2

[1] Computed from least squares trends of the logarithms of the index numbers of tables 3 (p. 89 of the report) and 5 (p. 91).

On page 18 of this report it is stated: "The long-run average rate of increase in output per man-hour has been about 2.2 percent per year for total real private nonfarm product, about 2 percent for farm product, about 3 percent for manufacturing, 2.4 percent for farm production (gross), over 2½ percent for mining, and about 3 percent for steam railroads.

"The rates of increase in each segment have varied widely over shorter periods. For example, in manufacturing the average rate of increase per year (computed from a least squares logarithmic trend line) was about 2.9 percent from 1909 to 1914, no change from 1914 to 1919, about 5.3 percent from 1919 to 1929, about 2.2 percent from 1929 to 1939, less than 1 percent from 1939 to 1947, and about 3.7 percent since 1947. Gross agricultural production per man-hour increased by only about 1¼ percent per year from 1910 to 1939, but rose at a rate of 4 to 4½ percent per year from 1939 to 1956."

The accompanying table 1 shows for manufacturing industries, for selected years:

(*a*) Real output per man-hour, 1947–49=100.

(*b*) Hourly earnings of production workers in both current and 1956 prices.

(*c*) Payrolls (1947–49=100).

(*d*) Corporate profits in manufacturing before and after tax.

(*e*) The BLS Consumer Price Index, in addition to the data relating to manufacturing industries only.

These are a complex set of data to analyze, quite apart from the limitations of the statistical measurement of output per man-hour. It should be noted, however, that the changes in corporate profits and in total payrolls reflect, among other factors, changes in prices, in total output, in employment, and in the length of the overage workweek. Between the terminal years 1914 and 1956, the data suggest that hourly earnings after allowance for changes in consumer prices, have shown about the same increase as has real output per man-hour. Within this long period, however, there have been intervals when hourly earnings, after allowance for changes in consumer prices, have apparently increased faster than output per man-hour and other intervals when they have increased slower.

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TABLE 1.—*Manufacturing*

Year	Real output per man-hour (1947-49=100)	Consumer Price Index (1947-49=100)	Hourly earnings (production workers)		Payrolls (1947-49=100)	Corporate profits (billions of dollars)	
			Current dollars	1956 prices		Before tax	After tax
1909	35.4	(1)	(1)	(1)	10.8	(1)	(1)
1914	40.8	42.9	0.223	0.604	12.7	(1)	(1)
1929	70.0	73.3	.566	.897	36.6	4.8	4.2
1930	71.6	71.4	.552	.899	29.7	1.6	1.3
1940	95.1	59.9	.661	1.283	34.6	5.5	3.8
1946	90.5	83.5	1.086	1.513	81.4	11.4	6.7
1953	119.7	114.4	1.77	1.80	151.4	21.2	8.9
1954	125.6	114.8	1.81	1.83	137.7	18.4	8.6
1955	130.0	114.5	1.88	1.91	152.5	24.8	11.9
1956	133.5	116.2	1.98	1.98	161.3	24.6	11.5
	Percentage increases						
1909-56	277.1				1,393.5		
1914-56	227.2	170.9	787.9	227.8	1,170.1		
1929-56	90.7	58.5	249.8	120.7	340.7	412.5	173.8
1940-56	40.4	94.0	199.5	54.3	366.2	347.3	202.6
1946-56	47.5	39.3	82.3	30.9	98.2	115.8	71.6
1953-56	11.5	1.6	11.9	10.0	6.5	16.0	29.2

[1] Not available.

Source: Real output per man-hour and payrolls from staff of the Joint Economic Committee report, Productivity, Prices, and Incomes; Consumer Price Index and hourly earnings from Bureau of Labor Statistics; corporate profits from Department of Commerce.

Table 2 shows for selected years indexes of real private production per man-hour and estimates, in billions of current dollars, of total compensation of employees and of total corporate profits before and after corporate profits tax liability. Also shown are employees' compensation and corporate profits as percentages of national income. It should be noted that the data on production per man-hour are based on deflated estimates of output; whereas the estimates of employees' compensation and profits reflect price changes as well.

These estimates indicate that growth in real production per man-hour for the private economy as a whole was substantially smaller than the increase in productivity for the manufacturing sector (shown in table 1), both for the entire period from 1909 to 1956 and for the last decade of this span. On the other hand, the estimated gain since World War II in real average hourly earnings in the private nonagricultural area as a whole (not shown in the table) was about the same as the increase in real average hourly earnings of production workers in manufacturing. (See estimates and discussion in Bureau of Labor Statistics study, Productivity, Earnings, Costs and Prices in the Private Nonagricultural Sector of the Economy, 1947–56, May 13, 1957.)

The relative shares of total national income accounted for by employees' compensation and by corporate profits before tax showed relatively small changes from 1953 to 1956 and were at levels well above those in 1929 and in 1940. Reflecting higher rates of taxation on corporate income, corporate profits after tax in recent years have been a smaller percentage of national income than in the immediate postwar and in prewar years. Thus, while employees' compensation and before-tax profits both increased by over 360 percent from 1940 to 1956, after-tax profits rose by about 225 percent. Taxes on individuals' incomes, however, have also been increased and, on an after-tax basis, the increase in employees' compensation would also be considerably smaller than the before-tax data in the table indicate. Estimates of personal taxes paid by employees are not available separately from the total of such taxes.

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TABLE 2.—*Output per man-hour, compensation of employees, and corporate profits, selected periods, 1909–56*

Year	Real private production per man-hour (1947–49 = 100)	Total compensation of employees	Total corporate profits		Percent of national income		
			Before tax	After tax	Total compensation of employees	Total corporate profits	
						Before tax	After tax
		Billions of current dollars	*Billions of current dollars*	*Billions of current dollars*			
1909	47.7	(1)	(1)	(1)	(1)	(1)	(1)
1929	66.9	51.1	9.6	8.3	58.2	10.9	9.5
1930	64.9	46.8	3.3	2.5	61.8	4.4	3.3
1940	85.9	52.1	9.3	6.5	63.8	11.4	8.0
1946	97.1	117.7	22.6	13.4	65.5	12.6	7.5
1953	118.6	208.1	37.0	16.7	68.9	12.2	5.5
1954	120.4	206.8	33.5	16.0	69.2	11.2	5.4
1955	125.4	223.1	42.5	21.0	68.8	13.1	6.5
1956	125.9	241.4	43.0	21.0	70.3	12.5	6.1
	Percentage changes						
1909–56	163.9	----------	----------	----------	----------	----------	----------
1929–56	88.2	372.4	347.9	153.0	----------	----------	----------
1940–56	46.6	363.3	362.4	223.1	----------	----------	----------
1946–56	29.7	105.1	90.3	56.7	----------	----------	----------
1953–56	6.2	16.0	16.2	25.7	----------	----------	----------

[1] Not available.

Source: Real private production per man-hour from staff of the Joint Economic Committee report, Productivity, Prices, and Incomes; compensation of employees and corporate profits by Department of Commerce.

Senator CARLSON. What is the cause of the relatively lower rate of the increase in productivity in the past 2½ years? And I believe we had testimony to that effect here from Secretary Humphrey and Secretary Burgess, and maybe yourself.

Mr. MARTIN. Well, I do not know. I cannot answer that specifically. I think there has been some tendency perhaps to compress, but I cannot explain.

Senator CARLSON. Would you be willing, if you can prepare some statement on that matter, to present it for the record?

Mr. MARTIN. I would be very glad to prepare it.

(The information referred to is as follows:)

The tables submitted for changes in productivity indicate that (*a*) Real private production per man-hour changed little from the year 1955 to the year 1956; and (*b*) output per man-hour in manufacturing activities showed a much smaller rise from the year 1955 to the year 1956 than in most preceding postwar years.

Any persistent decline in the rate of productivity increase would, of course, be a matter of concern. It should, however, be stressed that gains in output per man-hour have in the past been uneven from year to year. For example, from 1950 to 1951 real private production per man-hour showed about the same increase as from 1955 to 1956, while output per man-hour in the manufacturing industries changed little—and may have declined. Developments in late 1955 and early 1956 cannot, of themselves, be taken as indicative of a significant lowering of the long-term rate of productivity gain. Furthermore, these data give no indication of changes in productivity in 1957. Thus, to quote from Chairman Martin's answer to question 9 submitted by Senator Byrd, "The preliminary data for manufacturing, based on production workers only, suggests that in the last half of 1955 and the first half of 1956 output per man-hour was relatively stable rather than increasing. Wage rates continued to rise during this period. After mid-1956, however, it appears that output per man-hour again began to increase with the rise in output per man-hour between mid-1956 and mid-1957 probably more in line with historical trends."

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The reasons for the slowing up in the rate of productivity increase in the second half of 1955 and the first half of 1956 cannot be stated with certainty. The slowing up may in part represent the intensive utilization both of manpower and industrial capacity during this period. Thus, plants may have been used beyond their most efficient operating level. The effects of the large investment program on which industry embarked in early 1955 would not be felt until later. The tight labor market may well have been reflected in hiring new workers in a number of occupations who were not as experienced as the bulk of the work force. Furthermore, shortages of labor may have resulted in excessive work forces (in effect, hoarding) in many companies. Finally, the strong demands of the period and the fact that profits were at advanced levels may have put somewhat less pressure than usual on employers to push for productivity gains.

Senator CARLSON. What is the basic cause of a continuous rise in productivity over the past 50 years?

I think our economy has been growing, expanding. What is basically the cause of it?

Mr. MARTIN. I think the worker has performed more efficiently, and I think technology has played a very important part in it.

Senator CARLSON. What about the increased skill of workers?

Mr. MARTIN. I think that has been a major factor. That is one of the reasons why we need to keep our educational facilities abreast of the things, particularly in technical schools and that type of thing. We need additions to the skilled labor force in every way that we can get them.

Senator CARLSON. What about increased capital investment in more efficient machinery?

Mr. MARTIN. I think that has been a major factor also.

Senator CARLSON. I recently read an article which stated—I thought it was so interesting I copied a paragraph or two of it—which stated that today our labor force numbers 67 million and supports a population of 170 million by producing goods and services at the phenomenal rate of $425 billion per year.

The article also stated that it required a capital investment of about $12,000 to give him a job and furnish him employment over an 8-hour day. Now, this same article estimated that by 1965 each factory worker's job will represent an investment of $18,000, and that we should have at that time 76 million workers.

Now, is it your contention that our savings must be expanded to take care of this increased job of furnishing labor with jobs?

Mr. MARTIN. I do indeed. I think that, and I believe we can produce the savings for that. I think that we ought to devote our energies in a period like this to reducing spending and increasing savings so that we can properly finance this expansion which is required, and desirable.

Senator CARLSON. Well, on that basis, if we have a gross national production now of $425 billion or $427 billion, by 1965, where are you going to have us at that time?

Mr. MARTIN. I am not good on forecasts, Senator. But I think it will be higher than it is presently.

Senator CARLSON. I think I read sometime back that Dr. Burns, who was the economic adviser to the President sometime back, stated that we would reach $600 billion but I do not know whether it was 1970 or 1975. I have forgotten the figures.

Mr. MARTIN. He is a very able economist, and I am not, but I have great faith in the future of this country.

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Senator CARLSON. You may not take credit for being an economist, but you work with this every day so I am sure you follow it closely.

Should the source of the increased productivity influence the distribution or the benefits accruing from such increased productivity?

Mr. MARTIN. Yes, I think so. I think there should be wide distribution of the gains that there are to all of us. Gains from increased productivity should be spread through the economy as widely as it is possible to spread them.

Senator CARLSON. Well now, in distribution, that takes effect, I assume, in the normal operations of a free enterprise system, or is it going to require congressional action to move some of these benefits?

Mr. MARTIN. My conviction is that we will get wider distribution, assuming that competition is maintained, through the free-enterprise system than through congressional mandate or action. In fact, I think the size of the economy and the nature of the economy is such that, even with congressional action, it is very difficult to effectively direct the flow at any time.

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

Mr. MARTIN. That is right.

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

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

Senator CARLSON. Some contend, Mr. Martin, that the taxpayers have been forgotten, too.

Mr. MARTIN. Well——

Senator CARLSON. What was the increase in rate of increase in productivity since the end of 1945? If you do not have that, I would like for you to get it.

Mr. MARTIN. I will be glad to get that.

Senator CARLSON. Make it since the end of 1954, also.

Mr. MARTIN. All right.

Senator CARLSON. What is the cause of the relatively lower rate of the increase in productivity during the last 2½ years? If you do not have it——

Mr. MARTIN. I do not know, but I will work up a memorandum on it.

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

Mr. MARTIN. Well, we have collective bargaining, and I think that both management and labor have got to study that. It is not a one-sided operation. I think that, as you approach most of the labor negotiations, management is inclined to claim they cannot do any-

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thing and labor is inclined to ask for the moon, and I think the answer is probably in the middle ground.

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

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

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

Senator CARLSON. Well, ever since these hearings started with Secretary Humphrey and Secretary Burgess, and, I noticed, in your own statement, there has been some discussion about the accord, as of March 1951. If I understand the Federal Reserve policy correctly, after the accord of March 1951 you abandoned that policy of continuous market support in order to assure artificially low levels of interest rates, but you did from time to time aid the Treasury in refunding by buying substantial amounts of maturing Treasury issues. In other words, while you ended that in 1951, as I understand it, it was not completely ended; is that correct?

Mr. MARTIN. It was a gradual process, Senator, starting in April of 1951—March, actually—with the unpegging of the Government market. We had to recognize that you do not stop something that has gone on for 10 years with just 1 jolt. You have got to recognize that we have a responsibility for a market. Free markets are not markets that participate in the law of the jungle.

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

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

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

The CHAIRMAN. When were you made Chairman?

Mr. MARTIN. April 2, 1951.

The CHAIRMAN. During practically all of your tenure there has been no real support of the bond market by the Federal Reserve?

Mr. MARTIN. That is correct, sir.

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

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

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

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

Mr. MARTIN. Well, we help them—if you are talking about that in a general sense—we work with them just as closely as we can, advise them, help them, do everything we can to see that their issues are adequately financed, but so far as direct intervention is concerned, we do not peg prices.

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

Mr. MARTIN. I would say that the accord provided for moving as rapidly as we could in the direction of halting the monetization of the debt, but recognized that we had a very difficult transition period ahead. You do not spend 10 years in a pegged market and then come out of it the day after tomorrow without confronting some problems that require a different attitude. Let me put it this way; you had to reeducate the entire business and banking community to what the ingredients and requirements of a free market were.

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

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

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

Mr. MARTIN. That is right, sir.

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

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

What interpretation can you place on that situation?

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

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

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

This is a technical problem, in my judgment, and it seems to me that the problem is that the banks that are closer to the loan demand than we are—we follow it very closely, but after all, banks are the first line on the matter of judging loan demand, and they decided to go up in their prime rate to 4½ percent.

Now, with a 4½-percent prime rate and a discount rate of 3 percent—and we have had a bill rate in excess of 3 percent for nearly 9 months—it means that the policing of the discount window by the individual Reserve bank has a good bit more strain with a 1½-percent spread than it had with a quarter of 1-percent spread.

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

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

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

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

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

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

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

Senator CARLSON. Well, that is the question I was going to get into now, and I think maybe you have answered this.

Have you caused interest rates to rise?

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

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

Senator CARLSON. I think you have made the record clear, at least for me, that we do have sufficient money in this country. There has been some criticism over the fact that we did not have sufficient quan-

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tity of actual money in this Nation for the growth and expansion of our economy in peaceful employment.

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

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

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

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

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

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

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

Mr. MARTIN. No, I do not think we have acted affirmatively to cause an upward movement in interest rates.

I think we have permitted the forces of the market to operate; and insofar as we can influence them at particular times, we have not discouraged the movements that were in the economy.

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

Mr. MARTIN. Yes.

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

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Mr. MARTIN. We have not been disappointed that interest rates have moved up to discourage borrowing, because it seems to me that discouraging borrowing is one of the policy objectives that we have hoped would come about, but we have tried to keep the money stream fluid and adequate. In fact, I am inclined to think, as I said here the first day, that we have probably contributed a little bit too much money to the stream, in terms of availability.

If we had been a little bit less free in supplying money to the stream we might not have had the inflation get ahead of us to the extent that it has. But still I would rather err on the side of seeing that there is no starvation in the money stream than be dogmatic or rigid in contracting the money supply.

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

Mr. MARTIN. That is correct.

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

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

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

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

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

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

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

Mr. MARTIN. That is correct.

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

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Mr. MARTIN. It does.

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

Mr. MARTIN. That is right.

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

Mr. MARTIN. I think that is right.

Senator CARLSON. Let us take during the 1920's when corporate tax rates were around 11 percent, so that there was no such deduction as there is today to benefit the borrower as a business expense. It seems to me that with the Government taking 52 percent of all income from corporations and businesses we are virtually on a 50–50 partnership basis with the Government on these loans.

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

Mr. MARTIN. I think that is about right.

Senator CARLSON. Would it not be true that if we had an interest rate of 6 percent for Government bonds—and I hope we never get to that place, Mr. Chairman——

Mr. MARTIN. So do I.

Senator CARLSON (continuing). Which would be regarded by most people as alarming—yet in reality because of the tax deductions, such rate for corporate investors would give them only 2.88 percent income in the way of interest. Is that about right?

Mr. MARTIN. I think that is about right.

Senator CARLSON. It is an interesting study when you get into it and begin to realize the importance of taxes on the present economy and the income of individuals.

Do you think excessive rates of income tax are inherently inflationary, first because they prevent accumulation of new capital in the hands of individuals and businesses, and, second, thus force excessive reliance on bank credit as a means for business expansion, which—I think all are agreed, a corporation that wants to expand does not necessarily go out and sell stock because they can borrow money if they can borrow it at only 50 percent of the regular interest rate—is what it actually costs them?

Mr. MARTIN. Yes; I am inclined to think that is correct.

Senator CARLSON. Would you agree that the neutral income-tax system would be one which first provided a minimum interference with economic decisions of individuals and businesses, and second, did not penalize hard work, success, and business expansion, which is about what I believe we are doing at the present time?

Mr. MARTIN. Well, I think I would agree in general with that, Senator. I am not a tax expert, and I have not been devoting much attention to taxes. But it seems to me that along the lines of what I have been testifying to here, that our tax policy should be directed toward reducing spending and increasing saving also; and whatever can be done in that field, to produce what I believe to be the desirable goal, should be done.

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Senator CARLSON. Well, now, we discussed borrowing of corporations and businesses.

Do you consider that higher interest rates would deter large expenditures by the Government, whose outlays now equal 10 percent of the gross national product, as long as the budget is balanced?

Mr. MARTIN. Yes. I think it discourages outlays by the Government. I think that if we could provide 2 percent interest for the Government in new issues that there would be considerably more inflationary pressures than there are. There are plenty of pressures now, but I think that is one of the things that we have to deal with, and the Government has to compete in this money market, also.

Take the early part of this year. One of the things that was easing the money market was the return from F and G bonds and savings bonds which was going into the money market and financing private expansion.

Senator CARLSON. Well, now, we discussed borrowings by corporations and businesses and by Government.

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

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

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

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

Senator CARLSON. Well, do you consider that home construction is reduced by reason of higher interest rates despite reduced downpayments and extended terms?

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

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

Mr. MARTIN. I do.

Senator CARLSON. Really out of proportion to the additional money costs?

Mr. MARTIN. That is very difficult to measure. I think at different times they do. I think there is a psychological effect.

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

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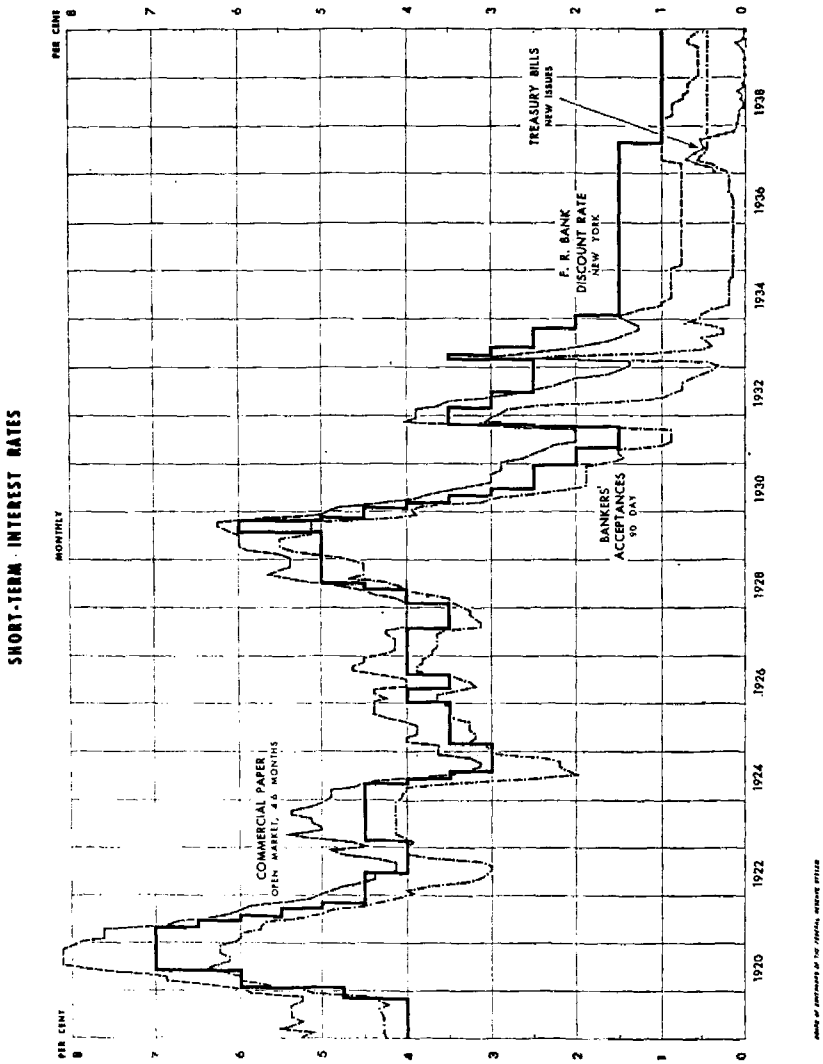
Mr. MARTIN. I do not know, Senator. I hope that we are reaching a leveling out place. I do not want to forecast the economy at all, but there are certainly soft spots in the economy as well as strong spots in the economy at the present time, and I think that savings are increasing, and I am inclined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

Senator CARLSON. Well now, does the history of interest rates indicate any long-term trend?

Mr. MARTIN. It is pretty difficult to make a history of interest rates but here is a chart we can put in the record. It is pretty hard for me to see any specific trends.

(The chart referred to is as follows:)



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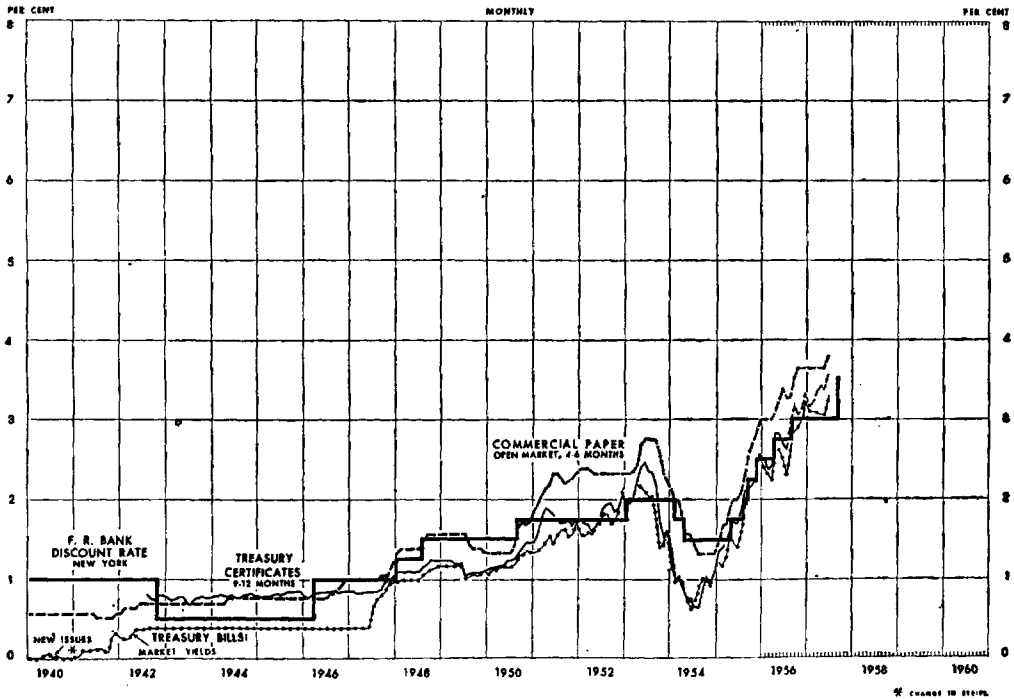
SHORT-TERM INTEREST RATES



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Mr. MARTIN. If you look over the discount rate, for example, apart from any general interest rates, you can see the highest discount rate we have had was 7 percent in 1920. We got down to 1 percent in August of 1937—I remember it very well; I was active in the stock exchange at the time—and we went then for nearly 11 years at 1 percent or less until an increase in 1948—that is an 11-year period of very low rate. And over that period there was very little play in interest rates. Money became so available that there was no particular interest in it. It did not cure unemployment. You had during that period a contraction of credit going on pretty consistently. There was a tendency here and there for prices to decline, and there was widespread unemployment. And I think that the history of interest rates does not really demonstrate much more than that they fluctuate.

Senator CARLSON. Does this chart or the periods reflected by this chart show the effect on wages and prices during those periods of varying interest rates? Do you have any study on that?

Mr. MARTIN. Yes; we have some studies on that, or we can make up a memorandum on it. I will have this chart analyzed for you.

Senator CARLSON. I would like, Mr. Chairman, if the Federal Reserve would, if they can—and I am sure they can—prepare a statement which shows, following the trend of interest rates back to 1920 or 1930 some place, and show at the same time the effect, if there is an effect, show the condition of wages, prices, and the reduction of the interest rates, if you can. I would like to have that.

Mr. MARTIN. We will do the best we can.

Senator CARLSON. Would you have objection to that, Mr. Chairman?

The CHAIRMAN. Without objection, it will be inserted in the record.

(The statement referred to is as follows:)

The accompanying table shows indexes of average wholesale prices (for commodities other than farm products and foods), indexes of average hourly earnings in manufacturing industries, and interest rates on corporate bonds and prime commercial paper for selected years from 1929 to 1956. Each of these series is, of course, only broadly representative of developments within its specific area and in any particular period there are always significant variations in prices, wages, and interest rates that are not indicated by these figures.

Changes in prices, wages, and interest rates are closely interrelated in our economy and reflect a wide variety of influences. It would certainly be unwise to attempt to explain changes or trends in any one of these solely in terms of the others. In general, however, broad movements in demands for commodities, for labor, and for funds are correlated; hence it is not unusual for prices, wages, and interest rates to change in the same direction for prolonged periods.

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TABLE 3.—*Prices, hourly earnings, and interest rates, selected periods, 1929–56*

Year	Wholesale price index for all commodities other than farm products and food	Consumer Price Index	Average hourly earnings of production workers in manufacturing	Corporate bond yields, Moody's Aaa (percent per annum)	Rates on prime commercial paper, 4–6 months (percent per annum)
	1947–49=100				
1929	65.5	73.3	42.6	4.73	5.85
1930	60.9	71.4	41.5	4.55	3.59
1940	59.4	59.9	49.7	2.84	.56
1946	78.3	83.4	81.7	2.53	.81
1953	114.0	114.4	133.2	3.20	2.52
1954	114.5	114.8	136.2	2.90	1.58
1955	117.0	114.5	141.5	3.06	2.18
1956	122.2	116.2	149.0	3.36	3.31
July 1957	125.6	120.8	156.5	3.99	3.88

Source: Prices and hourly earnings from Bureau of Labor Statistics; bond yields from Moody's Investors Service; rates on prime commercial paper from Federal Reserve.

Senator CARLSON. Mr. Martin, you have been very careful about making predictions, but I noticed just a few months ago you stated you did not want to look very far ahead. You are very cautious about forecasting the economy, I know. But I have here an article written by J. A. Livingston, and he has been quoted several times around here since this hearing started, so I am not starting something new. It is a recent article entitled, "Prosperity Gets Set for Another Year." It is a very interesting article.

I am not going to read it, Mr. Chairman, but I do want to read a few extracts from it:

After 12 years, I am about to take a "sabbatical" from the Business Outlook to finish a book on the American stockholder. Fortunately, I can do so in good conscience. Nine out of 10 economists assure me that when I return to my column in the fall, Wall Streeters will not be seeking crash shelters, help-wanted ads will still bring in good revenue to newspapers, consumers will have spending money, and prosperity will be America's lot.

Fifty-two out of the fifty-seven economists who replied to my semiannual questionnaire on the business outlook confirm my feelings. My hunch has been that business would slip in the first half of 1957 and that recovery would be underway in the second half. The economists go further. They're optimistic for 1958 as well. They do not anticipate a sharp slump in capital spending—construction of new factories, installation of new equipment, and erection of new office and commercial buildings.

I wanted to read that, and I am asking, Mr. Chairman, that we have it placed in the record, because there are some folks who seem to be contending we must be approaching a very serious recession and probably look forward to a depression.

While you have been cautious, 52 out of 57 of our economists—I do not know who they are, but I assume they are substantial—seem to think there are going to be good times through 1958.

The CHAIRMAN. Without objection, the insertion will be made.

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(The article is as follows:)

[From Washington Post and Times Herald, June 30, 1957]

BUSINESS OUTLOOK—PROSPERITY GETS SET FOR ANOTHER YEAR

(By J. A. Livingston)

After 12 years, I am about to take a "sabbatical" from the Business Outlook to finish a book on the American stockholder. Fortunately, I can do so in good conscience. Nine out of ten economists assure me that when I return to my column in the fall, Wall Streeters will not be seeking crash shelters, help-wanted ads will still bring in good revenue to newspapers, consumers will have spending money, and prosperity will be America's lot.

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THOSE ECONOMIC BUBBLE BATHS

And these are men strategically posted for business analysis. They're associated with banks, industrial corporations, investment firms, Government agencies, labor unions, research organizations, and universities. They not only are influenced by business decisions, they also influence such decisions.

And yet there is a remarkable, perhaps alarming, conformity in the forecasts. A popular delusion has been creeping up on us—the delusion of "2 percent a year inflation"—the feeling that bit-by-bit inflation can occur without culminating in a speculative bust.

Although the economists expect industrial production to rise 2 percent from current levels to the end of 1958, they expect the dollar value of all goods and services to rise by more than 4 percent. In short, a little more little-by-little inflation. Such thinking leads to popular delusions and economic bubble baths, such as Holland's tulipomania in 1634; John Law's Mississippi failure in 1720; Wall Street's new era crash in 1929. When human minds converge onto a single track, beware.

This 2-percent inflation theory is often said to have a "laboristic base." Labor unions are powerful. They can wrench annual wage increases from employers above increases in productivity. Yet, it has an "industrialistic base," too. If it weren't profitable for businessmen to avoid strikes, they wouldn't raise wages. They'd take strikes. But the market—the consumer—has paid the tab.

Thus, the economists predict that wages in manufacturing, which were $81.78 in May, will climb to $83.30 by the end of this year and $85.71 by the end of 1958. That, in spite of an expected increase in unemployment from 2,715,000 to 3,032,000 workers.

And wholesale prices will advance from the current level of 117.3 to 119.5 by the end of 1958. The cost of living will push up further from 119.6 to 122.1. But farm prices will go up hardly at all—from 243 to only 244. Industrial, not farm, prices tilt the index.

In summary, the economists expect that:

Expenditures on new plant and equipment—business investment—will hold steady throughout the next 18 months, at just under $38 billion a year.

Housing starts, now running at a 990,000 annual rate, will climb to nearly 1,100,000 by the end of 1958.

CONSUMERS WILL CONSUME

Defense spending will increase slightly. It's now running at an annual rate of $45 billion; it will hit $47 billion by mid-1958; then slough off to $46 billion, reflecting recent budget-cutting efforts of Congress.

Consumers will do what consumers are expected to do: Spend. They won't be bothered too much by tight money or low bond prices. Result: Department store sales will increase 5 percent—from 124 to 130 in the Federal Reserve Board index.

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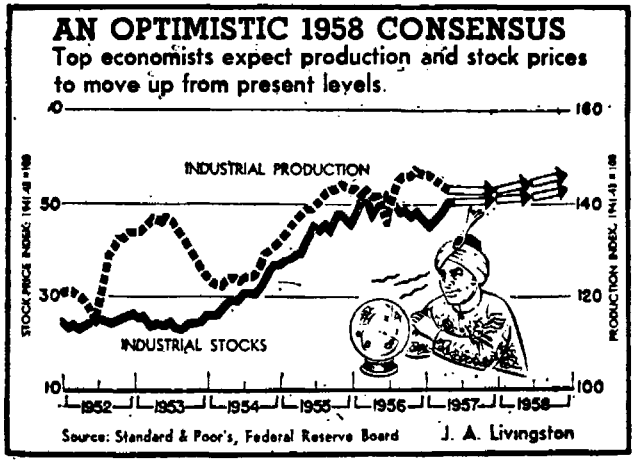

And so, industrial production, as measured by the Federal Reserve Board index, will climb from current levels of 143 to 146, not quite up to the high recorded in December last year—147. And total output of goods and services, measured in dollars, will rise from $427 billion to $434 billion by the end of 1957, and to $446 billion by the end of 1958—successive new highs.

What makes me hopeful, what makes me "absorb strength" from the consensus, is that slack is now appearing in the economy. Since December, hours of work are down from 41 to 39.7 per week. Steel, aluminum, copper, newsprint, and other commodities, long in short supply, are readily available. And the drop in the bond market has served notice that new financing is going to be costly and more difficult. There's less talk of inflation and some talk of deflation. The 2 percent inflation theory has had a setback.

GOOD TIMES THROUGH 1958

That's the consensus of 1957 of the Nation's top-ranking economists. They're not alarmed by tight money. Here's the way they see things:

Indicator	Consensus			
	Latest	December 1957	June 1958	December 1958
Production:				
Gross national product (bill. 1, A)	(a) $427	$434	$439	$446
Industrial production (2, B)	(b) 143		144	146
Business investment (bill. 1, 3, A)	(c) $37.89	$37.88	$37.39	$37.60
Housing starts (000, 4, A)	(b) 990	1,000	1,044	1,086
Defense spending (bill. 1, A)	(a) $45.0	$45.3	$47.1	$46.2
Prices:				
Wholesale prices (4, B)	(d) 117.3	118.1	118.6	119.5
Farm prices (5, C)	(b) 243	243	243	244
Cost of living (4, B)	(b) 119.6	120.5	121.3	122.1
Stock prices (6, D)	(e) 50.5	51.0	51.5	52.8
Unemployment, wages, retail sales:				
Unemployment (000, 7)	(b) 2,715	2,870	3,035	3,032
Weekly wages in manufacturing (4)	(b) $81.78	$83.30	$84.26	$85.71
Department store sales (2, B)	(b) 124	128	128	130

1. Department of Commerce; 2. Federal Reserve Board; 3. SEC; 4. Department of Labor; 5. Department of Agriculture; 6. Standard & Poor's; 7. Bureau of the Census.
(a) 1st quarter; (b) May; (c) 3d quarter 1957; (d) week ended June 18; (e) June 24.
A. Annual rate; B. 1947-49=100; C. 1910-14=100; D. 1941-43=10.

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Senator CARLSON. They have here a table showing the anticipated gross national production for December of 1957. They have it $427 billion in July, $434 billion in September, $439 billion in June of 1958, and $446 billion in December 1958. And they go through here with industrial production, prices, and unemployment. And frankly, I think it is an article that ought to be encouraging to those who might feel we have some troubles in the immediate future.

Then I would like to ask, Mr. Chairman, that an editorial that appeared in the Washington Post on August 15, Good News—and Bad, be placed in the record.

It reads—I am not going to read the entire thing:

The recent further increase in bank interest rates, quickly followed by a rise in the rediscount rate of several Federal Reserve banks, is "good" news in at least two respects. It indicates that bankers do not believe that any business recession is immediately in sight; rather they seem to expect that the demand for credit to expand plant and inventories will take its customary autumn upturn. This judgment is not universally held in the financial world, but the doubters are a minority.

I will ask that be made a part of the record.

The CHAIRMAN. That will be made a part of the record.

(The editorial is as follows:)

[From the Washington Post, August 15, 1957]

GOOD NEWS—AND BAD

The recent further increase in bank interest rates, quickly followed by a rise in the rediscount rate of several Federal Reserve banks, is "good" news in at least two respects. It indicates that bankers do not believe that any business recession is immediately in sight; rather they seem to expect that the demand for credit to expand plant and inventories will take its customary autumn upturn. This judgment is not universally held in the financial world, but the doubters are a minority.

Moreover, the rather courageous action by the "Fed" to close the widened gap between the prime bank rate and the rediscount rate seems to show that there is no disposition in the administration to be intimidated by the political clamor for a return to cheaper money. In fact the steam seems to have gone out of this movement in recent weeks, after all the initial fuss attending the launching of the Senate Finance Committee's "grand investigation" of money matters.

At the same time. it must be recognized that a strong reason for the further and unexpectedly large increase in interest rates is the continuing price inflation. The marked rise in money costs of the past year has not been a total cure for this alarming ailment, although falling wholesale indexes may foreshadow an improvement. This suggests that, while no weakening of interest rates is called for now, further doses of this remedy may not be what is needed. A more diligent search for other "medicine" is in order, including, perhaps, a more sympathetic and unprejudiced consideration of consumer-credit controls.

Senator CARLSON. I thank you for your kindness.

The CHAIRMAN. On Senator Carlson's time, the Chair would like to ask one question.

As I understand your testimony this morning, Mr. Martin, you think too much spending and too little savings are among the chief factors in the current inflation?

Mr. MARTIN. That is correct, sir.

The CHAIRMAN. Now, the Federal Government owes, as you know, approximately $275 billion and it is spending from 98 to 99 percent of its current income. Would you agree with me that perhaps the Federal Government is perhaps the chief offender?

Mr. MARTIN. I do agree with that, sir.

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The CHAIRMAN. Would you agree that reduction in the public debt would be one of the best things to do to avoid any further inflation?

Mr. MARTIN. I do, indeed.

The CHAIRMAN. Thank you.

(Discussion off the record.)

Senator FREAR (presiding). All right.

As you understood the chairman to say, we will recess until 2 p. m. this afternoon, at which time Senator Malone will ask questions. We stand in recess until 2 p. m.

(Whereupon, at 12:20 p. m., the hearing was recessed until 2 p. m.)

AFTERNOON SESSION

(Also present: Arthur W. Marget, Director, Division of International Finance, Federal Reserve Board; Guy Noyes, adviser, Division of Research and Statistics, Federal Reserve Board.)

Senator BENNETT (presiding). The meeting will come to order.

Senator Malone is recognized.

STATEMENT OF WILLIAM McCHESNEY MARTIN—Resumed

Senator MALONE. Mr. Martin, I am glad to meet you.

Mr. MARTIN. Thank you, sir.

Senator MALONE. I think that this hearing now being conducted by the Senate Finance Committee, if it is properly pursued until completed and hears the witnesses that should appear, could prove to be one of the most important hearings ever held by a Senate committee.

I think the Secretary of the Treasury made a fine witness. He knew exactly what his field was, and he was very reluctant to step out of it, and I think he had a point there, although I was disappointed, because I was always led to believe, of course, that the Secretary of the Treasury knew everything everybody was doing under him or with him, who had anything to do with the good of the Nation in the way of conducting its fiscal policies.

The Secretary said he was for our managed-currency policy, started in 1934. He said that he would not change it now.

It is difficult for me to understand how this Nation can have a "managed currency" and avoid a "managed economy."

We criticize foreign nations, including Russia, for their "managed economy"—their socialistic tendency. But Bulganin said, in answer to my direct question, that socialism was the first step to communism.

The Secretary left many of my questions for you to answer.

He said, and probably properly so, that you knew more about it than he did, and I hope that is true.

Mr. MARTIN. I question that, Senator.

Senator MALONE. Well, you are very complimentary, and I like that because George Humphrey is one of the best men we have ever had in the Cabinet.

I think a lot of George Humphrey. But, of course, this country is bigger than George Humphrey, William McChesney Martin, or Senator Malone, or anybody else for that matter, and that is the reason for my questions to you.

For those of us who pass in review, like the Secretary and you, as Chairman of the Federal Reserve Board, and all the rest of us, it is

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not so much a question of how long we stay here; it is what we do while we are here that counts.

Do you agree?

Mr. MARTIN. We do—I do.

Senator MALONE. We are all replaceable.

Mr. MARTIN. That is correct.

Senator MALONE. Some of these questions, Mr. Martin, several based on your testimony, I hope you will bear with me if some prove to be repetitious, and some questions that may seem simple to you will tend to complete the record so that the public and the committee may have the complete picture available to them.

You understand.

Mr. MARTIN. Yes.

Senator MALONE. Now, I note from your testimony, or at least it was suggested during your appearance here, that some economists have said that we should have at least 2 percent inflation a year.

Now, should we, or should we have any percent of inflation a year for the good of the country?

Mr. MARTIN. We should not have any percent, Senator, for the good of the country.

I think I made a computation here that shows at that rate of 2 percent a year we would have the purchasing power of the dollar halved in a generation.

Senator MALONE. We have already done that; have we not?

Mr. MARTIN. We have done it once.

Senator MALONE. And deliberately?

Mr. MARTIN. Well, I would not say it was done deliberately.

Senator MALONE. Why wouldn't you say so? We went off the gold standard deliberately; did we not?

Mr. MARTIN. I do not think that we went off it in order to halve the price of the dollar.

Senator MALONE. Halving the price of the dollar is inflationary. Why do you think we went off the gold standard?

Mr. MARTIN. Why?

Senator MALONE. Yes.

Mr. MARTIN. I think it was partly experimentation, partly a new period that we were coming into, and many conflicting views and ideas as to what would actually happen, and a certain amount of experimentation.

Sentor MALONE. It is a dangerous thing to experiment with; is it not?

Mr. MARTIN. I think it is.

Senator MALONE. What were these different ideas?

Mr. MARTIN. Well, there are constantly people who think if you adjust the price of gold that you will get monetary relationships that will improve the purchasing power of the mass.

Now, I do not think it works out that way, but the move in 1934 was directed to—when we changed the price of gold from $20.67 an ounce to $35 an ounce, there were some people who sincerely thought it would validate a level of debt that would be beneficial to everyone.

Senator MALONE. Let me ask you, as long as we quit using it for money and forbade anyone to have any gold, what difference would it make what the price was?

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Mr. MARTIN. Well, it would have the same value then as any other commodity. The fact that it is used for money gives it a different perspective than if——

Senator MALONE. Where is it used for money?

Mr. MARTIN. Where is it used for money?

Senator MALONE. Yes.

Mr. MARTIN. Well, it is used in this country for money.

Senator MALONE. How? Tell us about it.

Mr. MARTIN. Well, we have a modified gold standard today. The base of our currency is gold.

Senator MALONE. Tell us about it.

Mr. MARTIN. Well, at the present time our money supply is made up of, the base of our money is gold. We have roughly $22 billion.

Senator MALONE. We do?

Mr. MARTIN. We do.

Senator MALONE. Where?

Mr. MARTIN. We have it in Fort Knox and in various Federal Reserve banks around the country.

Senator MALONE. You mean it is nice just to have it stored here; the people who really own it are not charging us to keep it in the United States storage, so we can say that it is in fact stored in the United States, and that makes it all right; is that it?

Mr. MARTIN. Well, we own it.

Senator MALONE. Do you? Explain that to me.

Mr. MARTIN. We have purchased it at $35 an ounce.

Senator MALONE. We went all through this twice now. The Secretary of the Treasury said, and the Under Secretary not only confirmed it and was more positive, that if we followed our well-established long-range policy to honor a dollar balance by payment in gold when presented by a foreign nation—and foreign private holdings were converted, then our gold holdings would be less than $6.5 billion. That is the policy?

Mr. MARTIN. That is correct.

Senator MALONE. Now, the Secretary of the Treasury testified that he could refuse to give them the gold on their legitimate dollar balances, but if he did, it would have a tremendous adverse effect on the market value of our dollar; is that true?

Mr. MARTIN. It would. I would hope he would never refuse.

Senator MALONE. All right.

Now, if you understand this, it will take less time if you want to just tell me. The table is in the first volume of the printed hearings.

I would like to say to you that it was established that the foreign nations' dollar balance was somewhere around 9½ billion. Does that ring a bell?

Mr. MARTIN. About $13 billion, I think, Senator.

Senator MALONE. The foreign nations' balance?

Mr. MARTIN. These are foreign dollar balances, sir.

Senator MALONE. I am talking about foreign nations now. Do not get it confused.

Mr. MARGET. Do you mean—I am just questioning to get the facts. Do you want the monetary authorities?

Senator MALONE. What is your name, sir?

Mr. MARGET. My name is Marget, sir.

Senator MALONE. Will you identify yourself for the record?

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Mr. MARGET. Arthur W. Marget, Director of the Division of International Finance.

Senator MALONE. Then you should know something about this.

Mr. MARGET. I want to be sure, sir, I have understood your question. The figure for dollar balances owned by foreigners——

Senator MALONE. By foreign nations, now. Let us not get it confused.

Mr. MARGET. Do you want to distinguish between the monetary authorities and individuals?

Senator MALONE. Yes, because the next question will be about individual holdings.

Mr. MARGET. Yes; the amount held by monetary authorities is $7 billion, sir.

Senator MALONE. Well, I think you had better take another look. It required a full day to get this correct amount from the Secretary of the Treasury, and I hope it does not take that long to get it from you.

Mr. MARGET. I hope not, sir.

Mr. NOYES. Are you referring, sir, to the table on page 482?

Senator MALONE. I think that is true. "Foreign official short-term dollar holdings are $9,108 million." That is the figure I finally was given after considerable correspondence with the Under Secretary of the Treasury. He seemed reluctant to give it. If there is any difference, I want you to go into some detail.

Mr. MARGET. If you include among these foreign official holdings what we call international institutions, there is about $1.7 billion held by foreign institutions such as, for example the——

Senator MALONE. What was that——

Mr. MARGET. Such as, for example, the International Monetary Fund——

Senator MALONE. Wait just a moment.

What are these international institutions?

Mr. MARGET. Such as the International Monetary Fund, chiefly.

Senator MALONE. Is that the World Bank?

Mr. MARGET. No, sir. The World Bank is a separate institution. As for its dollar holdings, I do not happen to have them right here. They are relatively small.

Senator MALONE. The International Monetary Fund?

Mr. MARGET. It is the main holder.

Senator MALONE. How much do they hold?

Mr. MARGET. I do not have the exact figure of that portion of the $1.7 billion, but they hold most of the $1.7 billion.

Senator MALONE. That is $1.7 billion?

Mr. MARGET. Something over $1 billion of that $1.7 billion is held by the International Monetary Fund.

Senator MALONE. All right.

Now, give us the others.

Mr. MARGET. The International Bank—the World Bank that you referred to—is the other one which would be holding the balance of these.

Senator MALONE. What are the other two international organizations?

Mr. MARGET. Those are the two main ones.

Senator MALONE. There is another one recently organized.

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Mr. MARGET. The International Finance Corporation.

Senator MALONE. Does it hold any of this gold?

Mr. MARGET. It holds a small amount of these dollar balances.

Senator MALONE. International what?

Mr. MARGET. International Finance Corporation, the IFC.

Senator MALONE. Well, let us confine ourselves to the words, because I am not going to memorize several hundred initials of foreign organizations financed with American taxpayers money.

Now, there is the International Monetary Fund, the International Bank, which corresponds to the World Bank——

Mr. MARGET. That is right.

Senator MALONE. The International Finance Corporation, and the Import-Export Bank.

Mr. MARGET. No, sir. The Export-Import Bank is not an international institution. That is an American, United States Government institution.

Senator MALONE. I understand that, but we are speaking of gold, it does not hold any gold?

Mr. MARGET. That is right.

Senator MALONE. Now, tell us the individual holdings in the $1.7 billion of each of these organizations. All four are organized to promote American capital investment abroad.

Mr. MARGET. I do not have the breakdown of that $1.7 billion.

Senator MALONE. Will you provide it for the record at this point?

Mr. MARGET. Yes, sir; we will provide it.

(The information referred to follows:)

As of May 31, 1957, short-term dollar holdings of international institutions were as follows:

	Millions of dollars
International Monetary Fund	1,415
International Bank for Reconstruction and Development	224
International Finance Corporation	14
Other international institutions	47
Total	1,700

Senator MALONE. That is important when we analyze the objectives of each one of these institutions.

Mr. MARGET. All right. We will provide the breakdown of that $1.7.

Senator MALONE. Now, they have $1.7 billion.

Mr. MARGET. That is right.

Senator MALONE. That is included in the $9.108 billion?

Mr. MARGET. That is right.

Senator MALONE. Already included in it?

Mr. MARGET. Yes.

Senator MALONE. What does that leave them for the international banks, the countries, the nations?

Mr. MARGET. The official holdings; the latest figure I have in front of me, sir, is from the Federal Reserve Bulletin for the end of May 1957, which gives the holdings of the official institutions as $7.8 billion.

Senator MALONE. The two together, then should equal the $9.108 billion; should they not?

Mr. MARGET. Yes, except for variations in date. Obviously there would be some slight difference.

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Senator MALONE. That corresponds to the $9,108 million in the table submitted by the Under Secretary, does it not?

Mr. MARGET. Yes.

Senator MALONE. This corresponds then to table I, page 482, part 1 of the official hearings we are now conducting, table I, entitled "United States gold stock, monetary gold reserve requirements, and foreign dollar holdings, 1934–57." That is on an average, I suppose?

Mr. MARGET. It could be. I do not have that in front of me.

Senator MALONE. Right now, in 1957, as of this date, it is $9,500 million.

Mr. MARGET. Yes.

Senator MALONE. It continually fluctuates, does it not?

Mr. MARGET. Yes.

Senator MALONE. It is confusing to the committee to give partial figures which may not be inaccurate, but do not include the whole story.

The second question then: How much is owned by foreign individuals apart from foreign nations? "Total Foreign Dollar Holdings" are listed in the same table as $16,246 million. Does that correspond with your information?

Mr. MARGET. Yes, sir; roughly. These are again different dates, and it depends whether you include——

Senator MALONE. As of this date, what is the total?

Mr. MARGET. As of the latest date we have a record of?

Senator MALONE. Yes.

Mr. MARGET. The corresponding figure would be obtained by adding $1.7 billion to $13 billion.

Senator MALONE. That does not make very much sense, does it?

Mr. MARGET. Why not, sir?

Senator MALONE. Because it was $16,246 million, the best figure the Secretary could give us when he was here.

Mr. MARGET. It must be a discrepancy because of the date, sir, or because of a difference with respect to the components. All I can do, sir, is this: I can tell you what goes into the figures which we publish currently.

I do not know how these figures were arrived at, these ones here in the book, but we shall study them and then, perhaps, we can see what discrepancies there are.

Senator MALONE. I will just ask you then if you will do this, and do it for this point in the record, take the same kind of a table—this comes up to March 1957——

Mr. MARGET. Yes.

Senator MALONE. And bring it up to August.

Mr. MARGET. Yes, sir. We would be glad to do that. It may not be up to August because our figures are not necessarily that late, but as recently as we can bring it up.

Senator MALONE. How late?

Mr. MARGET. The next issue of the bulletin, which would be the next published figure, would give the figure for the end of June.

Senator MALONE. When is that published?

Mr. MARGET. It should be published very soon.

Senator MALONE. Those figures are available to you today; are they not?

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Mr. MARGET. Yes, sir. We can provide that.

Senator MALONE. Then you can give them to us for this particular day?

Mr. MARGET. Yes, sir; for our latest date.

(The information referred to follows:)

Foreign dollar holdings, 1934–57

[In millions of dollars]

End of period	Total dollar holdings	Short-term dollar holdings					Holdings of U. S. Government bonds and notes		
		Total	Foreign countries			International institutions	Total	Foreign	International institutions
			Total	Official	Private				
1934	(1)	670	670	(1)	(1)	----------	(1)	(1)	----------
1935	(1)	1,301	1,301	(1)	(1)	----------	(1)	(1)	----------
1936	(1)	1,623	1,623	(1)	(1)	----------	(1)	(1)	----------
1937	(1)	1,893	1,893	(1)	(1)	----------	(1)	(1)	----------
1938	(1)	2,158	2,158	(1)	(1)	----------	(1)	(1)	----------
1939	(1)	3,221	3,221	(1)	(1)	----------	(1)	(1)	----------
1940	(1)	3,938	3,938	(1)	(1)	----------	(1)	(1)	----------
1941	(1)	3,679	3,679	(1)	(1)	----------	(1)	(1)	----------
1942	(1)	4,205	4,205	2,244	1,961	----------	(1)	(1)	----------
1943	(1)	5,375	5,375	3,320	2,055	----------	(1)	(1)	----------
1944	(1)	5,597	5,597	3,335	2,262	----------	(1)	(1)	----------
1945	(1)	6,883	6,883	4,179	2,704	----------	(1)	(1)	----------
1946	(1)	6,480	6,007	3,044	2,963	474	(1)	(1)	(1)
1947	(1)	7,116	4,854	1,832	3,022	2,262	(1)	(1)	(1)
1948	(1)	7,718	5,854	2,836	3,017	1,864	(1)	(1)	(1)
1949	8,226	7,618	5,960	2,908	3,052	1,658	608	449	159
1950	10,197	8,645	7,117	3,620	3,497	1,528	1,552	1,276	276
1951	10,173	9,302	7,661	3,548	4,113	1,641	871	610	261
1952	11,719	10,546	8,961	4,654	4,307	1,585	1,173	903	270
1953	12,739	11,648	10,019	5,667	4,352	1,629	1,091	806	285
1954	14,019	12,919	11,149	6,770	4,379	1,770	1,100	746	354
1955	15,230	13,601	11,720	6,953	4,767	1,881	1,629	1,308	321
1956	16,433	14,939	13,487	8,045	5,442	1,452	1,494	1,103	391
1957—March	16,201	14,563	13,005	7,550	5,455	1,558	1,638	1,242	396
May	16,402	14,791	13,091	7,803	5,288	1,700	1,611	1,240	371
June	16,486	14,833	13,260	7,929	5,331	1,573	1,653	1,282	371

[1] Not available.

NOTE.—(1) Details may not add to totals because of rounding.

(2) A table showing the United States gold stock, monetary reserve requirements, and foreign dollar holdings, 1934–57, has been submitted by the Under Secretary of the Treasury and published as table I on p. 482, pt. 1, of these hearings. The column "Total foreign dollar holdings" of that table I corresponds for the years 1934–48 to the column "Short-term dollar holdings, total" of this table, and for the years 1949–57 to the column "Total dollar holdings" of this table; the column "Foreign official short-term dollar holdings" of that table I corresponds to the sum of the columns "Short-term dollar holdings, foreign countries, official" and "Short-term dollar holdings, international institutions" of this table.

(3) Figures for "Total dollar holdings" for December 1956 and March 1957 have been revised.

Senator MALONE. I see nothing wrong in this table—it says "United States gold stock, monetary gold reserve requirements, and foreign dollar holdings, 1934–57," it begins with 1934 and it ends with that part of 1957 ending with March.

Mr. MARGET. Well, sir, if I may predict, because we will have to study this table, I suspect there are various things that you can put in or leave out.

There will be no discrepancy. It will just mean our explaining why this table differs from the table that we publish in our bulletin.

Senator MALONE. But you see I do not get to you again. I do not want an explanation. I want a table as of the later date, but like this one.

Mr. MARGET. We will provide the explanation for these tables.

Senator MALONE. I do not want an explanation. I want the facts.

Mr. MARGET. Yes, sir; you will have them.

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Senator MALONE. I want them cold on each year.

Mr. MARGET. Yes, sir.

Senator MALONE. If you say that Mr. Burgess gave me the wrong figures, I want you to just tell me that.

Mr. MARGET. Yes.

Senator MALONE. Because I had to write him twice, and phone the Secretary 2 or 3 times, to get this far.

They seemed very reluctant to just give me the facts. No wonder the public is all messed up about it.

You and the Secretary of the Treasury should get together on the information you give out. The public cannot get the explanations. They are working for a living. And we do not have time, either.

Mr. MARGET. Yes, sir.

Senator MALONE. So, I want them cold, just like Burgess gave them to me in the second letter. He did not give me anything in the first one, I thought, purposely. No one could understand it.

Mr. MARTIN. We will give them to you cold.

Senator MALONE. All right. If they do not correspond, we will, I hope, call you again. Now, 483; following that was a table showing exactly where this money is, by nation up to the $16¼ billion. Do you agree with those figures?

Mr. MARGET. It means not where the money is, sir, but whom it belongs to, whom these dollar deposits belong to, to which countries.

Senator MALONE. Let us not split hairs. If I have $1,000, and it is in the bank in Reno, then it is my money; it is not the bank's money. And it would be wrong for the bank to claim it; is that right?

Mr. MARGET. That is right, sir.

Senator MALONE. Well, then, does this money belong to these foreign nations and to the foreign individuals?

Mr. MARGET. Yes, sir.

Senator MALONE. The custom is to pay in gold for the dollar balances when properly presented to the Treasury of the United States; is that true?

Mr. MARGET. Yes, sir.

Senator MALONE. Up to the $16,246 million, or whatever it is at the time they are presented; is that right?

Mr. MARTIN. That is right.

Senator MALONE. Now, the Secretary of the Treasury said that there is a certain amount of this held by individuals; the difference between the $9,108 million and the $16,246 million, whatever that is. It is $7,100 million, roughly, which would be held by these individuals, who could not demand, as of themselves, this money; is that true?

Mr. MARGET. Yes, sir.

Senator MALONE. And he was to put the details in the record, and I suppose he did. I have been in all of these nations examining their industrial strength and their manipulations of the price of their money in terms of the dollar. They have ways and means of transferring individual dollar balances into the Nation's dollar balances, do they not?

Mr. MARTIN. They do, sir.

Senator MALONE. There are no exceptions, are there?

Mr. MARTIN. None that I know of.

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Senator MALONE. None that I know of either. The Secretary would not say that, because he just said that you would know, and that he would try to find out of course. We know that whenever they want that gold delivered to their countries the transfers will be made. I made a point, the first 10 years I was here, to visit all the foreign nations of the world and that was one of the things I was very particular to check.

The other was to examine their industries and determine what they were manufacturing, and what they were digging out of the ground, and what they were raising, and how the people were dressing and eating, and how they liked their work and their government.

So, if you will take that particular table and you will say in your testimony now that it is the custom to honor these dollar balances up to the $16,246 million, whatever the foreign balances currently are, that is satisfactory when presented in proper form; that will be your testimony.

Mr. MARTIN. That is right.

Senator MALONE. How much gold is there altogether stored in Fort Knox and Colorado and New York and other Government depositories?

Mr. MARTIN. $22 billion, roughly.

Senator MALONE. Roughly, $22 billion?

Mr. MARTIN. That is correct, sir.

Senator MALONE. I think we had $22.4 billion, but that fluctuates.

Mr. MARTIN. Yes.

Senator MALONE. From day to day, I presume, since you honor foreign dollar balances in gold?

Mr. MARTIN. Yes.

Senator MALONE. Due to whatever dollar balances you have honored and gold you have purchased?

Mr. MARTIN. That is right.

Senator MALONE. That is very reasonable. Now, taking that $16.246 billion, that leaves $5,754 million of the gold in the United States that we would still have in such depositories after honoring all of these dollar balances; would that be about right?

Mr. MARTIN. Yes; that would be right, Senator. Of course, you have our reserve requirement listed in table II of this table.

Senator MALONE. Table II; what page?

Mr. MARTIN. 482. I am taking those figures.

Senator MALONE. Where?

Mr. MARTIN. The second column, United States monetary gold reserve requirement, $11,761 million, the last one.

Senator MALONE. Yes. But that is not your requirement; is it?

Mr. MARTIN. That is figured on our requirements.

Senator MALONE. What is your requirement based upon? Twenty-five percent gold?

Mr. MARTIN. Well, in the Federal Reserve Act we have to hold reserves against our deposit liabilities, including the reserves of our member banks that are deposited with the Reserve banks, and against our Federal Reserve notes outstanding; there the liabilities must not exceed four times our holdings of gold certificates.

Senator MALONE. In other words, you have to have 25 percent gold reserve.

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Mr. MARTIN. That is right, and the ratio today is about 47 percent.

Senator MALONE. Of what you actually have in the United States depositories?

Mr. MARTIN. That is right.

Senator MALONE. But what percentage of gold would we actually own if the dollar balances as described were demanded and paid?

Mr. MARTIN. Can you figure what that figure would be?

Senator MALONE. $5,754 million left after we paid off all of the foreign dollar balances of today?

Mr. MARGET. The free gold, if you take this reserve requirement of something over $11 billion, and deduct——

Senator MALONE. That is not the requirement; is it?

Mr. MARGET. Yes, sir.

Senator MALONE. How much money is there in circulation?

Mr. MARGET. Well, this would be——

Mr. MARTIN. There is about $30 billion in circulation at the moment.

Senator MALONE. Is that the amount you have to have, 25 percent reserve in gold?

Mr. MARTIN. No; it is not just the currency in circulation. It is the currency in circulation plus the deposits that are outstanding.

Senator MALONE. What would that amout be?

Mr. MARTIN. I would say it is about one-hundred-and-sixty-odd billion dollars.

Senator MALONE. What is it, plus the $30 billion now actually in circulation? That is paper money; is it?

Mr. MARTIN. Yes; that is paper money.

Senator MALONE. How much, then, is to be added to that $30 billion? You say the obligations to the banks, the member banks, the outstanding deposits, is that it?

Mr. MARTIN. Yes; that is right.

Senator MALONE. What you owe the banks or they owe you?

Mr. MARTIN. What we owe the banks; they have deposited with us as reserves.

Senator MALONE. How much is that?

Mr. MARTIN. I do not have the figures.

Senator MALONE. As of today?

Mr. NOYES. Federal Reserve notes are $26.5 billion, sir; deposits at Federal Reserve banks are roughly $20 billion in round figures, $19.7 billion; so you have $46.5 billion.

Mr. RIEFLER. That was June 26, 1957.

Mr. NOYES. June 26, 1957.

Senator MALONE. What is the answer to that question, then?

Mr. MARTIN. $46.5 is the amount.

Senator MALONE. $46.5 billion, is it not?

Mr. MARTIN. That is right.

Senator MALONE. $46.5 billion.

Mr. MARTIN. Yes.

Senator MALONE. Does that include the $30 billion?

Mr. MARTIN. Well, I remembered that to be $26.5 billion as the Federal Reserve notes outstanding.

Senator MALONE. Oh, yes. It is not $30 billion.

Mr. MARTIN. I was incorrect.

Senator MALONE. The Secretary testified it was approximately $27 billion, and, I suppose, it fluctuates?

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Mr. MARTIN. That is right.

Senator MALONE. So you do have $46.5 billion as of this date, approximately, with any fluctuations, minor fluctuations, that may have occurred since you added it all up, outstanding against your Federal Reserve?

Mr. MARTIN. That is right.

Senator MALONE. And you have listed here $11 billion?

Mr. MARTIN. $11,761 million.

Senator MALONE. $11.761 billion of gold reserve you have in the bank—have that much gold?

Mr. MARTIN. That is right. That is our requirement.

Senator MALONE. Oh, yes; that is your requirement.

How much do you figure you have?

Mr. MARTIN. We have $22 billion, roughly, all told.

Senator MALONE. Let me ask you a question that bothers me, and I know it bothers a good many just ordinary citizens of the United States.

As long as we have possession of $11,761 million, whether or not we actually could retain it if it were demanded, you believe that the law is being complied with?

Mr. MARTIN. Yes; I do.

Could we retain this amount, do you mean?

Senator MALONE. I did not ask you that question.

Do you believe the law is being complied with as long as you have in your possession $11,761 million in gold regardless of whether or not it could be demanded on foreign dollar balances.

Mr. MARTIN. Well, those are the requirements that we have in the Federal Reserve Act, so we are complying with the law.

Senator MALONE. As long as you have in your possession that amount of gold?

Mr. MARTIN. That is right, sir.

Senator MALONE. Whether or not it is obligated or would have to be paid out if demanded by foreign nations or on foreign nations' request that had been honored on a principle for these 180 years, whether you own it or not, that is to say, whether you would have to pay it out if the custom were followed, you think you are complying with the law?

Mr. MARTIN. We could not, Senator, dip into this reserve requirement without coming back to the Congress for a change in the law. That is our legal minimum.

Senator MALONE. What would you do if you suddenly, over the months ahead, found there were enough requests—you have already testified that under the custom you do honor the requests and I suppose when there is a legitimate dollar balance, foreign-dollar balance and—I suppose, you agree with the Secretary, that if you were to refuse suddenly to honor such requests in gold that it would have a severe effect on the price of our money on the exchange market?

Mr. MARTIN. I do, indeed.

Senator MALONE. Then, suppose that this money progressively was requested on legitimate dollar balances from foreign nations or in such a way that it followed the custom; what would you do when you would come to the point where you had only $11,761 million of gold left?

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Mr. MARTIN. I think at that point we would have to come back to the Congress if the situation——

Senator MALONE. Suppose the Congress asks you what you did with the gold? Then it would be a demand request from Congress, would it not, since the gold would already be in foreign vaults?

Mr. MARTIN. Well, Congress would have every right to think we were violating the law if we——

Senator MALONE. Maybe we would think you have already violated the law since you only have less than $6 billion that you can rightly call the property of the United States.

There are very few Senators, and I am one of them, who understand entirely all the machinations that you go through in international exchange.

I know considerable about it since I have visited all the foreign nations and watched their manipulations enough to know that we gave them the money to build up a dollar balance. That is the reason I was looking forward with much interest to getting these answers from you.

Mr. MARTIN. Well, this is the law, and we would abide by the law. Now, of course, you get into the——

Senator MALONE. Go ahead.

Mr. MARTIN. I was just going to say that if we conduct our monetary affairs properly, I see no likelihood of the situation you are suggesting occurring.

Senator MALONE. In other words, these people are most likely to think that this gold is safer in United States vaults than it would be over in their own countries that might be overrun by another country, so they just leave their gold here?

Mr. MARTIN. I think that is correct.

Senator MALONE. But suppose there happened to be a conflict of interests, which happens in dealings between foreign nations—you are aware of that, I suppose?

Mr. MARTIN. Oh, yes.

Senator MALONE. Every day you pick up a paper and some country has changed its mind. It believes that its best interests lie in another direction.

Here is the list of countries: Asia; the China mainland has $38 million.

What makes you think they would not demand it if it would embarrass you and the Congress, the Congress of the United States?

Mr. MARTIN. Well, I would think we would be able to pay it out. I do not think they are likely to demand it on the scale you suggest.

Senator MALONE. Well, here is Thailand. I was there. They are a nation of little people with men weighing about 110 pounds wringing wet, and the women about 80 pounds, and they do not even know who is running their country.

I hear all this talk, these wise, smart remarks that the State Department makes about these countries—that if we just continue to put up the taxpayers' money everything will come out right.

I was in Thailand in 1948 for a considerable time; I even went down their little canals in their boats or sampans; they are using the water for domestic purposes and waste disposal, sewage disposal, and bathing in it; and it is all very interesting, but the point is they don't even know who is in charge of them.

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The Chinese businessmen were running the country, as you probably already know.

So what about Thailand? They would be very likely, if they thought it would embarrass us, they would come in; would they not? They have $168 million.

Mr. MARTIN. Well, we would be prepared——

Senator MALONE. You would pay it, of course.

Mr. MARTIN. We would pay it; yes, sir.

Senator MALONE. What about Germany? We are giving them money all the time and they have piled up $1,777 million in credit. What would you do if they demanded it?

Mr. MARTIN. I would pay it.

Senator MALONE. Well, you would pay it all; would you not?

Mr. MARTIN. I would, indeed.

Senator MALONE. Until you come down and bounced on the $11,761 million balance in the depositories—and then would have to rush madly up to Congress and just stop payment on the checks until we acted; acted under duress, that is because the money would be gone; is that correct?

Mr. MARTIN. That is correct.

Senator MALONE. What got us into this position? How did we lose that part of the $22,400,000 in the last 24 years? How did we distribute it so well and fast? What did we get for it?

Mr. MARTIN. Well, this has been—these have been deposits. We had roughly, what is it, Arthur, 60 percent of the gold?

Mr. MARGET. We have about 60 percent of the world's gold.

Senator MALONE. You mean you had about 60 percent of the world's gold. What is the total amount of the world's gold?

Mr. MARGET. We have the figures for you; we will get it in just a moment I can give you the precise figure in just a moment. I would say that it is——

Senator MALONE. Roughly.

Mr. MARGET (continuing). Let us say around $40 billion.

Senator MALONE. Around $40 billion; and we own 60 percent of that?

Mr. MARGET. That is right.

Senator MALONE. That was $22 billion when?

Mr. MARGET. That was as of June 1957.

Senator MALONE. We just got all through with that, so you would modify that to the point that the foreign dollar credits against the $22 billion——

Mr. MARGET. $22.7 billion, actually. I would say that that is 60 percent, roughly, of the world's monetary gold; I would have to give you a precise figure of the gold holdings of the other countries.

Senator MALONE. $22.7 billion in gold is what you have in the depositories now?

Mr. MARGET. As of June.

Senator MALONE. We have gone all through that, and with foreign dollar balances against it that leaves us clear and aboveboard, with no mortgage on it or with no claim to it, of $5,754 million; that is just roughly it, because as I understand you to say, it varies from day to day; is that true?

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Mr. MARGET. Well, sir, again: Are we making a distinction between the governments and the nationals of other countries? Because it does make a difference, you see, Senator.

Senator MALONE. We went all through that. You sat right there while we went through it with Mr. Martin, and you read the Secretary of the Treasury's testimony?

Mr. MARTIN. Yes.

Senator MALONE. And then the testimony of the Chairman—you are with the Federal Reserve?

Mr. MARTIN. That is right.

Senator MALONE. He would honor them and, so far as he knew, he thought, as I do, that the nationals could transfer it in a very short time to the Nation's obligations. Why go all through that again? Answer my question.

Mr. MARGET. I may have misunderstood your question.

Senator MALONE. I guess you did.

I asked you if, then, instead of your having $22 billion today, as you said, 60 percent that we owned in 1934, instead of that amount, what we actually own and control free of obligations through the customary method of honoring dollar credits, is roughly $5,754 million——

Mr. MARGET. Making the assumptions you make; yes, sir.

Senator MALONE. What assumption would you make?

Mr. MARGET. I do think there is a distinction, an important distinction——

Senator MALONE. Go ahead and make it. I want you to make it.

Mr. MARGET (continuing). Between the official, foreign official holdings and the holdings of private individuals.

Senator MALONE. Is your testimony different from the Chairman's?

Mr. MARGET. No, sir.

Mr. MARTIN. No.

Mr. MARGET. I am trying to clarify it.

Senator MALONE. You are not clarifying anything. You are messing it up for me, and I am working against time.

Say it again and do not tangle it.

Mr. MARGET. I think, Senator, we are all trying to find out what is our position as against calls that might be made against the United States' gold reserves.

Senator MALONE. All right, make it.

Mr. MARGET. What I am saying is, if we want to get a realistic appraisal of our position in terms of demand obligations against us, it is important to distinguish between official dollar holdings——

Senator MALONE. You go ahead and do that. I gave you an opportunity awhile ago, and you did not do it. I am giving you another one, and then I want you to keep out of it.

Mr. MARGET. The reason why I make that distinction, Senator, is that the existing practice, which was described by Secretary Humphrey, and confirmed by Chairman Martin, is to honor requests from monetary authorities abroad.

Senator MALONE. Who are they?

Mr. MARGET. They are the accredited monetary authorities in all these countries, either the central bank, if designated by the Treasury, or the treasuries of those countries.

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Senator MALONE. Whatever it may be.

Mr. MARGET. Therefore, I say, in asking how much we are likely to be forced to face——

Senator MALONE. You go ahead and use your own language, and then I will ask you a couple of questions.

Mr. MARGET. Yes, sir.

I simply am saying that I think the relevant figure for dollar claims is the official holdings, as opposed to the total holdings, which include private claims, private dollar deposits here.

Senator MALONE. Are you through?

Mr. MARGET. Yes, sir.

Senator MALONE. Now let me ask you a question. Do you think there is any difficulty in transferring these individual dollar credit holdings claims in a foreign country to official government claims?

Mr. MARGET. I think there might be—it depends on what foreign governments choose to do in relation to their nationals.

If the question is, sir, whether the foreign governments could mobilize dollar claims from their nationals, I think that is perfectly true.

The only—well, I would like to add a comment to that.

Senator MALONE. Add it.

Mr. MARGET. For a foreign government to, in effect, appropriate the dollar holdings of its nationals means that that government is in a very serious state, and it would not be normally likely to do it.

What that adds up to is that while it is perfectly true, as you have been arguing, Senator——

Senator MALONE. I have not been arguing. I am asking the questions.

Mr. MARGET. It has been implied.

Senator MALONE. And you are not asking them.

Mr. MARGET. It is perfectly true that if all these——

Senator MALONE. I just want to stop you at that point. My arguing will be done in committee after we start writing up the report. Do you understand that?

Mr. MARGET. Yes, sir.

Senator MALONE. All right.

Mr. MARGET. My point was only that it has been admitted by the Chairman that if all these demand claims were suddenly called, we do not have enough to meet these claims without violating the existing law with respect to the reserve ratio.

But as I have understood the Chairman, he has said that it is not likely to happen in anything but an extraordinary kind of crisis.

Senator MALONE. Mr. Martin said that he agreed with the figure balance of gold of $5,752 million less all foreign dollar balances. I asked him the question, and he did not make a speech like you are making. Go ahead and finish.

Mr. MARGET. I am finished, sir.

Senator MALONE. Then a question or two now.

Is there not any way that the Government could get these dollar claims without confiscation?

Mr. MARGET. Confiscation? It depends what one means by confiscation. These countries may have exchange-control laws which would

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require their citizens to deliver the money against a payment in their own local currency.

Senator MALONE. Most of them do; do they not?

Mr. MARGET. Yes, sir; they do.

Senator MALONE. Most of them?

Mr. MARGET. In recent years, sir, the tendency has been to leave more in the hands of their nationals as these countries have relaxed their foreign-exchange controls.

Senator MALONE. I think the Secretary of the Treasury was to prepare a table. I am not sure that he did. He said he would, if he could. He said he would prepare a table that would show what the present practice was of each of these nations. Do you know what it is?

Mr. MARGET. It would be a book about this thick. We can deliver it; that is, I think we can ask permission of the Monetary Fund to give it to you.

Senator MALONE. I do not need a book that thick, and it is not necessary to have a book that thick. What you can do, there are only about 60 or 70 of these nations, and you can tell me what the practice is now.

Mr. MARGET. As of now.

Senator MALONE. Yes, and it does not need a book.

Mr. MARGAT. All right.

(The information requested is as follows:)

A list of countries requiring the surrender of dollar receipts to the monetary authorities, or to banks subject to control by the monetary authorities, has been submitted by the Secretary of the Treasury and published on page 461, part 1, of these hearings. The book mentioned by Mr. Marget is the Eighth Annual Report on Exchange Restrictions of the International Monetary Fund; the report is filed with the committee.

Senator MALONE. That is what is the matter with about 90 percent of you people who sit on these soft cushions here and get to liking it. You write a book, and no one reads it; so you are in the clear. You have not answered my question. Any foreign nation under discussion could exchange its own money on the free market for these individual dollar credits, or property, or for this money without confiscation?

Mr. MARGET. The ordinary practice is for them to give their own local currency.

Senator MALONE. That is the practice. I am not so sure it is altogether the practice, but, if they wanted to get the dollar balances from a national of their own country, it could be done without confiscation. It might be concessions of various kinds. It is not possible that they could be paid off very liberally, and the nation get this dollar balance without any confiscation at all.

Mr. MARGET. Well, sir, my only point is, if the Government has the power, and it certainly has the power——

Senator MALONE. We have the power right here to condemn anything, do we not?

Mr. MARGET. Yes, sir.

Senator MALONE. Why would they not have it?

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Mr. MARGET. Yes. But if the Government has the power, I do not see why they should give them anything more than the local currency.

Senator MALONE. Well, of course, you know they have the power, but if the man owning the dollar balance is influential enough, and many of them are, many of these governments are run by top people, and I am not so sure that we are entirely immune in a monetary way—is it not possible, without using their currency, to compensate them adequately for the dollar balances?

Mr. MARGET. I do not know of any case, but I do not know why it is not possible.

Senator MALONE. Of course, you do not. It is not something I am asking you at random. I have asked it in these nations, and I have been in all of them. I suppose you visited some of them, as long as you have such an important job, have you not?

Mr. MARGET. Yes, sir.

Senator MALONE. Well, did you find anything that is contrary to what I am developing?

Mr. MARGET. No. I just do not happen to know of any case in which it was done that way.

Senator MALONE. Don't you know of any case; are you not familiar enough with these nations to know the kind of concessions that are given top people in the government in mining, in concessions in property, in land?

Mr. MARGET. Again, I could not write a history of that. I just do not know of any such cases.

Senator MALONE. I am not asking you to write a history. In fact, I am trying to get you to condense your answers.

Mr. MARGET. Yes, sir. I know what the official practices are, and, I repeat, sir, I know of no case corresponding to the kind of case you have adduced. That is, maybe, because of my ignorance.

Senator MALONE. You do not see any reason why they could not do it?

Mr. MARGET. No.

Senator MALONE. It is helpful for you to get down to words of one syllable. I do not want to shut you off. Any time you want to talk, I want to let you talk, because I do not want anybody to say afterward they did not have an opportunity to explain. I know, if I can get it in language that I understand, that some of my neighbors are going to understand. I am asking you in deadly earnest about how we dissipated our gold reserve. If it sounds simple to you, it ought to be very simple to answer it. You told me that there were about $40 billion worth of gold in the world today that you know about.

Mr. MARGET. I can probably give you a more accurate figure, sir, if you will just let me look for it.

Mr. MARTIN. We will get you the figure.

Mr. MARGET. We will get you the exact figure.

Senator MALONE. Get it for me.

Mr. MARGET. It will be exclusive of Russia, because the Russians never give any official figures.

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(The information referred to follows:)

World gold reserves (excluding U. S. S. R.) as of June 30, 1957

[In millions of dollars]

United States	22,732
Foreign countries	15,111
International Monetary Fund	1,147
Total	38,990

Senator MALONE. I spent 2½ months behind the so-called Iron Curtain. I traveled 14,000 miles in Russia, and I would not be surprised, from my observation, if they have a couple of dollars in gold.

Mr. MARTIN. I think that is right.

Mr. MARGET. I have the figure published for March 1957. It was something under $40 billion. It was $38,765 million, and that is the figure as of March 1957.

These are the reported gold reserves of central banks and governments.

Senator MALONE. Do you have it by nations?

Mr. MARGET. Yes. We have the principal nations here, and we can give you a table on that.

Senator MALONE. How many nations are there, roughly?

Mr. MARGET. I will have to count them up, sir. There are 35.

Senator MALONE. Well, you can add or detract from that table, but prepare it for us, if you will, because it will correspond roughly with the table on page 483 of foreign dollar holdings.

Mr. MARGET. No, sir.

Senator MALONE. I do not mean the amounts will correspond, but they will include the same nations.

You are giving me then not only how much gold there is known to be in the world today, but where it is.

Mr. MARGET. Yes, sir.

But may I make one point clear?

Senator MALONE. Yes.

Mr. MARGET. There is a distinction between the gold holdings of these countries and their dollar holdings. The gold holdings——

Senator MALONE. I understand that. There need be no connection.

Mr. MARGET. All right; that is all.

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(The information referred to follows:)

Gold reserves of central banks and governments, by countries (excluding U. S. S. R.) as of Mar. 31, 1957

[In millions of dollars]

Europe:	
Austria	72
Belgium	848
Denmark	31
Finland	35
France	861
Germany, Federal Republic of	1,756
Greece	11
Italy	[1] 350
Netherlands	814
Norway	45
Portugal	461
Spain	56
Sweden	252
Switzerland	1,636
Turkey	144
United Kingdom	[2] 1,925
Yugoslavia	18
Bank for International Settlements (including European Payments Union)	367
Other	484
Total	10,166
Canada	1,112
Latin America:	
Argentina	194
Bolivia	([3])
Brazil	324
Chile	46
Colombia	[4] 57
Cuba	136
Dominican Republic	11
Guatemala	27
Mexico	166
Latin America—Continued	
Peru	35
El Salvador	32
Uruguay	183
Venezuela	669
Other	51
Total	1,931
Asia:	
India	247
Indonesia	43
Iran	138
Israel	10
Japan	128
Korea	1
Philippines	23
Thailand	112
Other	249
Total	951
Other countries:	
Australia	113
Belgian Congo	123
Egypt	188
Union of South Africa	233
All other	104
Total	761
Total foreign countries	14,921
International Monetary Fund	1,438
United States	22,406
World total (excluding U. S. S. R.)	38,765

[1] As of Feb. 28, 1957, latest date available.
[2] Estimated gold holdings of British Exchange equalization account, based on figure for total holdings of gold and of United States and Canadian dollars, as reported by British Government.
[3] Less than $500,000.
[4] As of Oct. 31, 1956, latest date available.

Senator MALONE. I might ask a question right there of you, Mr. Chairman; is it customary for these other nations to honor their trade balances with gold?

Mr. MARTIN. It is.

Senator MALONE. All of them? All of them that have this gold?

Mr. MARTIN. Most of them. There have been some that have not.

Senator MALONE. Will you also give me a list of the nations that are honoring their foreign-money balances in gold when presented?

Mr. MARTIN. Right.

Senator MALONE. Give me a list.

Mr. MARTIN. We will give you the list.

Senator MALONE. I think that is very important.

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(The information referred to follows:)

CONVERTIBILITY OF FOREIGN-HELD CURRENCIES

The following tabulation shows primarily the absence or presence of restrictions on the conversion of currencies into dollars. Dollar holdings in turn can be converted into gold, not only through transactions between foreign governments or central banks and the United States Treasury, but more generally in the world gold markets, primarily the London gold market (see below, under "United Kingdom").

I. COUNTRIES PERMITTING CONVERSION OF FOREIGN-HELD CURRENCIES

(*a*) All accounts converted at uniform rates:
Canada
Bolivia; Cuba; Dominician Republic; El Salvador; Guatemala; Haiti; Honduras; Mexico; Panama; Venezuela
Switzerland (restricts conversion of accounts held by residents of countries that restrict conversion of their Swiss-held accounts)
Lebanon; Liberia

(*b*) Some accounts (mainly those derived from capital transactions) converted at free-market rates which in some cases are at a substantial discount:
Costa Rica; Ecuador; Paraguay; Peru; Uruguay

II. COUNTRIES RESTRICTING CONVERSION OF FOREIGN-HELD CURRENCIES

A. Latin America

Argentina: Conversion permitted at various exchange rates for holdings derived from current transactions within limits of import licensing system, from profits earned after June 1955, and from investments made after October 1955.

Brazil: Conversion permitted at varying exchange rates for accounts with authorized banks within limits of import licensing system.

Chile: Conversion permitted at varying exchange rates, except that conversion of company accounts requires license.

Colombia: Conversion permitted at varying exchange rates for accounts arising from current transactions.

Nicaragua:[1] Conversion also permitted for accounts arising from current transactions.

B. Continental Europe (except Communist countries)

Austria[1]*:* In practice, conversion of foreign-held accounts generally possible at a discount.

Belgium-Luxembourg: Conversion of virtually all accounts permitted at free-market rate, which is practically identical with official rate.

Denmark.[1]

Finland: Conversion permitted for holdings arising from sale of convertible currencies.

France[1]*:* In practice, conversion of foreign-held accounts generally possible at a discount. Affiliated overseas countries: Morocco, Tunisia.

Germany: Conversion of most foreign-held accounts permitted at free-market rate, which is practically identical with official rate.

Greece.[1]

Italy.[1]

Netherlands: Conversion of virtually all accounts permitted at free-market rate, which is practically identical with official rate. Affiliated overseas countries: Netherlands Antilles; Surinam.

Norway.[1]

Portugal.[1]

Spain.[1]

Sweden.[1]

Turkey.[1]

C. Sterling area

United Kingdom: Conversion permitted without restriction for "American," "Canadian," or "registered" accounts, arising mainly from current transactions

[1] Countries permitting conversion of holdings arising from sale of convertible foreign currencies or from authorized foreign investment.

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with residents of countries with convertible currencies or from sale of gold or dollars; these accounts can also be used without restriction to purchase gold in London gold market. Conversion into other foreign currencies permitted without restriction for virtually all other foreign-held accounts ("transferable accounts"); in practice, these accounts can be converted into dollars at a discount, which in recent years has been less than 1 percent. In practice, domestic holdings ("resident accounts") also can be converted into dollars, but at a substantial discount.

Australia.[2]
Burma.[1]
Ceylon.[1]
Ghana.[2]
Iceland.[2]
India.[1]
Iraq.[1]
Ireland.[2]
Jordan.[1]
Libya: License required for all conversions.
New Zealand.[2]
Pakistan.[1]
Rhodesia.[2]
Union of South Africa.[2]

D. Rest of world (except Communist countries)

Afghanistan.[1]
Cambodia: License required for all conversions.
Egypt[1]: Conversion of "authorized" investment accounts subject to limits.
Ethiopia,[1]
Indonesia: License required for all conversions.
Iran.[1]
Israel:[1] Conversion of "authorized" investment accounts subject to limits.
Japan.[1]
Korea: License required for all conversions.
Laos: License required for all conversions.
Philippines: License required for all conversions, except for limited amount of profits.
Saudi Arabia: License required for all conversions.
Sudan.[1]
Taiwan:[1] Conversion of "authorized" investment accounts subject to limits.
Thailand: Conversion permitted for holdings arising from current transactions.
Vietnam: License required for all conversions.

Senator MALONE. How many of these nations right at this point allow their own nationals to have the gold?

Mr. MARGET. There are several that allow them to have it.

There is none that undertakes to redeem it, redeem their currency in gold at a fixed price.

In other words, there is a distinction in these countries between allowing the nationals to hold gold domestically—on the one hand—and then the governments' undertaking to redeem in gold any currency.

Senator MALONE. Redeem their own money in gold?

Mr. MARGET. That is right.

There are several countries which do allow people to hold gold internally. One is France, one is Switzerland, recently Belgium, and Germany.

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[1] Countries permitting conversion of holdings arising from sale of convertible foreign currencies or from authorized foreign investment.

[2] Countries permitting unrestricted conversion into pounds sterling, and thus indirectly conversion into dollars to the extent permitted or possible in the United Kingdom.

NOTE.—Countries that are printed in italic are members of the European Payments Union, which also includes Switzerland (see above). Union members (including overseas countries belonging to their currency area) settle balances with each other 25 percent in credit, repayable by agreement or at the time of the dissolution of the Union, and 75 percent in gold or dollars.

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Senator MALONE. Would you give me a list of those nations that allow their nationals to hold gold?

Mr. MARGET. Yes.

Senator MALONE. And let them transfer it, buy it and sell it?

Mr. MARGET. Yes.

Senator MALONE. In these nations, is there any limit on the price for which they can sell it, if they can get it, if they can sell it for $20 or $50 or whatever amount they can get for it, or is that price controlled by the government?

Mr. MARGET. The price is not controlled by the government.

(The information referred to follows:)

According to available information the following countries allow their nationals to hold, transfer, buy, and sell gold domestically:

Argentina	**Greece**	**Pakistan**
Belgium	**India**	**Peru**
Brazil	**Iran**	**Portugal**
Canada	**Italy**	**Saudi Arabia**
Chile	**Japan**	**Thailand**
Colombia	**Lebanon**	**Turkey**
Egypt	**Mexico**	**Switzerland**
France	**Morocco**	**Uruguay**
Germany		

Senator MALONE. That is free gold?

Mr. MARGET. Yes. Where they are allowed to hold it, they are allowed to trade internally. There may be restrictions on export and import.

Senator MALONE. But internally they can buy and sell?

Mr. MARGET. That is right. This is not true, sir, of all countries. I am just talking of those countries where they are allowed to deal in gold.

Senator MALONE. Yes.

Now, how many countries are there which will allow export or import of gold by nationals or by their own citizens?

Mr. MARGET. There are very few. We will give you a list.

Senator MALONE. Yes; give us a list of those nations for the record.

Mr. MARGET. As opposed to the monetary authorities; as opposed to the treasury, let us say, or the government?

Senator MALONE. Independent of it.

Mr. MARGET. Free export and import.

Senator MALONE. Yes.

Well, it might be they would have to have a permit, it might be, but if they do, let the record show whether they can do it without a permit, or whether they have to have a permit for import and export of gold, and whether the price is fixed, if they do export or import, or whether it is a free market.

You think it is a free market?

Mr. MARGET. There is no case I know of in which the government will deliver gold to its nationals at a fixed price for domestic holding.

Senator MALONE. They can if they want to?

Mr. MARGET. In practice they do not.

Senator MALONE. In practice they do not generally do it?

Mr. MARGET. That is right.

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(The information referred to follows:)

According to available information the following countries permit unrestricted imports and exports of gold: Canada, Lebanon, Morocco, Switzerland, and Uruguay.

Senator MALONE. Do you know, then, with these nationals in various nations buying and selling gold, or nations buying and selling gold, what the price has been, what has been paid per ounce for this gold over the past 10 or 15 years?

Mr. MARGET. Oh, yes, sir; we could give you a table on that. I happen to have with me somewhere in these papers a paper on the current free prices of gold.

While I am fishing for the paper, the generalization that I would make about the price of gold in these free markets is broadly this: That—here it is—that in what I would call the effective free gold markets, which are typified by, for example, London, the London free gold market or the Zurich free gold market——

Senator MALONE. The what?

Mr. MARGET. Swiss.

Senator MALONE. How many free gold markets are there?

Mr. MARGET. Those are the two principal ones, Switzerland——

Senator MALONE. How about Hong Kong?

Mr. MARGET. There is a market in Hong Kong, too, and the generalization I was going to make—your question was, what is the price?

Senator MALONE. Generally speaking, over the past couple of decades.

Mr. MARGET. Well, that has varied very considerably.

Senator MALONE. I understand that. That is what I want.

Mr. MARGET. If you ask me over the past decade, it has been varying from a very considerable premium over the $35 price to what is now the state of affairs, which is that in London, for example, as of now, as of July, for example, the dollar price of gold in the free market is in fact $35. That has not been true throughout this period.

Senator MALONE. How high did it go, and how low, over the past, say, 20 years, if you know?

Mr. MARGET. Well, the London market opened only in the post-war period.

Senator MALONE. Post-Second War?

Mr. MARGET. Post-Second War, and only relatively recently, sir.

Senator MALONE. You have that information?

Mr. MARGET. I do not have the date, but I can give you the date. It is within the last 2 or 3 years that they have opened it.

I say the price since that gold market has been opened has been, in effect, around $35.

Senator MALONE. How high did it go during that last 2 or 3 years?

Mr. MARGET. Not much higher. It has just been around—just a little under, below——

Senator MALONE. When I was in South Africa, I think in 1948, there was as high as a $75 per ounce market for gold in Europe.

Mr. MARGET. Yes, sir.

Senator MALONE. Do you know anything about these prices over the past 24 years?

Mr. MARGET. We can—since they are in many cases unofficial prices, they have to be approximate—but we can get you the price during this

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period of, shall I say, of distrust of the local currencies, and the premium was quite high.

Senator MALONE. About how high?

Mr. MARGET. Seventy dollars, a premium of as much as that.

I was going to—lest I mislead you, Senator, I would like to complete my statement about what the current prices are.

Senator MALONE. Go ahead.

Mr. MARGET. I said that in the typical, the principal functioning markets, namely, London and Zurich, Switzerland, the rate is in fact effectively around $35.

Now, there are some divergencies as between other markets, which are not so important because free import and export is not permitted.

For example, in Paris there is a market for bar gold, that is slightly higher, that is $36.50; and indeed, in one case, but it is really an exceptional case, namely, the case of Bombay, the premium, the price, is about $60. But that——

Senator MALONE. Bombay, India?

Mr. MARGET. In India, yes, sir.

Senator MALONE. Is that $60 in American dollars, 60 American dollars?

Mr. MARGET. That is the equivalent of 60 American dollars.

Senator MALONE. What do they use for money there? I was there in 1948——

Mr. MARGET. Rupees.

Senator MALONE. Rupees. That rupee varies quite widely, and generally is getting cheaper?

Mr. MARGET. It has shown some depreciation on the free market.

Senator MALONE. What is it now, to the dollar, roughly?

Mr. MARGET. I do not have that figure here, but I would say it depends on which free market. The black market, perhaps as much as 10 percent discount, or something of that kind. I would have to check that.

Senator MALONE. Do you know what the official rate is?

Mr. MARGET. Yes, sir. It is about five to the dollar.

Senator MALONE. You think it would vary about 10 percent?

Mr. MARGET. Yes. Mind you, these are black market quotations. You will not find them officially quoted.

Senator MALONE. I am familiar with what you mean there. I understand perfectly.

And that is, generally they have an official rate, and some of them have what they call a bank rate. It might be a little different than that. And then they have a street rate. You just walk out on the street and look uncertain where you are going, with American-cut clothes, why, you can get just about anything you ask for the dollar. That is about right; is it not?

Mr. MARGET. Yes.

Senator MALONE. I remember in France in 1947, I think it was, I think the official rate was 350 francs to the dollar.

Mr. MARGET. That is right.

Senator MALONE. That was quite a while ago.

If you went out on the street, you got whatever you asked for it, because they wanted that dollar in their little hot hands.

None of these countries, no country in the world is on the official gold standard today, is it?

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Mr. MARGET. In the sense of redeeming for domestic circulation for its own nationals——

Senator MALONE. Yes.

Mr. MARGET. At a fixed price, there is none, sir.

Senator MALONE. Are there any of them besides us—yes, you did say, and you did, I think, Mr. Chairman, that these countries, and you are furnishing me a table of the ones that do make up their foreign balances in gold on request; you will give me a list of those nations?

Mr. MARTIN. That is right.

Senator MALONE. And a list of the nations which do not do it, because there are so many of them it is pretty hard to remember the list.

Mr. MARTIN. Right.

Senator MALONE. You understand, I want this information for the record, since we will need it when we start adding it up.

Now, I would be very much interested in your statement—why are we not on a gold standard?

Well, I will ask that question first: Why are we not on a gold standard, if that would stop the inflation and keep the money somewhat stable, or a metal standard, whatever you want to call it?

Mr. MARTIN. Well, we got off the gold standard in the dislocations that came following World War I; and to get back on full redeemability of currency—and I hope some day we will get back on it—is a pretty hazardous undertaking at a time when you have got irresponsible countries, such as our Russian friends that you mentioned earlier, but who might make irresponsible demands through individual citizens in this country, if we were redeeming for individual citizens.

Senator MALONE. You are not doing that.

Mr. MARTIN. No, we are not, but I am saying if we did, they might make difficulties for us that I do not see any particular reason for us to run the risk of.

Now, over recent years, I think the management of our currency and finances has been such that the risk would be at a minimum. But we still have our Russian friends at all times as a threat, and we have probably some of them stirring up individual citizens in this country needlessly.

Senator MALONE. You mean our own citizens?

Mr. MARTIN. Stirring up our citizens, yes, sir.

Senator MALONE. I have a good idea who is stirring it up. But I will not go into that with you now.

What do you think—do you think it is going to get any better in the future, as far as our Russian friends are concerned?

Mr. MARTIN. I really do not know, Senator.

Senator MALONE. Do you think they are going to be less dangerous when they increase their own supply of gold?

Mr. MARTIN. No; I do not think they are going to be any less dangerous if they owned gold. I hope that the world can look forward to a more peaceful period at some time, but I do not have to much hope of it at the present time.

Senator MALONE. Do you have any idea that Russia is the only nation which might give us trouble if they had enough gold to do it with?

Mr. MARTIN. Well, I think all of the Iron Curtain countries would cooperate with them.

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Senator MALONE. Do you remember where the "Iron Curtain" phrase was created?

Mr. MARTIN. No; I am afraid I do not.

Senator MALONE. I will tell you, and I think it is time some of our American citizens start to analyze where they hear these catch words and phrases.

Mr. MARTIN. Right.

Senator MALONE. Mr. Churchill created that catch phrase when he made a speech for Mr. Truman in Missouri.

Mr. MARTIN. Westminster College, Fulton, Mo.

Senator MALONE. You remember?

Mr. MARTIN. That is right.

Senator MALONE. While we are on these catch words and phrases by which we have run this country for 24 years, do you remember where the "dollar shortage" was created?

Mr. MARTIN. Where the dollar——

Senator MALONE. Where the phrase "dollar shortage" was created.

Mr. MARTIN. No, I cannot say, offhand, that I do.

Senator MALONE. It was created by the London bankers to sell a bill of goods to our taxpayers that they should give them money. There are two ways in which a nation can have a dollar shortage; there is only one way you and I can have it.

When individuals spend more than they make each year, they have a dollar shortage.

But a nation can have it in two ways: By spending more each year than they earn, which are all doing, including ourselves, but we can still sell bonds to our citizens for our shortage or by printing money as you are allowed to do; but the foreign nations have a dollar shortage by simply fixing a price on their money in terms of the dollar higher than the market price and no one will take it at the official rate.

No one will buy it but a silly Congress. It has been picking up the international check since World War II.

Have you been aware that almost every nation in the world fixes a price on its money—higher than the market price in terms of the dollar? You have not been aware of that?

Mr. MARGET. Well——

Senator MALONE. Wait just a minute, will you, please?

We will call on you in a minute.

Mr. MARTIN. I am not sure that I follow you there.

Senator MALONE. I will ask it again.

Mr. MARTIN. Yes.

Senator MALONE. Do you have knowledge that nearly every nation in the world fixes a price—let us leave it at that now—on its own money in terms of the dollar? You know that, do you not?

Mr. MARTIN. That is right.

Senator MALONE. Well, are you aware that nearly all of them fix a price above the market price of their money in terms of the dollar?

Mr. MARTIN. I do not know how you determine the market price on that.

Senator MALONE. It should be very easy for you. I went to Hong Kong, a free port. I have seen all of the foreign nations. I even went to Lithuania. There is hardly room to land a plane there. In 1948, I walked up to a bank window in Hong Kong and laid

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down a dollar, and I got six Hong Kong dollars for it, I might be off a little; it might have been 5½ or 6½; and walked to another window and laid down about 15 or 16 Hong Kong dollars and got a British pound and, being a free market, I could spend it anywhere in the world. Did you know that?

Mr. MARTIN. Yes; I did know that.

Senator MALONE. All right. At that time, what do you think the price of the British pound was fixed by Britain? That was 1948, remember.

Mr. MARTIN. About $4.06.

Senator MALONE. $4.03. Your memory is good. Well, you could buy it for $2.60 in Hong Kong, if my computations are correct, or any other free market.

Mr. MARTIN. Sure.

Senator MALONE. Well, there is a good deal of difference between $2.60 and $4.03, is there not?

Mr. MARTIN. There is, indeed.

Senator MALONE. Well, we were picking up the check for the difference with gifts of taxpayers' cash to Britain. There was the $3¾ billion loan in 1946. Do you remember that?

Mr. MARTIN. Yes.

Senator MALONE. So-called loan; of course, it was a gift.

Mr. MARTIN. I was——

Senator MALONE. If I had been in the Senate I would have voted against it. I was not here. I was here the next year, when Mr. Marshall made his famous speech, and had a simple paragraph that the Secretary of the Treasury wrote into it—the old man probably did not know it was in there—that we ought to pick up the check for 3 years internationally. And the Prime Minister of England took the ball on the first bounce and told us in 30 days what it was going to cost us for 3 years; $17 billion. I was here then, and I did not like it. That was in 1947. So, as soon as we adjourned, I went to Europe, and inspected almost every nation in Europe. You are familiar with that transaction, are you not?

Mr. MARTIN. I am. You are talking about black-market transactions.

Senator MALONE. No; I am talking about walking right up to a bank market at Hong Kong, and I suppose you can do it in any free market country in the world, including Switzerland. I went into Italy in 1947, and an Italian banker there—it was a branch of the Bank of America, as a matter of fact—one of the bank managers that I consulted, and he was literally going nuts, because he had a balance of British pounds, £25 million of credit, and he thought his bank was in good shape; and on paper it was.

However, he said the English blocked the currency; would not honor the payments unless for goods purchased in England. He could not spend it unless he spent it in England, and there was nothing in England he wanted to buy, so he was just walking around in a circle, tearing his hair, a rich man, and could not get a dime, about to get fired, I think, because that had happened to him.

Now, is England the only one that blocked its currency?

Mr. MARTIN. No; there were other countries, Senator.

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Senator MALONE. Do you have some knowledge of such nations over the last 10 or 12 years, say, the years during and since World War II?

Mr. MARTIN. We can give you a list of the countries.

Senator MALONE. The ones that blocked their currencies at different times?

Mr. MARTIN. Right.

(The information referred to is as follows:)

According to available information, the following countries have either completely blocked foreign-held balances or imposed substantial restrictions on their use at different times since 1939. Except where noted, controls were imposed or were already in effect at the beginning of World War II. In recent years, some countries have eliminated all restrictions, and most countries have substantially relaxed controls. Communist countries are not listed. Current limitations on convertibility of foreign-held balances are shown in the insert for page 2981.

Afghanistan	France	Nicaragua
Argentina	Germany	Norway
Australia	Greece	Pakistan, 1947
Austria	Honduras	Paraguay
Belgium-Luxembourg	Hong Kong	Peru, 1945
Bolivia	Iceland	Philippines, 1949
Brazil	India	Portugal, 1948
Burma	Indonesia	Spain
Cambodia	Iran	Sudan, 1956
Canada	Iraq	Sweden
Ceylon	Ireland	Switzerland
Chile	Israel	Taiwan, 1950
Colombia	Italy	Thailand, 1942
Costa Rica	Japan	Turkey
Denmark	Jordan	Union of South Africa
Dominican Republic, 1942	Korea, 1946	United Kingdom
Ecuador	Laos	Uruguay
Egypt	Lebanon	Venezuela
Ethiopia, 1942	Netherlands	Vietnam
Finland	New Zealand	

Senator MALONE. But you are aware that practically all these nations fix a fictitious price in dollars on their currency—Canada does not, because her dollar is worth more than ours, and that is because they have more horsesense than we have. They do not give their money away. They do not give anything away. We have financed projects in Canada up to several hundred million dollars for our own citizens and others with our taxpayers' money. What is the Canadian dollar worth now, in terms of the dollar, on the market?

Mr. MARTIN. About a dollar and six cents.

Senator MALONE. Ours is getting a little cheaper all the time.

Mr. MARTIN. That is right.

Senator MALONE. Do we have any prospect, as long as we keep up our present unbusinesslike methods, to slow up the increased premium on the Canadian dollar?

Mr. MARTIN. I do not know, Senator. The volume of new investment, American money that is flowing into investment in Canada because of their more businesslike methods has been tremendous.

Senator MALONE. Do you know how much it is?

Mr. MARTIN. No; I do not. We could probably give it to you.

Mr. MARGET. We can give you some figures on that.

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Senator MALONE. I wish you might. We added it up here—I tell you what you might do—we added it up with Burgess. There were $46½ billion now of American capital in foreign countries, and you know our Department of Commerce, which is a very great organization, built up by former Secretary Hoover, I knew him when he was in there, I think he did a marvelous job, and I think there have been good secretaries since—however, they are now and have been spending a good part of their time promoting American investment abroad.

You know that, do you not?

Mr. MARTIN. That is right.

(The information referred to is as follows:)

United States outflow (—) to Canada

[In millions of dollars]

	1952	1953	1954	1955	1956 [1]	1957, January-March [1]
Total net outflow (—)	−431	−412	−423	−301	−962	−260
Private, net, total	−425	−408	−425	−310	−967	−260
Direct investments	−420	−413	−469	−279	−544	−160
New issues	−158	−209	−167	−38	−379	−87
Redemptions	38	108	89	160	99	9
Other long-term, net	90	93	145	−71	−115	−10
Short-term, net	25	13	−23	−82	−28	−12
Government, net, total	−6	−4	2	9	5	(2)
Long-term capital, outflow	−7	−6	−8	(2)	(2)	(2)
Repayments	1	2	11	9	5	(2)
Short-term, net	(2)	----------	−1	(2)	(2)	----------

[1] Preliminary.
[2] Less than $500,000.

Source: U. S. Department of Commerce, Survey of Current Business.

Senator MALONE. The promotion of American capital invested abroad by the Department of Commerce is in addition to the four organizations, the Import-Export Bank, the International Bank—the World Bank—the International Monetary Fund, and the International Finance Corporation.

Mr. MARTIN. The International Monetary Fund and the International Finance Corporation.

Senator MALONE. That is right.

And the one reason for their existence is to loan money, to encourage American money to invest abroad, using the foreign cheap labor and avoid American taxes and through our free trade policy import the metals, textiles, and manufactured goods into this country in competition with the American higher wages workingmen and investors.

Mr. MARTIN. To encourage; yes.

Senator MALONE. And we finance the Import-Export Bank exclusively, up to $5 billion; is that not right?

Mr. MARTIN. That is right.

Senator MALONE. And we guarantee 35 percent of the capital for each of the other three organizations; is that right?

Mr. MARTIN. That is roughly right for the International Bank—yes, I would say that is about right.

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Senator MALONE. That is about right for the three of them. If there is any difference, will you detail such difference when you correct your testimony?

Mr. MARTIN. Right.

Senator MALONE. It is approximately correct.

Mr. MARTIN. That is right.

Senator MALONE. Now, there are 60 to 70 nations that are members of each one of these three international organizations, each having a member of the Board of Directors?

Mr. MARTIN. That is right.

Senator MALONE. The three international organizations besides the Export-Import Bank, which is exclusively our own. All, however, promoting, through loans, American investments abroad?

Mr. MARTIN. That is right.

Senator MALONE. And those directors vote in accordance with that nation's stock of money put into the organization.

Mr. MARTIN. That is right.

Senator MALONE. It means that 65 percent of the voting power is in foreign nations' hands and 35 percent in American hands or control, does it not?

Mr. MARTIN. That is right.

Senator MALONE. In other words, in encouraging American capital investment and spending abroad, determining to whom the loans are made and under what conditions the Board of Directors is 65 percent foreign-controlled.

Mr. MARTIN. In those institutions; yes, sir.

Senator MALONE. Those three.

Mr. MARTIN. Yes, sir.

Senator MALONE. Do you believe—and you must have knowledge of these countries before even World War I—do you have any reason to believe that these small countries throughout Europe and Asia are going to be any better off permanently unless we continue to divide our own wealth with them? We are now dividing our cash, gold and markets with them.

The President organized the General Agreement on Tariffs and Trade (GATT) in 1947 under the 1934 Trade Agreements Act and transferred their operations to Geneva, Switzerland. At this time 34 competitive foreign nations are dividing our markets between them through continually lowering our duties or tariffs. Also they pile up dollar credits for which they can demand our gold through the Marshall plan, ECA, mutual security, and so forth. That is how they are better off.

Mr. MARTIN. I think these smaller countries are developing new products.

Senator MALONE. How do you mean, new products?

Mr. MARTIN. Principally raw materials.

Senator MALONE. What are these raw materials?

Mr. MARTIN. Copper, lead, zinc, gold, silver—all of the minerals.

Senator MALONE. Tungsten? And shut our own mines down.

Mr. MARTIN. Tungsten.

Senator MALONE. They are mining these materials—minerals and selling them in our market—and American investors using American higher standard-of-living workingmen cannot compete with them.

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Mr. MARTIN. Well, they are selling it not only here, but all through the world.

Senator MALONE. We are the principal market in all of these minerals.

Mr. MARTIN. In some of these items, yes; not in——

Senator MALONE. Of course, we are the principal market for all minerals and the only guaranteed market price for gold.

Mr. MARTIN. Why——

Mr. MARGET. We could give you——

Senator MALONE. Just a minute. I am asking the chairman and the chairman may turn to you.

Mr. MARGET. Yes.

Mr. MARTIN. I could not call off—I have not given any thought to it. I used to live in this field.

Senator MALONE. Do you not know, as a matter of fact, we are the principal market in the world, period and paragraph?

Mr. MARTIN. We are a major market in the world, no question about it.

Senator MALONE. And is it not our market that is being divided? When we take our markets out of the pot at Geneva there will be no Geneva—it is our markets they are after.

Mr. MARTIN. Well, multilateral trade is not our market. I think that we——

Senator MALONE. It is our markets that they are dividing at Geneva through "multilateral trade" agreements? I am very much interested in your slant on the market division. The division of our markets among the nations of the world is an integral part of the plan to destroy us.

You see, our citizens of this country trust Congress, or did trust Congress, and they almost worship the President, no matter who is President, or the Members of Congress. But the people know that something is wrong; however, they are not yet convinced that Congress would do these things to them. The monetary system is only one facet of the whole plan to destroy or divide the wealth of this Nation.

We went off the gold standard in 1933, and started a deliberate inflation cycle. To cheapen our dollar. To lower wages. To price ourselves out of the world markets. We started printing money.

In 1943, we passed a free trade bill, the 1943 Trade Agreements Act, transferring the constitutional responsibility of Congress, article I, section 8, that says Congress is to regulate our foreign trade, to the President, did we not?

Mr. MARTIN. We did.

Senator MALONE. Giving the President full authority in that act to transfer that responsibility of Congress to Geneva or to any point on earth, did we not?

Mr. MARTIN. I do not think I follow you there.

Senator MALONE. I will ask it again.

Mr. MARTIN. Yes.

Well now, what is there in that bill that gives the President authority to transfer?

Senator MALONE. That is what I asked Mr. Dulles, the Secretary of State. Mr. Dulles says the 1934 Trade Agreements Act (so-called Reciprocal Trade) gave the President authority to transfer the con-

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stitutional responsibility of Congress to regulate foreign trade to Geneva. The President made the transfer in 1947—did you know that?—transferred it to Geneva under the General Agreement on Tariffs and Trade.

Mr. MARTIN. No; I am sorry. I was not familiar with that.

Senator MALONE. I think you ought to study it. Your job is only a part of the plan and you are vitally affected by the 1934 Trade Agreements Act and by the four organizations you have described to encourage American capital to invest abroad.

I do think that, unless you understand it, you are not quite up to it; I am sorry.

Mr. MARTIN. I think it may be that I am not well up to the job, Senator.

Senator MALONE. You are up to your own particular job, but I am trying to tell you that you are only one factor.

Now, in 1947, under the 1934 Trade Agreements Act (so-called Reciprocal Trade) as extended, the President caused to be organized, through the State Department, the General Agreement on Tariffs and Trade. You heard of it?

Mr. MARTIN. Yes; that is right.

Senator MALONE. And you heard the State Department is responsible for that; they claim it?

Mr. MARTIN. Right.

Senator MALONE. He located the organization in Geneva. Any foreign nation that passed muster—and remember, now, just what the qualifications were—could join.

Mr. MARTIN. Right.

Senator MALONE. And then they were empowered, through the General Agreement on Tariffs and Trade, to make multilateral agreements on tariffs and trade, dividing our markets among themselves, which they have done.

I have been in Geneva. I took the British secretary of the General Agreement on Tariffs and Trade organization to lunch, and found him to be a fine, congenial fellow, as he would be, and a Britisher, as he would be, because there is where the whole division of our wealth is based.

Now, using the authority granted the President under the 1934 Trade Agreements Act, the transfer to Geneva was made to operate under the newly organized General Agreement on Tariffs and Trade. You know that was done, do you not?

Mr. MARTIN. That is right.

Senator MALONE. Secretary Dulles, sitting right where you are now, in 1955, and under my direct questioning, said that the 1934 Trade Agreements Act gave the President full authority to organize the General Agreement on Tariffs and Trade and locate the operation in Geneva.

Are you aware that he testified to that fact?

Mr. MARTIN. I may have been, Senator. I would have to refresh myself.

Senator MALONE. I am reminding you; and, if you will check it, I think it will be very helpful to you.

As a result of Mr. Dulles' testimony, and other pressures, the Congress did exactly, in 1955, what they have been doing for 24 years;

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they extended the 1934 Trade Agreements Act for 3 more years—it now expires in June of 1958.

I was able to persuade this committee to hold it to 1 year at one time. I never did vote for it, because it is a free-trade act, and puts the foreign cheap labor in direct competition with American workingmen and investors. The original act in 1934 allowed the tariffs or duties to be cut 50 percent. The second extension allowed an additional 50 percent, making the allowable duty cuts 75 percent.

In 1955, this Congress allowed them to cut it another 15 percent under certain conditions, 5 percent a year. They are busily engaged in doing that very thing in Geneva at this time.

Now, the 1934 Trade Agreements Act expires in June 1958, next year, and I hope to God this Congress has the gumption and the guts to let it expire. The regulation of our foreign trade through flexible duty or tariff adjustment reverts to the Tariff Commission, an agent of Congress, under the 1930 Tariff Act. That act directs the Tariff Commission to determine the difference in the cost of production of an article in this country and the product or a like article in the chief competitive foreign nation, and recommend that as the duty or tariff, which simply takes the profit out of the low-cost wages at the water's edge.

Now, it is a fact, is it not, that it is against the law for any of our nationals, as we call the citizens of foreign nations, our own citizens to have possession of gold?

Mr. MARTIN. Yes, unless they have it for adornment or for something of that sort.

Senator MALONE. They can buy jewelry. They can also buy gold from the Treasury for manufacturing purposes, under certain conditions?

Mr. MARTIN. That is right.

Senator MALONE. That is already in the record.

Do you know what those transactions amount to each year?

Mr. MARTIN. No; I do not have the figures on it, but I can get them.

Senator MALONE. I wish you would, and just for each year, say, 10 or 15 years.

Mr. MARTIN. Right.

(The information referred to is as follows:)

A table showing the sale of gold by the mint to United States industry and net industrial consumption of gold by United States industry, 1947–55, has been submitted by the Secretary of the Treasury and published on page 456, part 1, of these hearings.

Senator MALONE. After the Treasury had sold the gold for this purpose, presumably for ornaments and jewelry, what is known about this gold afterwards, what becomes of it, whether it is sold or whether it is melted up and sold again, or it goes out of the country as jewelry and then might be melted up?

Is anything known about it after it has been sold by the Treasury for that purpose?

Mr. MARTIN. I think the Treasury does have some general idea of what happens to it.

Senator MALONE. Could you give me the regulation?

Mr. MARTIN. Right.

Senator MALONE. Just as a matter of information.

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Senator MALONE. You can insert it in the record. Now then, what do you think would be the matter with allowing our nationals, as we call them, in this country citizens, to have possession of gold and transfer it among themselves, and if they sold it—first, just confine it to the United States and our possessions. What would be the disadvantages?

(The following was later received for the record:)

SUBPART B—CONDITIONS UNDER WHICH GOLD MAY BE ACQUIRED AND HELD, TRANSPORTED, MELTED OR TREATED, IMPORTED, EXPORTED, OR EARMARKED

§ 54.12 *Conditions under which gold may be acquired, held, melted, etc.* Gold in any form may be acquired, held, transported, melted or treated, imported, exported, or earmarked only to the extent permitted by and subject to the conditions prescribed in the regulations in this part or licenses issued thereunder.

§54.13 *Transportation of gold.* Gold may be transported by carriers for persons who are licensed to hold and transport such gold or who are permitted by the regulations in this part to hold and transport gold without a license.

§ 54.14 *Gold situated outside of the United States.* Gold in any form situated outside of the United States may be acquired, transported, melted or treated, or earmarked or held in custody for foreign or domestic account without the necessity of holding a license.

§ 54.15. *Gold situated in the possessions of the United States.* Gold in any form (other than United States gold coin) situated in places subject to the jurisdiction of the United States beyond the limits of the continental United States may be acquired, transported, melted or treated, imported, exported, or earmarked or held in custody for the account of persons other than residents of the continental United States by persons not domiciled in the continental United States: *Provided, however,* That gold may be transported from the continental United States only as authorized by §§ 54.25, 54.32, 54.33, or 54.34, or licenses issued pursuant thereto.

§ 54.16 *Fabricated gold.* Fabricated gold as defined in § 54.4 may be acquired, held, transported within the United States or imported without the necessity of holding a license therefor. Fabricated gold may be exported only as authorized in § 54.25 or in a license issued pursuant to that section.

§ 54.17 *Metals containing gold.* Metals containing not more than 5 troy ounces of fine gold per short ton may be acquired, held, transported within the United States, or imported without the necessity of holding a license therefor. Such metals may be melted or treated, and exported only to the extent permitted by and subject to the conditions prescribed in or pursuant to § § 54.21 to 54..27, inclusive.

§ 54.18 *Unmelted scrap gold.* Unmelted scrap gold may be acquired, held, transported within the United States, or imported in amounts not exceeding at any one time 50 fine troy ounces of gold content without the necessity of holding a licence therefor. Persons holding licenses issued pursuant to paragraph (a) of § 54.25, or acquiring, transporting, importing or holding gold pursuant to § 54.21, may not acquire, transport, import or hold any gold under authority of this section.

§ 54.19 *Gold in its natural state.* (a) Gold in its natural state, as defined in § 54.4, may be acquired, transported within the United States, imported, or held in custody for domestic account only, without the necessity of holding a license therefor.

(b) Gold amalgam which results from the addition of mercury to gold in its natural state, recovered from natural deposits in the United States or a place subject to the jurisdiction thereof, may be heated to a temperature sufficient to separate the mercury from the gold (but not to the melting temperature of gold) without a license by the person who recovered the gold from such deposits or his duly authorized agent or employee. The retort sponge so resulting may be held and transported by such person without a license: *Provided, however,* That no such person may hold at any one time an amount of such retort sponge which exceeds in fine gold content 200 troy ounces. Such retort sponge may be acquired from such persons:

(1) By the United States;

(2) By persons holding licenses issued pursuant to paragraph (a) of § 54.25;

(3) By other persons provided that the aggregate amount of such retort sponge

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acquired and held by such other persons does not exceed at any one time 200 fine troy ounces of gold content.

(c) Persons acquiring retort sponge under paragraph (b) (3) of this section are authorized to dispose of such retort sponge only to the United States and to persons holding licenses issued pursuant to paragraph (a) of § 54.25.

(d) Except as provided in §§ 54.12 to 54.20, inclusive, and in §§ 54.32 and 54.33, gold in its natural state may be melted or treated or exported only to the extent permitted by, and subject to the conditions prescribed in, or pursuant to, §§ 54.21 to 54.27, inclusive.

§ 54.20 *Rare coin.* (a) Gold coin of recognized special value to collectors of rare and unusual coin may be acquired and held, transported within the United States, or imported without the necessity of holding a license therefor. Such coin may be exported, however, only in accordance with the provisions of § 54.25.

(b) Gold coin made prior to April 5, 1933, is considered to be of recognized special value to collectors of rare and unusual coin.

(c) Gold coin made subsequent to April 5, 1933, is presumed not to be of recognized special value to collectors of rare and unusual coin.

SUBPART C—GOLD FOR INDUSTRIAL, PROFESSIONAL, AND ARTISTIC USE

§ 54.21 *Fifty ounce exemption for processors.* (a) Subject to the conditions in paragraph (b) of this section, any person regularly engaged in an industry, profession, or art who requires gold for legitimate, customary, and ordinary use therein, may, without the necessity of obtaining a Treasury gold license:

(1) To consign gold bullion, including semiprocessed gold, to other persons authorized to hold and dispose of gold in such form and amount under the regulations in this part or a license issued pursuant hereto;

(2) Hold, transport, melt, and treat such gold;

(3) Furnish unmelted scrap gold to the United States, to persons operating pursuant to §§ 54.18 or 54.21, or to the holder of a license issued pursuant to paragraph (a) of § 54.25; and

(4) Furnish melted scrap gold to the United States or to the holder of a license issued pursuant to paragraph (a) of § 54.25 which authorizes the acquisition of such melted scrap gold.

(b) The privileges of paragraph (a) of this section are granted subject to the following conditions:

(1) That the aggregate amount of such gold acquired, held, transported, melted and treated, and imported, does not exceed, at any one time, 50 fine troy ounces of gold content (not including gold which may be acquired, held, etc., without a license under any other section of this part, except § 54.18);

(2) That the aggregate amount of such gold acquired, held, transported, melted and treated, and imported, does not exceed, in any calendar month 350 fine troy ounces of gold content (not including gold which may be acquired, held, etc., without a license under any other section of this part, except § 54.18);

(3) That such gold is acquired and held only for processing into fabricated gold, as defined in § 54.4, by such person in the industry, profession, or art in which he is engaged; and

(4) That full and exact records are kept and furnished in compliance with § 54.26.

(c) Persons acquiring, holding, transporting, melting and treating, and importing gold under authority of this section are not authorized;

(1) To consign gold bullion, including semi-processed gold, to other persons for processing, except that scrap gold may, for processing and return in semi-processed form, be consigned to the holder of a license issued pursuant to paragraph (a) of § 54.25, which authorizes the acquisition and melting and treating of such gold.

(2) To furnish melted scrap gold to persons operating pursuant to the provisions of this section or § 54.18.

(3) To dispose of gold held under authority of this section otherwise than in the form of fabricated gold or scrap gold.

(d) Persons holding licenses issued pursuant to paragraph (a) of § 54.25 or acquiring, holding, transporting, or importing gold pursuant to § 54.18 may not acquire, hold, transport, melt or treat, or import any gold under authority of this section.

§ 54.22 *Licenses required.* Except as permitted in §§ 54.12 to 54.20, inclusive, and § 54.21, gold may be acquired and held, transported, melted or treated,

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imported, exported, or earmarked for industrial, professional, or artistic use only to the extent permitted by licenses issued under § 54.25.

§ 54.23 *Issuance of licenses or general authorizations.* The Director of the Mint may issue or cause to be issued licenses or other authorizations permitting the acquisition and holding, transportation, melting and treating, importing and exporting of gold which the Director is satisfied is required for legitimate and customary use in industry, profession, or art by persons regularly engaged in the business of furnishing or processing gold for industry, profession, or art, or for sale to the United States.

§ 54.24 *Applications.* Every application for a license under paragraph (a) of § 54.25 shall be made on Form TG–12 (except that applications for export licenses shall be made on Form TG–15) and shall be filed in duplicate with the Director of the Mint, Treasury Department, Washington, D. C. Every applicant for a license under paragraph (a) of § 54.25 shall state in his application whether or not any applications have been filed by or licenses issued to any partnership, association, or corporation in which the applicant has a substantial interest or, if the applicant is a partnership, association, or corporation, by or to a person having a substantial interest in such partnership, association, or corporation. The Director of the Mint shall not issue any license to any person if in the judgment of the Director more than one license for the same purpose will be held for the principal use or benefit of the same persons or interests. Any person licensed under this subpart acquiring a principal interest in any partnership, association, or corporation, holding a license under this subpart for this purpose, shall immediately so inform the Director of the Mint.

§ 54.25 *Licenses*—(a) *Licenses for the acquisition and holding, transportation, melting and treating, importing and disposition of gold.* (1) Upon receipt of the application and after obtaining such additional information as may be deemed advisable, the Director of the Mint, shall, if satisfied that gold is necessary for the legitimate and customary requirements of the applicant's industry, profession, art, or business, and that the applicant is qualified in all respects to conduct gold operations in full compliance with the provisions of this part and the provisions of a Treasury gold license, issue or cause to be issued to the applicant a Treasury gold license on the approved form for the kind of industry, profession, art, or business in which the applicant is engaged.

(2) Licenses issued under this section may authorize the licensee to acquire and hold not to exceed a maximum amount specified therein; to transport such gold, melt or treat it to the extent necessary to meet the requirements of the industry, profession, art, or business for which it was acquired and held, or otherwise to carry out the purposes for which it is held under license; and to import gold so long as the aggregate amount of all gold held after such importation does not exceed the maximum amount authorized by the license to be held.

(3) Licenses issued under this paragraph do not permit the exportation or transportation from the continental United States of gold in any form. Such exportation or transportation is permitted only to the extent auhorized in paragraph (b) of this section or in a separate license issued pursuant to such paragraph.

(b) *Licenses and authorizations for the exporting of gold*—(1) *Semiprocessed gold.* Semiprocessed gold, as defined in § 54.4, may be exported or transported from the continental United States only pursuant to a separate export license. Such licenses shall be issued by the Director of the Mint upon application made on Form TG–15 establishing to the satisfaction of the Director that the gold to be exported is semiprocessed gold and that the export or transport from the continental United States is for a specific and customary industrial, professional, or artistic use and not for the purpose of using or holding or disposing of such semiprocessed gold beyond the limits of the continental United States as, or in lieu of, money, or for the value of its gold content.

(2) *Fabricated gold.* Fabricated gold, as defined in § 54.4, may be exported or transported from the continental United States without the necessity of obtaining a Treasury gold license: *Provided, however,* That the Bureau of the Census Schedule B statistical classification number of each specific commodity to be exported shall be plainly marked on the outside of the package or container, the shipper's export declaration shall contain a statement that such gold is fabricated gold as defined in § 54.4 and is being exported pursuant to the authorization contained in this subparagraph, and such additional documentation shall be furnished as may be required by the Bureau of Customs or any other government agency charged with the enforcement of laws relating to the exportation of merchandise from the United States.

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(3) *Rare coin.* (i) Rare gold coin as defined in § 54.20, made prior to April 5, 1933, may be exported or transported from the continental United States without the necessity of obtaining a Treasury gold license: *Provided, however,* That the shipper's export declaration shall contain a statement that such coin is rare gold coin and is being exported pursuant to the authorization contained in this subparagraph and such additional documentation shall be furnished as may be requested by the Bureau of Customs or any other government agency charged with the enforcement of laws relating to the exportation of merchandise from the United States.

(ii) Gold coin made subsequent to April 5, 1933, may be exported or transported from the continental United States only under license on Form TGL-11 issued by the Director of the Mint. Application for such a license shall be executed on Form TG-11 and filed with the Director of the Mint, Treasury Department, Washington 25, D. C.

(4) *Other exports of gold.* Export licenses may also be issued upon application made on Form TG-15B in the same manner as prescribed in subparagraph (1) of this paragraph, authorizing the exportation of gold in any form for refining or processing subject to the condition that the refined or processed gold (or the equivalent in refined or processed gold) be returned to the United States, or subject to such other conditions as the Director may prescribe.

§ 54.26 *Investigations; records; subpoenas.* (a) The Director of the Mint is authorized to make or cause to be made such studies and investigations, to conduct such hearings, and to obtain such information as the Director deems necessary or proper to assist in the consideration of any applications for licenses, or in the administration and enforcement of the acts, the orders, and the regulations in this part.

(b) Every person holding a license issued under paragraph (a) of § 54.25, or acquiring, holding, or disposing of gold pursuant to the authorizations in §§ 54.18 and 54.21, shall keep full and accurate records of all his operations and transactions with respect to gold, and such records shall be available for examination by a representative of the Treasury Department until the end of the fifth calendar year (or if such person's accounts are kept on a fiscal year basis, until the end of the fifth fiscal year) following such operations or transactions. The records required to be kept by this section shall include the name, address, and Treasury gold license number of each person from whom gold is acquired or to whom gold is delivered, and the amount, date, description, and purchase or sales price of each such acquisition and delivery, and any other records or papers required to be kept by the terms of a Treasury Department gold license. If the person from whom gold is acquired, or to whom gold is delivered, does not have a Treasury gold license, such records shall show, in lieu of the license number of such person, the section of the regulations in this part pursuant to which such gold was held or acquired by such person. Such records shall also show all costs and expenses entering into the computation of the total domestic value of articles of fabricated or semiprocessed gold as defined in § 54.4.

(c) The Director of the Mint (or the officers and employees of the Bureau of the Mint specifically designated by the Director) or any department or agency charged with the enforcement of the acts, the orders, or the regulations in this part, may require any person to permit the inspection and copying of records and other documents and the inspection of inventories of gold and to furnish, under oath or affirmation or otherwise, complete information relative to any transaction referred to in the acts, the orders, or the regulations in this part involving gold or articles manufactured from gold. The records which may be required to be furnished shall include any records required to be kept by this section and, to the extent that the production of such information is necessary and appropriate to the enforcement of the provisions of the acts, the orders, and the regulations in this part, or licenses issued thereunder, any other records, documents, reports, books, accounts, invoices, sales lists, sales slips, orders, vouchers, contracts, receipts, bills of lading, correspondence, memoranda, papers, and drafts, and copies thereof, either before or after the completion of the transaction to which such records refer.

(d) The Director of the Mint may administer oaths and affirmations and may, whenever necessary, require any person holding a license under § 54.25 or acquiring, holding, or disposing of gold pursuant to the authorizations of § 54.18 or 54.21, or any officer, director, or employee of such person, to appear and testify or to appear and produce any of the records specified in paragraph (c) of this section, or both, at any designated place.

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§ 54.27 *Reports.* Every person holding a license issued pursuant to paragraph (a) of § 54.25 shall make reports on the appropriate report form specified in such license for the six months' periods ending on the last days of June and December, respectively, and shall file such reports with the Director of the Mint, Treasury Department, Washington 25, D. C. Reports shall be filed within twenty-five days after the termination of the period for which such reports are made.

Mr. MARTIN. I think, in the last few years, there would have been no disadvantage. I think the disadvantage would come if somebody like our Russian friends stirred up a conversion from dollars into gold on the part of individual citizens; that would be only a troublemaking operation.

Senator MALONE. How would it make trouble?

Mr. MARTIN. Well, I think the mere conversion of dollars into gold just for the sake of saying that you are safer that way would cause trouble; do you not?

Senator MALONE. No.

Mr. MARTIN. You do not?

Senator MALONE. I am for returning to the gold standard, of course, and using a little horsesense and taking the lead in that move. We are a powerful nation, and it has been the record over the years that a powerful nation took the lead in establishing sound money; as a matter of fact, we did do that ourselves one time, did we not? Was it not 1889? Is that right?

Mr. MARTIN. Around that time.

Senator MALONE. Probably our trouble in going on the gold standard now would be that we have given foreign nations dollar balances that could demand all but about $6 billion of our $22.4 billion in gold. We did take the lead in going on the gold standard in 1889 or whatever year it was.

Mr. MARTIN. That is right.

Senator MALONE. And is it not the fact that weaker nations follow, they do not lead?

Mr. MARTIN. No. But you have a situation——

Senator MALONE. Please answer me. Over the history, has it not been the powerful nations which took the lead going on a metal standard, or whatever was used for stabilizing money?

Mr. MARTIN. I think that is true.

Senator MALONE. Are we not the most powerful nation now? Let us leave Russia out for a minute. Are we not the most powerful nation in the world?

Mr. MARTIN. I think we are.

Senator MALONE. Well, are we not, including Russia, too?

Mr. MARTIN. I think we are, even including Russia. But I think Russia is powerful enough to cause us real trouble in this.

Senator MALONE. I spent 2½ months behind the so-called Iron Curtain. While I was traveling more than 14,000 miles in Russia, they would not even let our Ambassador out of Moscow, or any member of the Embassy. I know Bulganin and Khrushchev better than I know you, and I let them drink that "vulcanizer special" they call vodka, and I took a few drinks of wine. Bulganin and Khrushchev finally let me go into all of the 16 Socialist Republics. I am writing a report on the Eastern Hemisphere that will be available to you.

There are two reports on the Western Hemisphere that are now available to you. One of them is Senate Report 1627 of the 83d Congress. The other one is Senate Document 83 of the 84th Congress.

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The first one covers the accessibility of critical materials in the Western Hemisphere. The second one, the economic structure of each of these 42 entities and nations, showing exactly how they manipulate the value of their currency in terms of dollars for trade advantage; and how trade between the nations of the Western Hemisphere can be facilitated and be made self-sufficient in the production of critical materials for war or peace.

Mr. MARTIN. Did you get any indication from them as to the amount of gold they had, the Russians, on your trip?

Senator MALONE. Not accurate information, but they can mine it pretty fast.

Mr. MARTIN. Right.

Senator MALONE. And, according to mining engineers, one of them, as a matter of fact, the chief, ex-President Hoover, can tell you considerable about one of the large deposits of gold in Siberia that one of his companies owned at one time. There are tremendous mineral deposits in Russia. All this poppycock that you are going to surround them and keep them from industrial development, or arming themselves, is just that.

I went into the Urals, one of the greatest mineralized areas in the world, and I saw mining machinery, some of the largest in the world being "poured" there. I hope our report will be ready by the first of the year.

And there will be no effective revolt. All that is poppycock. They are living so much better than they were under the Czars, or that they were 5 or 10 years ago.

But now back to our own citizens. Personally, I do not think Russia is going to have any influence on any good American citizen, and 999/10 of them are good American citizens. The few traitors are not the most dangerous. The many good, honest people who mouth these catchwords and phrases that are created by the few traitors and by foreign nations are really doing the most damage.

These catchwords and phrases, such as "dollar shortage," "trade not aid," catch on and become popular to repeat.

You say you do not think Americans should be allowed to own gold and buy it and sell it among themselves. Tell me, now, why, again? I was not too clear on that answer. You only mentioned Russia.

Mr. MARTIN. Well, I mentioned the generally upset condition of the world.

Senator MALONE. What has that to do with it?

Mr. MARTIN. Well, I think it has a lot to do with it. There are gold markets that we have already referred to, in Paris, in London, and in Switzerland. They are good gold markets.

There are gold markets in Kuwait——

Senator MALONE. You mean for much above the $35?

Mr. MARTIN. Well, the trade that we are talking about would be endeavoring to try to get more for the gold; otherwise, there would be no particular point in——

Senator MALONE. Let us confine this question right now to the United States of America. Let us say they would have to have an export permit to send it anyplace else, but among ourselves why could we not take the lid off and say you could not put me in jail if you caught me with a $5 goldpiece. You could now, could you not?

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Mr. MARTIN. We could now, yes.

Senator MALONE. All right, what is the reason we could not raise that curtain?

Mr. MARTIN. I do not think there is any reason why we cannot raise that curtain. I think it is purely a policy question that it seems to me it would be unwise to raise it.

Senator MALONE. Why?

Mr. MARTIN. Because of the unsettled international situation.

Senator MALONE. What has that got to do with it, if you just buy and sell and trade it in our own country?

Mr. MARTIN. Well, if you could hold it for just around the country, it would not make any difference.

Senator MALONE. How could you export gold through the regular channels without knowing it if you had to have an export permit.

Mr. MARTIN. Well, it is a matter of judgment, Senator. I would think you would have great difficulty in controlling it, limiting it.

Senator MALONE. You think our citizens would export it, regardless, and that is your only objection to it?

Mr. MARTIN. That is my principal objection.

Senator MALONE. Otherwise, if it could be controlled, you think, as far as locally is concerned, that they ought to be able to own their own gold if they produced it or bought it, and sell it for any price it would bring, or sell it to the Government if they want to, for the $35 an ounce. You would then know what our people thought it was worth per ounce.

Mr. MARTIN. That is right. I would favor ultimately the redeemability of the currency in gold. I would not see any objection to it. I would like to see us get there some day.

Senator MALONE. What do you mean my "some day"?

Mr. MARTIN. I do not see it in the foreseeable future, because you must remember we have been off of the gold redeemability now for over 20 years——

Senator MALONE. How long; 24 years, is it not, 25 years?

Mr. MARTIN. Twenty-four years.

Senator MALONE. Next year it will be 26.

Mr. MARTIN. All right.

Senator MALONE. What has to happen?

Mr. MARTIN. To put us back on it?

Senator MALONE. Yes.

Mr. MARTIN. I think you have to have more stable world conditions than you have today, and we have to be certain that we are managing our monetary affairs in a way which will warrant confidence, and I think we are making progress in that direction.

Senator MALONE. There have been unsettled conditions in the world for 2,000 years. Do you have any idea there has ever been a condition such as you describe in the world?

Mr. MARTIN. Well, we know there have been periods which have been less strenuous, I would say, than the present.

Senator MALONE. Well now, you must know this, but just for purposes of the record I am going to refresh your memory. For 300 years, 2 or 3 or 4 European nations have controlled colonial systems and quashed the revolts, have they not?

Mr. MARTIN. That is right.

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Senator MALONE. And they would send a warship or cruiser, for example, if England had trouble in the Malayan States, you would read in the paper a cruiser was on the way.

Mr. MARTIN. Yes.

Senator MALONE. And the cruiser arrives in about a week, and they throw a little grapeshot over in the jungle, and there is no more insurrection; is that not right? Do you not remember reading about that in the old days?

Mr. MARTIN. Yes, sir.

Senator MALONE. Of course you do.

The difference now is that the colonial system is deader than Julius Caesar. We were the first Nation to break away from England's colonial system 180 years ago. Is that not right?

Mr. MARTIN. Yes.

Senator MALONE. Why did we break away from it? I guess you would know that they would not allow us to build any manufacturing plants or produce anything but raw materials. We sold them the raw materials and were forced to buy their manufactured stuff, were we not?

Mr. MARTIN. Right.

Senator MALONE. We were treated exactly like the Malayan States until our people got tired of it, and one day the so-called tea party broke up the act. Isn't that right?

Mr. MARTIN. That is right.

Senator MALONE. The tea tax did not cause it, but it was the last insult that broke the camel's back.

Mr. MARTIN. You are probably right.

Senator MALONE. It had been building up.

We were the first Nation to break away from the colonial system.

Mr. MARTIN. We were certainly one of the first.

Senator MALONE. Well, was it not the well-disciplined colonial system that kept an armed peace until World War I and you might say up until World War II?

Mr. MARTIN. Colonialism was a factor.

Senator MALONE. What else was a factor?

Mr. MARTIN. I think the whole currents of world trade. I do not think just colonialism.

Senator MALONE. Do you not think the world trade was directed largely through that colonial system?

Mr. MARTIN. A large part of it but not all of it.

Senator MALONE. Do you remember the history—when Spain lost South America?

They lost their South American colonies; did they not? They had practically every nation in South America under their control except Brazil; did they not?

Mr. MARTIN. Right.

Senator MALONE. I have been in every nation in South America. And most of the nations have a statue of a fellow named Bolivar. Ever hear of him?

Mr. MARTIN. Simon Bolivar.

Senator MALONE. That is right; and he rode a horse all over South America arousing them against Spain. He is always on a horse, that statue.

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Mr. MARTIN. Yes.

Senator MALONE. And they worship him; do they not?

Mr. MARTIN. Right.

Senator MALONE. Because he freed them from Spain, that is what they say. He is their George Washington; is he not?

Mr. MARTIN. He is a great national hero.

Senator MALONE. All right.

In Spain, why, Spain, since they lost South America, has no power at all; do they? Is that not right?

Mr. MARTIN. I would not go that far.

Senator MALONE. Have you been in Spain?

Mr. MARTIN. Unfortunately I have not been in Spain.

Senator MALONE. I have. It is a terribly poor, proud little nation. It does not have anything. When it lost its colonies, it was deader than Julius Caesar, and, of course, neither England nor France have any more power than Spain now because they have lost their colonies. They are still making a pretense to hold nations in Africa with material and money we furnished them. France is using our money, and the munitions we send there under a great clamor that we are saving the world, to kill those colored people by the thousands in North and French West Africa; is that not right?

Mr. MARTIN. I do not——

Senator MALONE. Do you not read the papers?

Mr. MARTIN. I read the papers.

Senator MALONE. Do you not read about it?

Mr. MARTIN. I read about it.

Senator MALONE. Where do you think they are getting munitions and money to carry on the fight in these colonial possessions?

Mr. MARTIN. I do not know.

Senator MALONE. I am simply telling you this because you are talking about stabilizations. It was stabilized under a colonial system—the Far East, the Middle East, Africa, all divided between about 4 or 5 nations. And Spain in South America at one time. Is that not right?

Mr. MARTIN. I will agree with you that things are not stable.

Senator MALONE. Will you agree with me that they were stable; whatever stabilizing effect they had was under a colonial system for several hundred years?

Mr. MARTIN. There was some stability under that system; yes.

Senator MALONE. That is right.

Now, Africa was simply divided among 3 or 4 nations; was it not?

Mr. MARTIN. Right.

Senator MALONE. South Africa belonged to the Dutch. The British took it away from the Dutch. They fought each other, fought over an area that did not belong to either one of them, of course.

I took occasion to visit every nation in Africa, which is a tedious thing, starting in Egypt, Cairo, went up the Nile, stopped at each of the nations—Khartoum where the English had their headquarters. Khartoum; is that it?

Mr. MARTIN. Khartoum.

Senator MALONE. Khartoum. You are right. Talked to the British governor there. He was not expecting to see a Senator, I know, and especially one like me that was not favorable to the colonial systems, but just trying to find out what was going on.

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I continued through the Lake Victoria country into Johannesburg, the Cape, and back through the Belgian Congo, the Gold Coast, the Ivory Coast, French West Africa, and Morocco into Portugal.

Mr. MARTIN. I envy you the trip. It must have been very interesting.

Senator MALONE. It was interesting; however, I did not make the trip for social purposes. I made the trip to see and judge the industrial development and possibilities. It is not easy since the people do not talk your language.

But back to your idea of waiting for more stabilization before going on the gold standard; it was stable under the 4 or 5 European Colonial nations, France, England, Spain and Belgium—there is a Belgian Congo you know. Africa was very stable for many, many generations under the Colonial-minded European nations. Do you think we should return to the colonial system for stability? At the moment the colonial system is dead.

Mr. MARTIN. No. I hope we will never go back to the colonial system.

Senator MALONE. Well, you must know that those little nations, many of them, cannot make a living and exist if they were free.

Mr. MARTIN. It is going to be difficult for them.

Senator MALONE. It is not only going to be difficult, but impossible. If we make our system work the influence of Russia on us in greatly exaggerated. It is vastly overrated. My personal opinion is that if all these American citizens who take the fifth amendment or refuse to take the oath of allegiance to this country should be kept off the Federal, State, municipal, or school payroll, we would be in little danger. If they can actually be disloyal without violating any law of the United States of America that is their business, but they should not be on a public payroll.

But that is where the influence of Russia is felt, if they have any, through disloyal people in the public service.

Mr. MARTIN. I think that is one of the places.

Senator MALONE. Of course it is, and we are just gutless wonders letting them do it. In almost every other nation they chop their heads off or put them in jail and throw the key away.

This country may wake up quicker than you think.

Now, then, if the influence of Russia that you mention could be minimized, do you see any reason why the people of the United States within the borders should not own and buy and sell gold? You say it is a commodity. We have minimized the value of gold in trade. Our Government since 1933 will not pay it to a national, a citizen of our country, so why should they not establish a market for it in this country?

Mr. MARTIN. Well, I think the present market is a little different operation, but I see no reason, aside from the international reason—I am only giving you my——

Senator MALONE. That is only Russia you are talking about, Russian influence?

Mr. MARTIN. Russia and there may be others; it is Russia and her satellites. It is the division of the world.

Senator MALONE. Are you now confining it to the Russian satellites?

Mr. MARTIN. Well, I do not want to confine it to anybody. I would

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say any unstable area in the world is a source of pull, perhaps, on gold.

Senator MALONE. How are you going to stabilize everything in the world? You have England now as helpless as a babe in arms. For 300 years they lived on a colonial system, and it is gone and they have twice as many people there as can ever eat regularly again unless they can become the production center and sell to us with their cheap labor under the free trade fostered at Geneva. Our high wage standard of living was developed under article 1, section 8 of the Constitution, with Congress adjusting the duty to take the profit out of sweatshop labor at the water's edge.

Mr. MARTIN. I do not think you and I are in disagreement on this matter of redeemability. It is just a question of judgment as to when exactly.

Senator MALONE. What has to happen? We are the strong Nation, the Nation is a stable nation, or was before we started giving everything we have which includes markets and cash and gold to foreign nations. It can easily be made stable again if we stabilize our currency, quit giving our gold away, and let the 1934 Trade Agreements Act expire next year. I think Congress is about to take over its constitutional responsibilities again. I only have one vote, but it will be cast that way. There are 435 Members of the House. I think the people are going to instruct them to get back on the job.

We are the most stable nation in the world; are we not?

Mr. MARTIN. I hope we are.

Senator MALONE. Well, if we are not, it is our own fault, is it not, through distributing our wealth to foreign nations?

Mr. MARTIN. That is right.

Senator MALONE. Then are we not the ones to take the lead in any stabilization of currency?

Mr. MARTIN. I think we are. And I think the only difference that we have is this matter of judgment as to whether now is the time. You have traveled very extensively in Africa and pointed out very clearly—I wish I could have taken that trip—the ferment and change that is going on in that great continent.

Senator MALONE. That is only my judgment, you know. I was trying to tell you what they thought of the price of gold.

Even in Johannesburg they wanted a free market for gold, but they were also very certain that they wanted us to continue to guarantee $35 for it.

Mr. MARTIN. That is right.

Senator MALONE. They were very friendly, and on further questioning they were not sure it would require very much additional gold to satisfy the market above $35 per ounce.

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They thought the price might come back very close to the $35 per ounce if a free market were to be established. Speaking of chromite, I could have gotten a concession to produce manganese and chromite in South Africa. Their wages are about one-tenth or one-fifteenth of American wages, and with this virtually free trade we have now through the Geneva operations, the American market for chromite, manganese, zinc, lead, and tungsten is furnished by foreign low-cost labor. That is what is the matter with the domestic market, imports from cheap labor countries?

Mr. MARTIN. Well, I would not say that imports are what is necessarily wrong with our market.

Senator MALONE. What is wrong with it?

Mr. MARTIN. I think you have to have efficient production and you have to have, you have to deal in the price mechanism. I do not think we can fix prices the world over. I believe this country can produce more efficiently and effectively and meet competition.

Senator MALONE. You do?

Mr. MARTIN. I do.

Senator MALONE. My friend, I know you are not going to study this lesson, but I am going to give you one.

Mr. MARTIN. I appreciate it. I am glad to have it.

Senator MALONE. And that is when this American capital, $44.5 billion, that has gone into foreign nations, promoted by our own Department of Commerce and the four organizations financed largely by American taxpayers go abroad with our machinery and know-how, then the American working men and investors have no chance to compete.

Mr. MARTIN. We would be glad to put in the record a table we have on this investment capital if you would like to have it.

Senator MALONE. I already asked for that and you have agreed to do that. That is right; is it not?

Mr. MARGET. Not that particular one, but we will be glad to do that, Senator.

Senator MALONE. I asked for the American investments abroad and understand that they were about $44.5 billion.

Mr. MARTIN. A little bit more than that. I did not understand you to ask for that, but it gets up to nearly $50 billion.

Senator MALONE. Let us clarify it now so there is no question about it.

Mr. MARTIN. Fine.

Senator MALONE. That is what the committee needs.

Mr. MARTIN. That is right. We will be glad to put it in.

Senator MALONE. Total amount and by country.

Mr. MARTIN. Right.

Senator MALONE. That is to say, all investments, whether private or Federal investment, and designate it in each case.

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(The information requested is as follows:)

United States investment abroad, by area

A. INTERNATIONAL INVESTMENT POSITION OF THE UNITED STATES

[In millions of dollars]

	End of year				
	1952	1953	1954	1955	1956 [1]
I. Private investments:					
Western Europe	4,071	4,207	4,843	5,360	6,103
Western European dependencies	507	647	647	681	874
Other Europe	14	14	15	14	29
Canada	8,331	8,771	9,739	10,625	12,070
Latin American Republics	7,018	7,051	7,698	8,282	9,306
Other foreign countries	2,487	2,732	3,143	3,616	4,175
International institutions	401	425	504	476	420
Total	22,829	23,847	26,589	29,054	32,977
II. U. S. Government credits and claims:					
Western Europe	8,839	9,767	9,564	9,592	9,625
Western European dependencies	60	63	35	30	21
Other Europe	329	320	316	304	298
Canada	15	19	15	7	3
Latin American Republics	586	930	960	1,010	1,104
Other foreign countries	1,147	1,175	1,285	1,507	1,958
International institutions	3,448	3,446	3,445	3,443	3,476
Total	14,424	15,720	15,620	15,893	16,485
III. Total private and Government:					
Western Europe	12,910	13,974	14,407	14,952	15,728
Western European dependencies	567	710	682	711	895
Other Europe	343	334	331	318	327
Canada	8,346	8,790	9,754	10,632	12,073
Latin American Republics	7,604	7,981	8,658	9,292	10,410
Other foreign countries	3,634	3,907	4,428	5,123	6,133
International institutions	3,849	3,871	3,949	3,919	3,896
Total	37,253	39,567	42,209	44,947	49,462

[1] Preliminary.

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United States investment abroad, by area—Continued

B. NET OUTFLOW (–) OF UNITED STATES CAPITAL

	1952	1953	1954	1955	1956 [1]	1957, Jan.–Mar.[1]
I. Private investments:						
Western Europe	–116	133	–198	–191	–742	–144
Western European dependencies	10	–81	12	7	–36	–9
Other Europe	----------	----------	(2)	(2)	–15	(2)
Canada	–425	–408	–425	–310	–967	–260
Latin American Republics	–418	162	–501	–329	–826	–206
Other foreign countries	–90	–124	–345	–303	–406	–118
International institutions	–119	–59	–164	–27	12	–62
Total	–1,158	–377	–1,621	–1,153	–2,980	–799
II. U. S. Government credits and claims:						
Western Europe	–110	151	203	–47	–58	–75
Western European dependencies	–30	–4	7	4	2	(2)
Other Europe	3	5	4	4	3	1
Canada	–6	–4	2	9	5	(2)
Latin American Republics	–65	–345	–34	–53	–97	–13
Other foreign countries	–206	–25	–90	–221	–448	–163
International institutions	–6	2	1	2	–33	----------
Total	–420	–220	93	–302	–626	–250
III. Total private and Government:						
Western Europe	–226	284	5	–238	–800	–219
Western European dependencies	–20	–85	19	11	–34	–9
Other Europe	3	5	4	4	–12	1
Canada	–431	–412	–423	–301	–962	–260
Latin American Republics	–483	–183	–535	–382	–923	–219
Other foreign countries	–296	–149	–435	–524	–854	–281
International institutions	–125	–57	–163	–25	–21	–62
Total	–1,578	–597	–1,528	–1,455	–3,606	–1,049

[1] Preliminary.
[2] Less than $500,000.

Source: U. S. Department of Commerce, Survey of Current Business.

Senator MALONE. Now, what kind of machinery and workers do you think these American companies use in these foreign countries? Do you think we and our efficiency here with our $17, $18, and $19 a day labor in mining zinc and lead and tungsten and about 15 other metals, do you think our great efficiency would compete with the $2 labor, 50-cents-a-day labor, and $2.50 labor with our machinery and know-how?

You said that, did you not?

Mr. MARTIN. I think over a period of years it is surprising how——

Senator MALONE. I am glad to get your point of view. You assume they are not efficient I suppose.

Well, you are just two decades late. In every one of these countries that I inspected, beginning in 1947 in Europe and ending last year, I think, 1956 in Ireland. In 1955 I was in Russia, in the Iron Curtain countries 2 months and a half, traveled 14,000 miles in Russia. I thought I had to see our star boarders first, and then I just went in and finished the job behind the so-called Iron Curtain. They would not let our Ambassador leave Moscow. We have destroyed our ambassadors by putting them on civil service. They do not dare cross a dictator of a country or they may get sent home, and that is a black mark and they do not get promoted to another grade in pay.

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We are back on this reason why we cannot own gold in this country until we stabilize all these countries again. How many of them do you think have to be stabilized?

Mr. MARTIN. I do not think it is very many on that.

Senator MALONE. How many?

Mr. MARTIN. Why, I should say 8 or 10.

Senator MALONE. Who are they?

Mr. MARTIN. Well, I would say France, Germany, Britain, Italy, the Far East.

Senator MALONE. Far East, they do not even have an economic system or a standard of living there; did you know that? They do not know what you are talking about.

Is that what you are talking about?

Mr. MARTIN. Well, I think that is part of the problem today, as long as you have the East and the West, the division between the East and the West. Have you traveled in the Far East, Senator?

Senator MALONE. Yes throughout China, Malayan States, and other nations. I went through the oil plant at Abadan, Iran, in 1947 with a fine-toothed comb. They were training Iranians in a school there for jobs in the plant. About 350,000 Iranians were profiting by that oil operation of the British. The British were paying 18 to 20 cents a barrel royalty and we were paying 50 or 60 cents just across the line. Everybody knew the British were going to get run out of Iran. It was a question of time. So when it happened we paid the bill and gave it back to them.

I inspected all of the oil areas in the Middle East. I stopped with King Ibn Saud for a while. The old king.

Mr. MARTIN. Can I ask you a question on this because I am interested?

Senator MALONE. Yes.

Mr. MARTIN. Do you think there is less likelihood in the foreseeable future of these being a world war? I do think we pretty well put that back of us.

Senator MALONE. No. We are moving toward a world war only because we insist upon controlling areas as near to Russia as Cuba is to the United States. If we had the gumption to make our system work, which we are not doing at the moment—and simply retain the lead in bombs and ability to deliver them—we would not have a war in 50 years. We are destroying our currency through inflation, the route of every unstable nation in the world. Germany went that way until it required a wheelbarrow full of money to buy a pair of ham and eggs, so they pay their debts with worthless money, then took a new start. That is the way we are now headed, and I think you know it, unless we reestablish a sound basis for our money.

Do you know any way out except to reestablish the gold or metal standard so that when you exchange money with a nation you receive paper or credit representing the same number of grains of gold or ounces of silver that our money represents.

You know that was a factor a long time; do you not?

Mr. MARTIN. Right.

Senator MALONE. Do you not have to reach that status again in order to have fair dealing?

Mr. MARTIN. No. I think the important thing is to not have inflation, which you and I are both against equally.

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Senator MALONE. How are you going to prevent it unless by returning to the gold or metal standard?

Mr. MARTIN. Well, you are going to prevent it, as I have been saying in these hearings, by reducing your spending and increasing your saving and getting a better balance in your general activity than we have had; and I think that the last few years we have been making a good bit of progress; but you and I are not in disagreement on this redeemability of gold. It is merely a matter of judgment as to whether in the foreseeable future—and you have traveled much more widely than I have——

Senator MALONE. This is your business. If you were talking engineering and we were discussing foundations, dams, or electric power, then I would take over.

But I have been in all of these foreign nations—I have seen them manipulate the price of their currency for trade advantage. So when I hear men like you talk, I can try to evaluate it.

Mr. MARTIN. Right. I was just making the point that I would hope that we can have ultimate redeemability of gold, but I do not think it is likely in the foreseeable future, and I do not think we should run the risk—that is just a matter of judgment—of returning to it immediately as long as the war clouds that you foresee are as——

Senator MALONE. I do not foresee it if we have to settle all of the problems of the world first. There has always been a war in Europe and Asia. Many of these nations have never had an economic system or a standard of living. There will be no war as long as we are able to win any time it starts. That is the effective preventive, not distributing the taxpayers' money all over the world and weakening our own economic structure.

Mr. MARTIN. Right.

Senator MALONE. If we keep dividing tax money and the nations of the world, we are asking for an economic slump and in that event the foreign nations win without a war.

Mr. MARTIN. I am not unduly optimistic about the possibilities of peace in the world at the moment.

Senator MALONE. Peace? Let us talk about our economic system. If you make our system work, you do not have to buy anybody. They will all be with you. But if our economic system does not work—and at the moment I think you will agree with me it is not working too well—then no one will be with you.

Mr. MARTIN. It is not working as well as it should, but I am a bit more optimistic about it than you are, Senator.

Senator MALONE. Well, if you keep up 3 percent per year, then any savings will decrease in value as they have the past 24 years. How much was the inflation last year?

Mr. MARTIN. It was over 3 percent.

Senator MALONE. All right. How much was it the year before?

Mr. MARTIN. It was not quite that much.

Senator MALONE. How much was it beginning in 1933 until 1957? It is admitted to be 53 percent. Could you prepare a table for the record?

Mr. MARTIN. I can get you a table on that, yes, for the record, but you and I are both opposed to inflation, and I want to do everything I can.

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(The information requested is as follows:)

The Consumer Price Index of the Bureau of Labor Statistics for January 1933 was 55.1 percent of the 1947–49 average; in July 1957, the index was 120.8. This is an increase of 119 percent. It might be mentioned, however, that the CPI at the beginning of 1933 was down 24.6 percent from January 1930 and was at its lowest level since July 1917.

The BLS index of wholesale prices for all commodities other than farm products and foods was 48.1 in January 1933; in July 1957, it was 125.6. The rise in these prices amounts to 161 percent. In early 1933, of course, wholesale prices were also at very depressed levels.

The increase in average consumer prices from July 1956 to July 1957 was 3.2 percent; in the preceding year it was 2.0 percent. Average prices of all wholesale commodities rose 3.6 percent from mid-1956 to mid-1957, as compared with 3.2 percent from mid-1955 to mid-1956. Excluding farm products and foods, the rise in wholesale prices was 3.5 percent from July 1956 to July 1957; in the preceding year these prices increased 4.2 percent. (See accompanying table.)

Consumer and wholesale prices, July 1955, 1956, and 1957

[1947–49=100]

July of each year	Consumer Price Index, all items	Wholesale Price Index, all commodities	Wholesale Price Index, other than farm products and food
1955	114.7	110.5	116.5
1956	117.0	114.0	121.4
1957	120.8	118.1	125.6
	Percentage increases		
1955–56	2.0	3.2	4.2
1956–57	3.2	3.6	3.5
1955–57	5.3	6.9	7.8

Source: Bureau of Labor Statistics.

Senator MALONE. I think you are doing as good a job, and I think the fine Secretary of the Treasury, Mr. Humphrey, did a wonderful job of keeping that bunch of boxes—they are so high now nobody can see the top of them—balanced. That is all he did while he was in there, he did not cure anything; and you are never going to cure anything until you again create a sound basis for our money system—when you exchange our money with England, France, or the Argentine, and the paper or the promise to pay represents the same number of grains of gold or ounces of silver that you give them, then you are making progress.

Do you agree that you will never stop inflation or slow it up substantially until you do that?

Mr. MARTIN. I am more optimistic about getting there than you are.

Senator MALONE. I think you could do it right away if Congress had not given away all our gold through foreign dollar balances built up by gifts of taxpayers' money. I certainly do not have to explain that to you. We started with the $3.75 billion American money, to England in 1946, did we not, then continued with the real giveaway plans?

Mr. MARTIN. That was the British loan.

Senator MALONE. And you could take that money and build up dollar balances with it.

Mr. MARTIN. Well, they bought goods with it.

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Senator MALONE. I did not ask that.

Mr. MARTIN. Well, they could have bought gold with it, but they would have used the gold to buy goods.

Senator MALONE. Well, now, England has $1,175 million piled up in dollar balances, which you would pay them tomorrow if they presented it; would you not?

Mr. MARTIN. That is right.

Senator MALONE. How did they get it?

Mr. MARTIN. Well, they got a lot of it by trade.

Senator MALONE. Did they?

Mr. MARTIN. Yes, sir.

Senator MALONE. How much money do you suppose we have given them since World War II?

Mr. MARTIN. It is a very sizable amount.

Senator MALONE. Much more than that—several billion dollars, is it not?

Mr. MARTIN. Yes, it is more than that.

Senator MALONE. The State Department says we have $15 billion worth of trade. We always had 4 or 5 percent of our exportable goods exported over the years. Today we have exported a less percentage of our exportable goods than we did when the 1934 trade agreement was passed. Goods that are paid for, not goods you give away. This silly stuff that we are manufacturing like tanks and sending over there for foot soldiers, nobody is going to use in a third world war. However, we are afraid to quit manufacturing it because of unemployment there.

But if you deduct—and this Senate Report 1627, 83d Congress, did that for you—deduct the amount of goods that we give them, and deduct the money and subsidies we give the foreign nations, we are now exporting a less percent of exportable goods than we were in 1934 when you passed the act.

Mr. MARTIN. I will be glad to check it, Senator.

Senator MALONE. The Assistant Secretary of State was testifying on the sugar bill extension, how much surplus we were allotting Cuba, how much we are going to give Peru, how much to other nations. I would have liked to see Cuba's allocation slightly reduced in favor of other nations.

During that cross-examination of the Assistant Secretary, I asked him, for example, why the State Department was so adamant that we keep such a large percentage of this surplus sugar coming from Cuba. He said because Cuba buys our wheat. I said that is very interesting. What price do we get for the wheat? Do we get our support price for it or the world price? There was some hesitation, not much. He said they pay the world price for it. I said, when we buy their sugar, do we pay the support price for the sugar or the world price, where they sell the rest of their sugar and make money. Considerable hesitation. He said we pay the support price for the sugar. I figured right at that moment, and the record will show—that every hundred pounds of wheat that we sent to Cuba costs our taxpayers $1.35.

Did you ever hear of that?

Mr. MARTIN. No; I did not.

Senator MALONE. You are talking about trade in very learned terms to me. I was in the engineering business 30 years before I came here,

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and I do understand those terms, and I know how to separate the wheat from the chaff. We are faking it to our taxpayers. We are buying our foreign trade—subsidizing our exports. Secretary Benson said that when we peddle our surplus grain at or below world prices the nations which had been furnishing these foreign markets write us off their list.

Now, you say, and I want to get this clear, you are for going back on the gold standard at some uncertain future time when everything irons out and it is all peaceful and nice in the world and there is no danger of a war, although there has never been such a period except by force through the colonial system.

Mr. MARTIN. We are on a modified gold standard now, and I see no reason——

Senator MALONE. What is a modified gold standard? Keep that out a minute and answer my first question. You are in favor of going on a gold standard, not modified or anything, when the millennium arrives; is that what you said?

Mr. MARTIN. Ultimately; yes.

Senator MALONE. And that has nothing to do with 1 year, 2 years, or 5, or 10, or 50?

Mr. MARTIN. That is right.

Senator MALONE. In the meantime, you are for what?

Mr. MARTIN. In the meantime I think we are doing very well on our present understanding that gold is the base of our currency. We use it for all of our international transactions. We purchase it freely at $35 an ounce, and we permit it to go into jewelry and for legitimate use by artisans through licenses by the Treasury.

Senator MALONE. And you pay give the foreign nations cash to build up dollar balances. Then any dollar balance held by a nation can without question be converted to gold by presenting them here.

You have already testified that the nationals of these nations who hold dollar balances can with little trouble convert their dollar balances into the nation's dollar balances, central banks, or whatever they use for the purpose. Then such dollar balances submitted by such foreign nations would be honored in gold. You could refuse the payment in gold, I suppose, or could you?

Mr. MARTIN. Well, we could. I would hope we would not.

Senator MALONE. What would be the effect, in your opinion, if we suddenly refused to honor these dollar balances in gold?

Mr. MARTIN. I think it would be most unfortunate and might precipitate a panic.

Senator MALONE. Well, this next panic will probably make the last one look like a colt?

Mr. MARTIN. It may very well.

Senator MALONE. I believe that such refusal to pay in gold could very well precipitate a panic, if we suddenly refuse to honor these dollar balances.

Mr. MARTIN. I do not see any reason why we would not.

Senator MALONE. If we did not pay in gold?

Mr. MARTIN. If we did not.

Senator MALONE. That was a question?

Mr. MARTIN. In my judgment.

Senator MALONE. Well, your judgment is what I want. This is your field and your judgment is important.

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I think if a man becomes an authority in one field, like an engineer, or a lawyer, he is pretty lucky.

Mr. MARTIN. Right.

Senator MALONE. And in private practice, you only have to do that a couple of times and the sign comes down off the door because you cannot pay the rent. So we learn better.

Working for the Government, very few people learn that important lesson. They think when elected or appointed they suddenly know everything, and it works as long as Congress picks up the check.

Now, it is a fact that pretty near any fool system works as long as somebody picks up the check?

Mr. MARTIN. That is right.

Senator MALONE. Who has been picking up the check internationally for the last, say, since the beginning of World War I? What nation has been picking up this check in exchanges and trade and various other ways?

Mr. MARTIN. I think the United States has been.

Senator MALONE. That is one of the things that is the matter with our debt; is it not?

Mr. MARTIN. That is one of the problems.

Senator MALONE. How long do you think we can continue to do that?

Mr. MARTIN. I think we have got to watch our step very carefully all of the time.

Senator MALONE. Well, are we?

Mr. MARTIN. I believe we are making progress.

Senator MALONE. I am about to give you a little information on that.

Mr. MARTIN. We would like to get it.

Senator MALONE. There is a bill in here now that I do not myself think will work. I have told the Secretary of the Interior that it will not work.

It is the lead-zinc bill—the American mines are closed or closing. The workingmen are on the street. You know that; do you not?

Mr. MARTIN. Yes.

Senator MALONE. So the Secretary presented this long-range mineral plan that the administration talked about for 2 or 3 years. The Secretary of the Interior presented it to the Senate Interior and Insular Affairs Committee, of which I am a member, the ranking Republican member, as a matter of fact. I listened to the Secretary saying that they had figured out 17 cents for zinc and 14 for lead and that when the price went below those amounts that 1, 2, or 3 cents a pound tariff would be added—and would go off when the price went above that amount. We have been all through that on copper. And there is one advantage being older than anybody else—there are not very many. But one of them is you have seen all these theorists come and go and they do not worry you very much. They make their cycle and disappear completely.

So when the Secretary got through, I said, does the White House agree with this? He said they do. I said, Mr. Secretary, I am for you. It will not work, but the reason I am for you, you are the first man in 24 years who has broken through the "sound barrier" at the White House and got them to admit that there must be a tariff or a duty to make up the difference in the wages and costs of doing business,

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including taxes, here and in the chief competing countries on each product.

As long then as they have admitted principle, I am going with you, because once you admit the principle, then it is only a question of who should do the job and the latitude they should have.

Would you say that?

Mr. MARTIN. I think so.

Senator MALONE. All Congress needs to do is to sit still on those soft cushions and not extend the 1934 Trade Agreements Act when it expires in June of 1958 and the American workingmen and investors are back in business. The 1930 Tariff Act must be amended then to give the Tariff Commission the necessary latitude to adjust the flexible import fee to take the profit out of the sweatshop wages at the waters edge.

Then do you understand that if you had never interfered with the flexible tariff adjustment in 1934, and had not cheapened the dollar 53 percent, lowering to that extent the fixed duties or tariffs you would not need the adjustment now?

Mr. MARTIN. I follow you.

Senator MALONE. I believe it is nearer 65 percent that the dollar has been cheapened when you consider the entire market range, nevertheless if you can keep people believing it is only 53 percent, that is bad enough.

In any case what you did was to cut the tariffs a little more than half, any fixed tariff; did you not?

Mr. MARTIN. I assume you are right.

Senator MALONE. All right.

All we need in Washington—it might not be all we need but it is the first thing we need—is a little common horse sense. And as far as I am concerned, I have found very little of it here in the 11 years I have been in the Senate, and I am sorry.

I want to get your idea of the gold standard straight in the record. You believe we ought to go back to a gold standard just as soon as it is possible, but you do not say whether it is to be 1 or 50 years?

Mr. MARTIN. That is correct.

Senator MALONE. You believe 5 or 6 of the principal nations of Europe must be stabilized and getting back on a profitable basis before it can be done?

Mr. MARTIN. That is right.

Senator MALONE. Of course, that statement alone makes returning to a sane money policy impossible for a century of time, because these nations are gone economically. They lived for 300 years on a colonial slavery system. They have lost their colonies. The radio and airplane killed the colonial system.

We are now furnishing the money and military equipment to kill the people in the colonial systems to subdue them. The greatest harm done to this country was that somebody told us that there were definite answers to all economic problems. If we had any gumption at all, we would know that there are no definite answers to all economic problems.

You do not think we ought to have a free market for gold?

Mr. MARTIN. Not at the present.

Senator MALONE. Where do you think the price of gold would go if you had a free market tomorrow? Just leave the law of supply and

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demand alone so the Government would buy it at $35 if they brought it in; if they did not, they could sell or trade it to anybody.

Mr. MARTIN. I do not know, Senator.

Senator MALONE. Would it go above or below $35?

Mr. MARTIN. It is a pure guess.

Senator MALONE. In this country I am talking about now.

Mr. MARTIN. In this country, I think it would probably go below, but I do not——

Senator MALONE. What makes you think it would go below?

Mr. MARTIN. Just guesswork.

Senator MALONE. Well, I am going to give you a little more information so that you can use it for guessing purposes.

Mr. MARTIN. Fine.

Senator MALONE. There is only one mine in the United States of any consequence that can profitably produce gold, and it is threatened with a shutdown; now the mine is in North Dakota, the Homestead.

Mr. MARTIN. Homestead.

Senator MALONE. That is right. Every other mine has closed down unless they have a byproduct. The gold being produced now, you will find, is a byproduct of copper or some other metal that they are selling which helps in the price of that metal. They are not in the gold-mining business at all except the Homestead. You have shut them all down through inflation. The Government made it illegal to run a gold mine during World War II. Executive Order L-12, shut down all the gold mines on the theory that the people who are working in the mines would go to defense work. Of course, they never saw a gold miner. You know that, do you not?

Mr. MARTIN. That is right.

Senator MALONE. They did not get 10 men for defense work under the order but they shut the gold mines down, which was their objective. When I say they, I do not know exactly who they are, do you?

Mr. MARTIN. The gold miners, you mean?

Senator MALONE. No. I know who the gold miners are. I am acquainted with them. But who are the people who wanted us to go off the gold standard and wanted us to quit mining gold? Do you know anything about that?

Mr. MARTIN. No.

Senator MALONE. You have no way of finding out, no sources of information?

Mr. MARTIN. No.

Senator MALONE. You do know you cannot produce gold profitably now under the increased wages and the decreased purchasing power of the dollar at $35, do you not?

Mr. MARTIN. I have not gone into the production costs.

Senator MALONE. If you are going to testify about gold, that the gold might decrease in this country if we had a free market, you ought to know something about the costs of mining, should you not?

Mr. MARTIN. About the production costs? Well, I am just putting it on the basis of supply and demand.

Senator MALONE. Well, there is no demand until you are using it for money, is there?

Mr. MARTIN. Well, there is some demand for it by artisans.

Senator MALONE. You are selling that to them at $35?

Mr. MARTIN. Right.

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Senator MALONE. But you think it might go below that price?

Mr. MARTIN. I do.

Senator MALONE. Why?

Mr. MARTIN. It is just my guess on supply and demand relations.

Senator MALONE. I was not talking about the world supply. I was talking about the United States situation having a free market.

Mr. MARTIN. I do not think you can isolate gold in the United States.

Senator MALONE. You mean that if you let American citizens have it, we might sell it to foreigners surreptitiously.

Mr. MARTIN. That is right.

Senator MALONE. Every other nation allows their citizens to have it?

Mr. MARTIN. Not all nations. Some do.

Senator MALONE. You could sell it in any nation if you could own it here?

Mr. MARTIN. Well, we promised a table, I think, Senator, indicating in which countries it was permitted to deal in gold. There are many countries which do not permit it.

Senator MALONE. Why do you think that they could control their nationals any more than you could control our own citizens? They would probably deal internationally regardless. Do you think foreign nations could control their citizens better than we could our own?

Mr. MARGET. Well, sir, we are not speaking now— are we speaking of a gold market, the existence of a gold market, or the convertibility of gold, the redemption of gold?

Senator MALONE. You know exactly what we are talking about. Let the $35 per ounce law stand so that an American may sell an ounce of gold for $35, but they could also sell it to each other for any price offered.

Mr. MARGET. You are speaking of a gold market. And your question is why can other countries tolerate a gold market?

Senator MALONE. No, I did not ask that at all. The chairman just testified if we had a free market here among ourselves we could not keep our people from sending it out of the country; that is what you said, did you not?

Mr. MARTIN. That is right.

Senator MALONE. If we cannot keep our nationals from sending it to a man in South Africa, how is South Africa going to keep a national there from sending it to another nation?

Mr. MARGET. As a matter of fact, I do not think those export controls are effective in those countries.

Senator MALONE. Do you think there is quite a bit of it imported here then?

Mr. MARGET. Well, it would have to come to the Treasury. I have no information that it comes to private purchasers.

Senator MALONE. How do you know that it could not be smuggled into this country and never go to a bank?

Mr. MARGET. I do not know that it could not.

Senator MALONE. Do you not think we could have a better system than any other nation that you know about?

Mr. MARGET. You mean in terms of controls?

Senator MALONE. Yes. You could control it from being shipped internationally if any other nation could do it.

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Mr. MARGET. I suspect we do, as a matter of fact.

Senator MALONE. Well, could not we, if we had a free market here so that Jim can sell it to John for any price per ounce that John wanted to pay—John might send some to his cousin in another nation—you are afraid that you could stop the transaction. But no other nation seems to be afraid of that procedure.

Mr. MARGET. May I state what—this is not my own opinion but what I have heard—some of my friends say their position is on the gold market. They say this—now I am not saying whether it is right or not, but I think this is the argument that ought to be faced—they say if you start permitting a gold market, you have a situation in which a gold premium would emerge, not necessarily tomorrow but some other time. The price might go over $35 an ounce.

Senator MALONE. What would be the matter with that result?

Mr. MARGET. Then, they say, there would then be great pressure on the United States Government to keep that premium from rising, that is to say to keep the dollar price going from above $35 an ounce, so we would have to take the next step, namely, internal gold redeemability.

Senator MALONE. You mean raise the price?

Mr. MARGET. No. They say you would have to pass from the free gold market system, which is what we have been talking about, to the next, what they would regard as the inevitable step, the "gold standard" as you have been using the term, namely, internal gold redeemability.

Senator MALONE. What would be the matter with that procedure?

Mr. MARGET. Well, the arguments are those which the chairman has stated from his own standpoint as to what the risks might be. If your question, Senator, is why does—why do the other countries tolerate——

Senator MALONE. No. My question was not that at all. My question is: How is it that foreign countries can control the export and import of gold and allow their citizens to own it and buy and sell it where we cannot, according to the testimony of the chairman?

Mr. MARGET. I think we do in effect right now control the export and import, under the existing restrictions. I do not know what degree of success we would have if we had a free market.

What I was going to try to answer, Senator, was what I took to be your question, namely, how is it that other countries take the risks associated with permitting the existence of a free gold market.

Senator MALONE. How can they do it? How can they control the export of gold if we cannot?

Mr. MARGET. I do not think they control the export of gold. I do not think any Government is——

Senator MALONE. Do you think it injures their system?

Mr. MARGET. That was the point I was going to come to.

The argument of those who do not want us to go to the gold market, because they think it would lead to internal gold redeemability, is this: That it does not make much difference, they say, whether a small country, even like Switzerland, does or does not see a premium develop in a free market on its currency, but the suggestion is that it does make a great deal of difference to the United States; and that therefore, the United States would be forced to take an action with

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respect to a free market which these small countries are not necessarily forced to take.

I am merely stating the argument, Senator.

Senator MALONE. You do not believe it yourself?

Mr. MARGET. Well, it is a question of judgment, honestly.

Senator MALONE. What is your judgment, as long as we are talking to you?

Mr. MARGET. Honestly, I do not know the answer.

Senator MALONE. Well, I did not think you did.

Now, all these other little nations are running wild in manipulating the price of their currency, are they not? They fix a price on their moneys in Bolivia; three times its value, for example. When I was there, a little nation, the Indians sitting out on the mesas herding a few sheep or 6 or 7 llamas—they have nothing else in the world, nothing visible to live upon. So the government manipulates its currency value in terms of the dollar for trade advantage.

When you got a dollar, if you are a trader there, the rule of the treasury or central bank was that you turned it in within 30 or 60 days, under penalty, at the price set by that central bank.

Mr. MARGET. Yes.

Senator MALONE. Do you know what it was in 1954 when I was there? Five hundred bolivianos is what you got for your little dollar. You know what the market price on the street for a dollar was? Seventeen hundred bolivianos.

So they stole two-thirds of it in the first goaround, so profitable trade with them was out of the question.

Mr. MARGET. Eventually, it went up to 14,000, Senator.

Senator MALONE. All right. You know exactly what I am talking about, and that is where the dollar is going one of these days if we just keep a managed currency long enough.

Mr. MARTIN. We are trying to manage it so it will not go that far.

Senator MALONE. I know that you will pass out of the picture one of these days, and be gone and forgotten, just like all Senators and Cabinet officials.

But while we are temporarily in these positions, my opinion is it is necessary to leave a factual record.

Then as long as these people refuse to do anything but take advantage by fixing a fictitious price on their currency in terms of the dollar for trade advantages, you do not think we can go gack on the gold standard?

Mr. MARTIN. That is correct.

Senator MALONE. England manipulates the price of the pound. Nobody thinks it is worth $2.80 for a pound. It was only worth $2.60 in the Hong Kong free market when they held it at $4.03.

So as long as they do that, and they are going to do it forever until we stop honoring or tolerating it, you just do not think we can return to an honest currency in this country?

Mr. MARTIN. I think we are making a move toward honest currency by managing. Now, we may abuse this management of the currency, as you rightly say, but I think we are managing our affairs pretty well.

Senator MALONE. I think you are doing a marvelous job under the conditions. But no human being can manage it except with continued inflation. You do not think you can stop inflation, do you?

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Mr. MARTIN. I do.

Senator MALONE. When do you think it is going to be stopped?

Mr. MARTIN. I think before too long.

Senator MALONE. Would you set a date?

Mr. MARTIN. No; I cannot set a date.

Senator MALONE. Is it 2 years or 5 or 10?

Mr. MARTIN. I think we have got to stop it, and I think we will.

Senator MALONE. How are you going to stop it?

Mr. MARTIN. I think you are going to stop it by refusing to print money, which is where the root of it comes from.

Senator MALONE. Of course, you and I know that, but you have not refused.

Mr. MARTIN. We have been doing the best we can.

Senator MALONE. Well, I will get to that pretty soon.

I am going to ask you one of the $64,000 questions. The Secretary was very careful to keep out of your business. I did not think he should have, because I thought he should understand it, and I think he did, but that was his judgment, and I bowed to it, because I like him and I did not want to have any controversy with him.

He was very frank, eventually, that he set the interest on Government bonds, that it was his responsibility. Of course, he made quite a speech about it. Said he consulted a lot of people.

But in the last analysis, it was his sole judgment as to what interest they should carry so that they would sell. Is that true?

Mr. MARTIN. That is correct. We consult with him, but it is his responsibility to set the coupon.

Senator MALONE. After giving him all the best advice you can give him, and he has talked to everybody else he cares to, eventually he puts the finger on it, whether it is 5 or 6 percent or 2 percent, or whatever it is, or 10?

Mr. MARTIN. Unless he decides to do it at auction, that is, permit the market to set it without setting a coupon rate.

Senator MALONE. Does he often do that?

Mr. MARTIN. He has done it increasingly in the last year or so, because it has been very difficult——

Senator MALONE. What percentage of the bonds, of the $280 billion, or thereabouts, have been sold under those conditions?

Mr. MARTIN. Well, I would—about 10 percent.

Senator MALONE. There you are. You see, it does not amount to anything.

Ninety percent of the time, he does fix the interest on issues coming up, after getting whatever advice he wants to get. If he did not want any advice, he still has authority to fix it, has he not?

Mr. MARTIN. He fixes it by making a judgment on what the market is.

Senator MALONE. And he does not have to take anybody's advice, does he?

Mr. MARTIN. No; he does not.

Senator MALONE. I will come to you. He finally did tell me that you with your Board (seven men) determined how much money there is to be in circulation. Is that true?

Mr. MARTIN. The money supply is in our—is one of our prerogatives.

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Senator MALONE. Well, that "our" is used courteously, but it is really in your hands, is it not?

Mr. MARTIN. That is right. We have the responsibility.

Senator MALONE. You are the Chairman?

Mr. MARTIN. Well, the Chairman alone cannot do it. I am just 1 man on a Board of 7.

Senator MALONE. How many Board members?

Mr. MARTIN. There are 7 Board members, and each of the—there are 12 Reserve banks and 24 branches.

Senator MALONE. Would you put a list of those banks in the record?

Mr. MARTIN. I will. I will put a list of the banks and the directors of the banks.

(The information referred to is as follows:)

DIRECTORS OF FEDERAL RESERVE BANKS AND THEIR BRANCHES

[A majority of the directors of a branch are appointed by the board of directors of the Federal Reserve bank and the remaining directors are appointed by the Board. Directors appointed by the Board are indicated by an asterisk]

FEDERAL RESERVE BANK OF BOSTON

Class A:

Harold I. Chandler, president, The Keene National Bank, Keene, N. H.

Oliver B. Ellsworth, president, Riverside Trust Co., Hartford, Conn.

William D. Ireland, president, Second Bank-State Street Trust Co., Boston, Mass.

Class B:

Frederick S. Blackall, Jr., president and treasurer, the Taft-Peirce Manufacturing Co., Woonsocket, R. I.

Harry E. Umphrey, president, Aroostook Potato Growers, Inc., Presque Isle, Maine.

Milton P. Higgins, president, Norton Co., Worcester, Mass.

Class C:

Robert C. Sprague (chairman), chairman and treasurer, Sprague Electric Co., North Adams, Mass.

Harvey P. Hood, president, H. P. Hood & Sons, Inc., Boston, Mass.

James R. Killian, Jr., president (deputy chairman), Massachusetts Institute of Technology, Cambridge, Mass.

FEDERAL RESERVE BANK OF NEW YORK

Class A:

Ferd I. Collins, president and trust officer, Bound Brook Trust Co., Bound Brook, N. J.

Howard C. Sheperd, chairman of the board, The First National City Bank of New York, New York, N. Y.

Charles W. Bitzer, president, City Trust Co., Bridgeport, Conn.

Class B:

Augustus C. Long, chairman, The Texas Co., New York, N. Y.

Clarence Francis, director, General Foods Corp., New York, N. Y.

Lansing P. Shield, president, the Grand Union Co., East Paterson, N. J.

Class C:

Forrest F. Hill, vice president (deputy chairman), the Ford Foundation, New York, N. Y.

Franz Schneider, consultant to Newmont Mining Corp., New York, N. Y.

John E. Bierwirth, president (chairman), National Distillers & Chemical Corp., New York, N. Y.

Buffalo branch:

Vernon Alexander, president, National Bank of Geneva, Geneva, N. Y.

Leland B. Bryan, president, First National Bank & Trust Co., Corning, N. Y.

Charles H. Diefendorf, chairman of the executive committee, the Marine Trust Company of Western New York, Buffalo, N. Y.

*Raymond E. Olson, president, Taylor Instrument Cos., Rochester, N. Y.

*Ralph F. Peo, chairman and president, Houdaille Industries, Inc., Buffalo, N. Y.

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John W. Remington, president, Lincoln Rochester Trust Co., Rochester, N. Y.
*Clayton G. White (dairy farmer) (chairman), Stow, N. Y.

FEDERAL RESERVE BANK OF PHILADELPHIA

Class A:
W. Elbridge Brown, president and trust officer, Clearfield Trust Co., Clearfield, Pa.
Lindley S. Hurff, president and trust officer, the First National Bank of Milton, Milton, Pa.
Geoffrey S. Smith, president, Girard Trust Corn Exchange Bank, Philadelphia, Pa.

Class B:
Bayard L. England, president, Atlantic City Electric Co., Atlantic City, N. J.
Charles E. Oakes, president, Pennsylvania Power & Light Co., Allentown, Pa.
R. Russell Pippin, treasurer, E. I. du Pont de Nemours & Co., Inc., Wilmington, Del.

Class C:
William J. Meinel (chairman), chairman of the board, Heintz Manufacturing Co., Philadelphia, Pa.
Henderson Supplee, Jr., president (deputy chairman), the Atlantic Refining Co., Philadelphia, Pa.
Lester V. Chandler, professor of economics, Princeton University, Princeton, N. J.

FEDERAL RESERVE BANK OF CLEVELAND

Class A:
Edison Hobstetter, president and chairman of the board, the Pomeroy National Bank, Pomeroy, Ohio.
King E. Fauver, director, the Savings Deposit Bank & Trust Co., Elyria, Ohio.
John A. Byerly, president, Fidelity Trust Co., Pittsburgh, Pa.

Class B:
Joseph B. Hall, president, the Kroger Co., Cincinnati, Ohio.
Charles Z. Hardwick, executive vice president, the Ohio Oil Co., Findlay, Ohio.
George P. MacNichol, Jr., president, Libbey-Owens-Ford Glass Co., Toledo, Ohio.

Class C:
Frank J. Welch, dean, College of Agriculture and Home Economics, University of Kentucky, Lexington, Ky.
Arthur B. Van Buskirk (chairman), vice president and governor, T. Mellon & Sons, Pittsburgh, Pa.
Joseph H. Thompson, president (deputy chairman), the M. A. Hanna Co., Cleveland, Ohio.

Cincinnati branch:
Roger Drackett, president, the Drackett Co., Cincinnati, Ohio.
Bernard H. Geyer, president, the Second National Bank of Hamilton, Hamilton, Ohio.
*Anthony Haswell, president (chairman), the Dayton Malleable Iron Co., Dayton, Ohio.
*W. Bay Irvine, president, Marietta College, Marietta, Ohio.
*Ivan Jett (farmer), Georgetown National Bank Building, Georgetown, Ky.
Franklin A. McCracken, executive vice president and trust officer, the Newport National Bank, Newport, Ky.
William A. Mitchell, president, the Central Trust Co., Cincinnati, Ohio.

Pittsburgh branch:
Frank C. Irvine, president, First National Bank in Tarentum, Tarentum, Pa.
John H. Lucas, chairman of the board, Peoples First National Bank & Trust Co., Pittsburgh, Pa.
*Douglas M. Moorhead (farmer), North East, Pa.
*Ben Moreell, chairman of the board, Jones & Laughlin Steel Corp., Pittsburgh, Pa.
Sumner E. Nichols, president, Security-Peoples Trust Co., Erie, Pa.
*John C. Warner, president (chairman), Carnegie Institute of Technology, Pittsburgh, Pa.
Irving W. Wilson, president, Aluminum Company of America, Pittsburgh, Pa.

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Federal Reserve Bank of St. Louis

Federal Reserve Bank of Richmond

Class A:

Daniel W. Bell, president and chairman of the board, American Security & Trust Co., Washington, D. C.

Joseph E. Healy, president, the Citizens National Bank of Hampton, Hampton, Va.

Robert Gage, president, the Commercial Bank, Chester, S. C.

Class B:

Robert O. Huffman, president, Drexel Furniture Co., Drexel, N. C.

L. Vinton Hershey, president, Hagerstown Shoe Co., Hagerstown, Md.

W. A. L. Sibley, vice president and treasurer, Monarch Mills, Union, S. C.

Class C:

D. W. Colvard, dean of agriculture, North Carolina State College of Agriculture and Engineering, Raleigh, N. C.

John B. Woodward, Jr. (chairman), chairman of the board, Newport News Shipbuilding & Dry Dock Co., Newport News, Va.

Alonzo G. Decker, Jr. (deputy chairman), executive vice president, the Black & Decker Manufacturing Co., Towson, Md.

Baltimore branch:

*Gordon M. Cairns, dean of agriculture, University of Maryland, College Park, Md.

*William Purnell Hall (chairman), executive vice president, Maryland Shipbuilding & Drydock Co., Inc., Baltimore, Md.

James M. McElroy, executive vice president, First National Bank, Baltimore, Md.

Charles A. Piper, president, the Liberty Trust Co., Cumberland, Md.

John W. Stout, president, the Parkersburg National Bank, Parkersburg, W. Va.

Stanley B. Trott, president, Maryland Trust Co., Baltimore, Md.

*Clarence R. Zarfoss, vice president, Western Maryland Railway Co., Baltimore, Md.

Charlotte branch:

*William H. Grier (chairman), executive vice president, Rock Hill Printing & Finishing Co., Rock Hill, S. C.

Charles D. Parker, president, First National Bank & Trust Co., Asheville, N. C.

Ernest Patton, chairman of the board, the Peoples National Bank of Greenville, Greenville, S. C.

I. W. Stewart, president, the Commercial National Bank, Charlotte, N. C.

*Paul T. Taylor, president, Taylor Warehouse Co., Winston-Salem, N. C.

G. G. Watts, president, the Merchants & Planters National Bank, Gaffney, S. C.

*T. Henry Wilson, president and treasurer, Henredon Furniture Industries, Inc., Morganton, N. C.

Federal Reserve Bank of Atlanta

Class A:

W. C. Bowman, chairman of the board, the First National Bank of Montgomery, Montgomery, Ala.

William C. Carter, chairman and president, Gulf National Bank, Gulfport, Miss.

Roland L. Adams, president, Bank of York, York, Ala.

Class B:

Pollard Turman, president, J. M. Tull Metal & Supply Co., Inc., Atlanta, Ga.

Donald Comer, chairman of the board, Avondale Mills, Birmingham, Ala.

Joseph T. Lykes, chairman and director, Lykes Bros. Steamship Co., Inc., Tampa, Fla.

Class C:

Henry G. Chalkley, Jr., president, the Sweet Lake Land & Oil Co., Lake Charles, La.

Walter M. Mitchell, vice president (chairman), the Draper Corp., Atlanta, Ga.

Harllee Branch, Jr., president (deputy chairman), the Southern Co., Atlanta, Ga.

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Birmingham branch:

*Edwin C. Bottcher (farmer) (chairman), Post Office Drawer 385, Cullman, Ala.

Robert M. Cleckler, president, First National Bank of Childersburg, Childersburg, Ala.

John R. Downing, executive vice president, Citizens-Farmers & Merchants Bank, Brewton, Ala.

E. W. McLeod, president, the Morgan County National Bank, Decatur, Ala.

Malcolm A. Smith, first vice president, Birmingham Trust National Bank, Birmingham, Ala.

*John E. Urquhart, president, Woodward Iron Co., Woodward, Ala.

*Adolph Weil, Sr., president, Weil Bros.-Cotton, Inc., Montgomery, Ala.

Jacksonville branch:

Linton E. Allen, chairman, the First National Bank at Orlando, Orlando, Fla.

W. E. Ellis, chairman and president, the Commercial Bank & Trust Co., Ocala, Fla.

James G. Garner, president and chairman, Little River Bank & Trust Co., Miami, Fla.

James L. Niblack, president, the First National Bank of Lake City, Lake City, Fla.

*J. Wayne Reitz, president (chairman), University of Florida, Gainesville, Fla.

*Harry M. Smith, president and manager, Winter Garden Ornamental Nursery, Inc., Winter Garden, Fla.

*McGregor Smith, chairman of the board and director, Florida Power & Light Co., Miami, Fla.

Nashville branch:

Jo H. Anderson, president, Park National Bank of Knoxville, Knoxville, Tenn.

Stewart Campbell, president, the Harpeth National Bank of Franklin, Franklin, Tenn.

J. R. Kellam, Jr., executive vice president, Commerce Union Bank, Nashville, Tenn.

*Ernest J. Moench, president, Tennessee Tufting Co., Nashville, Tenn.

*A. Carter Myers, treasurer (chairman), Knoxville Fertilizer Co., Knoxville, Tenn.

*Frank B. Ward, dean, College of Business Administration, University of Tennessee, Knoxville, Tenn.

C. L. Wilson, chairman and president, the Cleveland National Bank, Cleveland, Tenn.

New Orleans branch:

William J. Fischer, president, Progressive Bank & Trust Co., New Orleans, La.

*Joel L. Fletcher, Jr., president, Southwestern Louisiana Institute, Lafayette, La.

J. Spencer Jones, president, the Citizens National Bank in Hammond, Hammond, La.

*G.. H King, Jr., executive vice president, King Lumber Industries, Canton, Miss.

D. U. Maddox, president, the Commercial National Bank & Trust Company of Laurel, Laurel, Miss.

H. A. Pharr, president, the First National Bank of Mobile, Mobile, Ala.

*E. E. Wild (rice grower) (chairman), Midland, La.

FEDERAL RESERVE BANK OF CHICAGO

Class A:

Walter J. Cummings, Chairman, Continental Illinois National Bank & Trust Co. of Chicago, Chicago, Ill.

Nugent R. Oberwortmann, president, the North Shore National Bank of Chicago, Chicago, Ill.

Vivian W. Johnson, president, First National Bank, Cedar Falls, Iowa

Class B:

Walter E. Hawkinson, vice president in charge of finance, and secretary, Allis-Chalmers Manufacturing Co., Milwaukee, Wis.

William J. Grede, president, Grede Foundries, Inc., Milwaukee, Wis.

William A. Hanley, director, Eli Lilly & Co., Indianapolis, Ind.

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Class C:

Bert R. Prall (chairman), 558 Ridge Road, Winnetka, Ill.

Robert P. Briggs, executive vice president, Consumers Power Co., Jackson, Mich.

J. Stuart Russell, farm editor (deputy chairman), the Des Moines Register & Tribune, Des Moines, Iowa

Detroit branch:

*John A. Hannah, president (chairman), Michigan State University, East Lansing, Mich.

Ira A. Moore, chairman of the board, Peoples National Bank of Grand Rapids, Grand Rapids, Mich.

Howard P. Parshall, president, Bank of the Commonwealth, Detroit, Mich.

*C. V. Patterson, executive vice president, the Upjohn Co., Kalamazoo, Mich.

Raymond T. Perring, president, the Detroit Bank & Trust Co., Detroit, Mich.

Ernest W. Potter, president, Citizens Commercial & Savings Bank, Flint, Mich.

*J. Thomas Smith, president, Detroit Harvester Co., Detroit, Mich.

FEDERAL RESERVE BANK OF ST. LOUIS

Class A:

Phil E. Chappell, president, Planters Bank & Trust Co., Hopkinsville, Ky.

J. E. Etherton, president, the Carbondale National Bank, Carbondale, Ill.

Kenton R. Cravens, president, Mercantile Trust Co., St. Louis, Mo.

Class B:

Leo J. Wieck, vice president and treasurer, the May Department Stores Co., St. Louis, Mo.

S. J. Beauchamp, Jr., president, Terminal Warehouse Co., Little Rock, Ark.

Harold O. McCutchan, executive vice president, Mead Johnson & Co., Evansville, Ind.

Class C:

Joseph H. Moore (farmer) (deputy chairman), Charleston, Mo.

J. H. Longwell, dean, College of Agriculture, University of Missouri, Columbia, Mo.

Pierre B. McBride, president (chairman), Porcelain Metals Corp., Louisville, Ky.

Little Rock branch:

Donald Barger, president, Peoples Exchange Bank, Russellville, Ark.

*T. Winfred Bell, president, Bush-Caldwell Co., Little Rock, Ark.

E. C. Benton, president, Fordyce Bank & Trust Co., Fordyce, Ark.

H. C. McKinney, Jr., president, the First National Bank of El Dorado, El Dorado, Ark.

*Shuford R. Nichols (farmer, ginner, and cotton broker), Des Arc, Ark.

J. V. Satterfield, Jr., president, the First National Bank in Little Rock, Little Rock, Ark.

*A. Howard Stebbins, Jr. (chairman), Post Office Box 1413, Little Rock, Ark.

Louisville branch:

*David F. Cocks (chairman), vice president and treasurer, Standard Oil Co. (Kentucky), Louisville, Ky.

*Philip Davidson, president, University of Louisville, Louisville, Ky.

Magnus J. Kreisle, president, the Tell City National Bank, Tell City, Ind.

W. Scott McIntosh, president, State Bank of Hardinsburg, Hardinsburg, Ind.

M. C. Minor, president, the Farmers National Bank of Danville, Danville, Ky.

*J. D. Monin, Jr. (farmer), Oakland, Ky.

Merle E. Robertson, chairman of the board and president, Liberty National Bank & Trust Company of Louisville, Louisville, Ky.

Memphis branch:

*Henry Banks (farmer), Clarkedale, Ark.

J. H. Harris, president, the First National Bank of Wynne, Wynne, Ark.

*A. E. Hohenberg, president (chairman), Hohenberg Bros., Memphis, Tenn.

John A. McCall, president, the First National Bank of Lexington, Lexington, Tenn.

*John D. Williams, chancellor, the University of Mississippi, University, Miss.

John K. Wilson, president, the First National Bank of West Point, West Point, Miss.

(Vacancy.)

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FEDERAL RESERVE BANK OF MINNEAPOLIS

Class A:

Harold C. Refling, cashier, First National Bank in Bottineau, Bottineau, N. Dak.

Joseph F. Ringland, president, Northwestern National Bank of Minneapolis, Minneapolis, Minn.

Harold N. Thomson, vice president, Farmers & Merchants Bank, Presho, S. Dak.

Class B:

Ray C. Lange, president, Chippewa Canning Co., Inc., Chippewa Falls, Wis.

Thomas G. Harrison, president, Super Valu Stores, Inc., Hopkins, Minn.

John E. Corette, president and general manager, Montana Power Co., Butte, Mont.

Class C:

O. B. Jesness, head (deputy chairman), department of agricultural economics, University of Minnesota Institute of Agriculture, St. Paul, Minn.

F. Albee Flodin, president and general manager, Lake Shore, Inc., Iron Mountain, Mich.

Leslie N. Perrin, director (chairman), General Mills, Inc., Minneapolis, Min..

Helena branch:

A. W. Heidel, president, Powder River County Bank, Broadus, Mont.

J. Willard Johnson, financial vice president and treasurer, Western Life Insurance Co., Helena, Mont.

George N. Lund, chairman of the board and president, The First National Bank of Reserve, Reserve, Mont.

* Carl McFarland, president (chairman), Montana State University, Missoula, Mont.

* George R. Milburn, manager, N Bar Ranch, Grass Range, Mont.

FEDERAL RESERVE BANK OF KANSAS CITY

Class A:

Harold Kountze, chairman of the board, the Colorado National Bank of Denver, Denver, Colo.

W. S. Kennedy, president and chairman of the board, the First National Bank of Junction City, Junction City, Kans.

W. L. Bunten, president, Goodland State Bank, Goodland, Kans.

Class B:

Max A. Miller (livestock rancher), Omaha, Nebr.

E. M. Dodds, chairman of the board, United States Cold Storage Corp., Kansas City, Mo.

K. S. Adams, chairman of the board, Phillips Petroleum Co., Bartlesville, Okla.

Class C:

Joe W. Seacrest, president (deputy chairman), State Journal Co., Lincoln, Nebr.

Raymond W. Hall, (chairman), vice president and director, Hallmark Cards, Inc., Kansas City, Mo.

Oliver S. Willham, president, Oklahoma State University, Stillwater, Okla.

Denver branch:

Merriam B. Berger, vice president, the Colorado National Bank of Denver, Denver, Colo.

Arthur Johnson, president, First National Bank in Raton, Raton, N. Mex.

Ralph S. Newcomer, executive vice president, First National Bank in Boulder, Boulder, Colo.

*Aksel Nielsen, president (chairman), the Title Guaranty Co., Denver, Colo.

*Ray Reynolds, (cattle feeder and farmer), Longmont, Colo.

Oklahoma City branch:

*Davis D. Bovaird, president (chairman), the Bovaird Supply Co., Tulsa, Okla.

George R. Gear, president, the City National Bank of Guymon, Guymon, Okla.

*Phil H. Lowery (owner), Lowery Hereford Ranch, Loco, Okla.

R. Otis McClintock, chairman of the board, the First National Bank & Trust Co. of Tulsa, Tulsa, Okla.

C. L. Priddy, president, the National Bank of McAlester, McAlester, Okla.

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Omaha branch:

C. Wheaton Battey, president, the Continental National Bank of Lincoln, Lincoln, Nebr.

George J. Forbes (ranching and investments), Laramie, Wyo.

*Manville Kendrick (rancher), Sheridan, Wyo.

William N. Mitten, chairman of the board, First National Bank of Fremont, Fremont, Nebr.

*James L. Paxton, Jr., president (chairman), Paxton-Mitchell Co., Omaha, Nebr.

FEDERAL RESERVE BANK OF DALLAS

Class A:

Sam D. Young, president, El Paso National Bank, El Paso, Tex.

J. Edd McLaughlin, president, Security State Bank & Trust Co., Ralls, Tex.

John M. Griffith, president, the City National Bank of Taylor, Taylor, Tex.

Class B:

D. A. Hulcy, chairman of the board, Lone Star Gas Co., Dallas, Tex.

J. B. Thomas, president and general manager and director, Texas Electric Service Co., Fort Worth, Tex.

John R. Alford (industrialist and farmer), Henderson, Tex.

Class C:

Robert J. Smith, president (chairman), Slick Airways, Inc., Dallas, Tex.

Hal Bogle (rancher and feeder) (deputy chairman), Dexter, N. Mex.

(Vacancy).

El Paso branch:

F. W. Barton, president, the Marfa National Bank, Marfa, Tex.

John P. Butler, president, the First National Bank of Midland, Midland, Tex.

Floyd Childress, vice president, the First National Bank of Roswell, Roswell, N. Mex.

*James A. Dick, president (chairman), James A. Dick Investment Co., El Paso, Tex.

Thomas C. Patterson, vice president, El Paso National Bank, El Paso, Tex.

*D. F. Stahmann, president, Stahmann Farms, Inc., Las Cruces, N. Mex.

*E. J. Workman, president and director of research and development division, New Mexico Institute of Mining and Technology, Socorro, N. Mex.

Houston branch:

I. F. Betts, president, the American National Bank of Beaumont, Beaumont, Tex.

L. R. Bryan, Jr., vice chairman of the board and chairman of the executive committee, Bank of the Southwest National Association, Houston, Tex.

W. B. Callan, president, the Victoria National Bank, Victoria, Tex.

*A. E. Cudlipp, vice president and director, Lufkin Foundry & Machine Corp., Lufkin, Tex.

*John C. Flanagan, (chairman), vice president and general manager, Texas distribution division, United Gas Corp., Houston, Tex.

S. Marcus Greer, vice chairman of the board, First City National Bank of Houston, Houston, Tex.

*Tyrus R. Timm, head, department of agricultural economics and sociology, Agriculture and Mechanical College of Texas, College Station, Tex.

*Clarence E. Ayres, professor of economics, the University of Texas, Austin, Tex.

J. W. Beretta, president, First National Bank of San Antonio, San Antonio, Tex.

E. C. Breedlove, president, the First National Bank of Harlingen, Harlingen, Tex.

Burton Dunn, chairman of the executive committee, Corpus Christi State National Bank, Corpus Christi, Tex.

V. S. Marett, president, the Citizens National Bank of Gonzales, Gonzales, Tex.

*Alex R. Thomas (chairman), 1425 Wiltshire, San Antonio, Tex.

*Harold Vagtborg, president, Southwest Research Institute, San Antonio, Tex.

FEDERAL RESERVE BANK OF SAN FRANCISCO

Class A:

Carroll F. Byrd, president, the First National Bank of Willows, Willows, Calif.

John A. Schoonover, president, the Idaho First National Bank, Boise, Idaho.

M. Vilas Hubbard, president and chairman of the board, Citizens Commercial Trust & Savings Bank of Pasadena, Pasadena, Calif.

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Class B:

Reese H. Taylor, chairman of the board, Union Oil Company of California, Los Angeles, Calif.

Walter S. Johnson, chairman of the board, American Forest Products Corp., San Francisco, Calif.

N. Loyall McLaren, partner, Haskins & Sells, San Francisco, Calif.

Class C:

Philip I. Welk, president, Preston-Shaffer Milling Co., Walla Walla, Wash.

Y. Frank Freeman, vice president (deputy chairman), Paramount Pictures Corp., Hollywood, Calif.

A. H. Brawner (chairman), chairman of the board, W. P. Fuller & Co., San Francisco, Calif.

Los Angeles branch

Anderson Borthwick, president, the First National Trust & Savings Bank of San Diego, San Diego, Calif.

*Leonard K. Firestone, president, Firestone Tire & Rubber Company of California, Los Angeles, Calif.

Joe D. Paxton, chairman of the board, County National Bank & Trust Company of Santa Barbara, Santa Barbara, Calif.

James E. Shelton, chairman, Security-First National Bank of Los Angeles, Los Angeles, Calif.

(Vacancy.)

Portland branch

*Warren W. Braley, partner (chairman), Braley & Graham Buick, Portland, Oreg.

J. H. McNally, president, the First National Bank of Bonners Ferry, Bonners Ferry, Idaho.

John B. Rogers, president, the First National Bank of Baker, Baker, Oreg.

E. C. Sammons, president, the United States National Bank of Portland, Portland, Oreg.

*William H. Steiwer, Sr. (livestock and farming), Fossil, Oreg.

Salt Lake City branch:

Harry Eaton, president, Twin Falls, Bank & Trust Co., Twin Falls, Idaho.

George S. Eccles, president, First Security Bank of Utah, National Association, Salt Lake City, Utah.

Russell S. Hanson, executive vice president, the First National Bank of Logan, Logan, Utah.

*Joseph Rosenblatt, president (chairman), the Eimco Corp., Salt Lake City, Utah.

*George W. Watkins, president, Snake River Equipment Co., Idaho Falls, Idaho.

Seattle branch:

James Brennan, president, First National Bank in Spokane, Spokane, Wash.

*Lyman J. Bunting, president, Rainier Fruit Co., Yakima, Wash.

Charles F. Frankland, president, the Pacific National Bank of Seattle, Seattle, Wash.

S. B. Lafromboise, president, the First National Bank of Enumclaw, Enumclaw, Wash.

*D. K. MacDonald (chairman), chairman of the board, D. K. MacDonald & Co., Inc., Seattle, Wash.

Senator MALONE. Do those banks have a certain capitalization in each area?

Mr. MARTIN. Each of the banks is formed as a corporation, and all national banks have to belong to the System, and State member banks can belong to the System, and the capital is made up of 6 percent; they purchase stock in the bank—6 percent of their capital and surplus.

Senator MALONE. Six percent of their own capital is the stock purchased from you?

Mr. MARTIN. Purchased by the member banks in the Reserve banks.

Senator MALONE. In other words, the 12th district comprises what area, is that the Far West?

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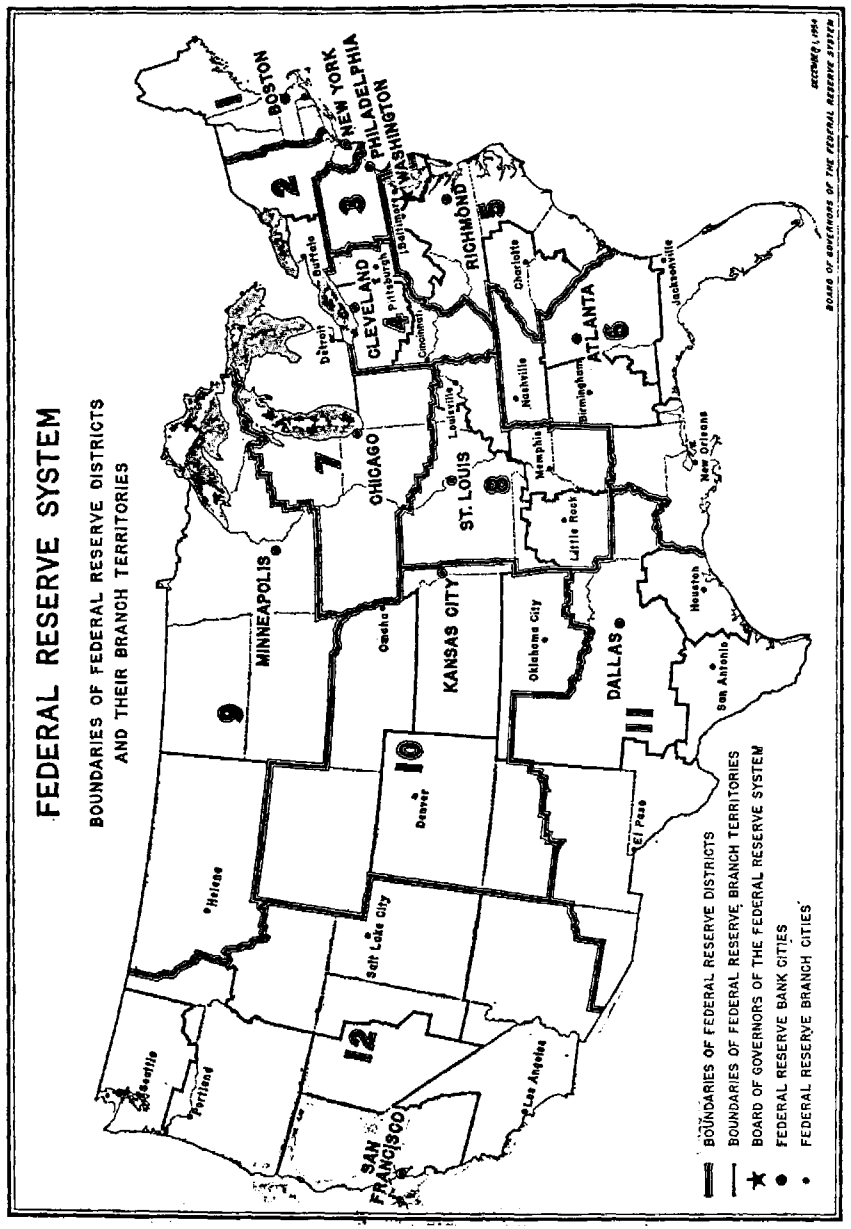
Mr. MARTIN. That is right.

Senator MALONE. What States are included in it?

Mr. MARTIN. Washington, Oregon, California, Nevada, Idaho, Utah—I can put the map in the record.

(The material referred to follows:)



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Federal Reserve Bank of St. Louis

Number of member banks and capital of Federal Reserve banks, June 30, 1957

Federal Reserve district	Number of member banks	Paid-in capital of Federal Reserve bank [1]
Boston	296	$17,120,000
New York	577	95,177,000
Philadelphia	541	21,066,000
Cleveland	604	31,985,000
Richmond	469	15,322,000
Atlanta	394	16,122,000
Chicago	1,027	45,540,000
St. Louis	492	11,372,000
Minneapolis	475	7,310,000
Kansas City	751	13,525,000
Dallas	632	18,714,000
San Francisco	180	39,443,000
Total	6,438	332,696,000

[1] Every member bank is required to subscribe to the Federal Reserve bank capital in an amount equal to 6 percent of its own capital and surplus and to pay in ½ of its subscription; the balance is subject to call by the Board of Governors of the Federal Reserve System.

Senator MALONE. I hope you will make that a part of the record here.

Mr. MARTIN. Very glad to.

Senator MALONE. To be accepted and printed, published, along with No. 2 volume or part 2; and also together with the names of the banks, their location, their boards of directors, and what percentage of stock they have purchased, what they own currently.

Mr. MARTIN. Right.

Senator MALONE. It might be well if you could give a 10-year period of variation; or is there any variation?

Mr. MARTIN. There is not a great deal of variation. It is largely a growth factor.

(The information referred to is as follows:)

Paid-in capital of the 12 Federal Reserve banks combined on June 30, 1948–57

[In thousands of dollars]

June 30—	Paid-in capital of Federal Reserve banks [1]	June 30—	Paid-in capital of Federal Reserve banks [1]
1948	198,540	1953	259,536
1949	205,133	1954	272,316
1950	219,130	1955	295,179
1951	231,308	1956	315,742
1952	245,187	1957	332,696

[1] Every member bank is required to subscribe to the Federal Reserve bank capital in an amount equal to 6 percent of its own capital and surplus and to pay in ½ of its subscription; the balance is subject to call by the Board of Governors of the Federal Reserve System.

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Senator MALONE. Let me ask you—I did ask you under another subject when we digressed momentarily—how much money is in circulation at this point? Let us just include it here.

Mr. MARTIN. Twenty-six and a half billion dollars.

Mr. NOYES. That is Federal Reserves notes only. Thirty is closer to the total circulation.

Mr. MARTIN. Money in circulation consists of Federal Reserve notes and coin and——

Senator MALONE. That is silver coin?

Mr. MARTIN. Yes.

Senator MALONE. Dollars and smaller coins?

Mr. MARTIN. Yes; that is right. And the Treasury $1 and $2 bills, which are Treasury currency.

I think the relation is about 85 percent of the currency in circulation are Federal Reserve notes; about 9 percent, roughly, in 1- and 2-dollar bills, and about 6 percent in coin.

Senator MALONE. Could you not prepare a table with just a short statement, and give us the detail on all of it? Because you are the final authority.

Mr. MARTIN. I will be very glad to give you that.

Senator MALONE. It is not necessary we have it exactly right here, if you will submit the table.

Mr. MARTIN. Right.

(The information referred to is as follows:)

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Circulation statement of United States money, June 30, 1957

Kind of money	Total amount	Money held in the Treasury					Money outside of the Treasury			
		Total	Amount held as security against gold and silver certificates (and Treasury notes of 1890)	Reserve against United States notes (and Treasury notes of 1890)	Held for Federal Reserve banks and agents	All other money	Total	Held by Federal Reserve banks and agents	In circulation [1]	
									Amount	Per capita [2]
Gold	[3] $22,622,942,692	$22,622,942,692	$21,977,196,984	$156,039,431		$489,706,277				
Gold certificates	[4] (21,977,196,984)	[4] (19,129,100,255)			[4] [5] ($19,129,100,255)		$2,848,096,729	$2,815,555,600	$32,541,129	$0.19
Standard silver dollars	488,435,800	229,200,021	202,218,385			26,981,636	259,235,779	6,628,920	252,606,859	1.48
Silver bullion	2,209,149,846	2,209,149,846	2,209,149,846							
Silver certificates	[4] (2,410,226,345)						2,410,226,345	248,636,991	2,161,589,354	12.62
Treasury notes of 1890	[4] (1,141,886)						1,141,886		1,141,886	.01
Subsidiary silver	1,382,455,600	17,343,019				17,343,019	1,365,112,581	49,787,640	1,315,324,941	7.68
Minor coin	484,631,000	1,516,515				1,516,515	483,114,485	9,210,553	473,903,932	2.77
United States notes	346,681,016	2,232,507				2,232,507	344,448,509	23,300,110	321,148,399	1.88
Federal Reserve notes	27,632,726,755	64,295,715				64,295,715	27,568,431,040	1,239,085,830	26,329,345,210	153.76
Federal Reserve bank notes	133,963,891	205,765				205,765	133,758,126	1,192,250	132,565,876	.77
National bank notes	62,076,657	97,120				97,120	61,979,537	234,250	61,745,287	.36
Total June 30, 1957	55,363,063,257	25,146,983,200	24,388,565,215	156,039,431	[4] (19,129,100,255)	[6] 602,378,554	[7] 35,475,545,017	4,393,632,144	31,081,912,873	181.52

Footnotes at end of table.

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Circulation statement of United States money, June 30, 1957—Continued

Denomination	Paper currency of each denomination in circulation, June 30, 1957								Comparative totals of money in circulation [1]		
	Gold certificates	Silver certificates	Treasury notes of 1890	United States notes	Federal Reserve notes	Federal Reserve bank notes	National bank notes	Total	Date	Amount	Per capita [2]
									June 30, 1957	$31,081,912,873	$181.52
$1		$1,295,235,408	$293,369	$5,097,839		$1,498,189	$339,722	$1,302,464,527	May 31, 1957	30,836,348,286	[8] 180.35
$2		2,824,157	177,202	73,673,447		340,980	161,688	77,177,474	Apr. 30, 1957	[9] 30,518,977,498	178.75
$5		769,978,888	324,530	232,186,440	$1,085,923,970	2,123,512	11,344,860	2,101,882,200	Dec. 31, 1956	[10] 31,790,236,325	187.38
$10	$8,691,400	92,644,986	221,335	6,548,016	6,477,280,440	10,176,445	19,659,200	6,615,221,822	June 30, 1956	30,715,188,963	[8] 182.64
$20	12,614,174	647,910	69,650	2,430,432	9,921,412,700	27,664,750	19,933,140	9,984,772,756	June 30, 1955	30,229,323,246	182.91
$50	3,474,155	151,485	1,300	201,225	2,656,039,400	31,613,500	4,396,400	2,695,877,465	June 30, 1950	27,156,290,042	179.03
$100	4,875,150	90,520	29,500	329,500	5,505,183,200	59,148,500	5,740,150	5,575,396,520	June 30, 1945	26,746,438,483	191.61
$500	1,073,750	7,000		352,500	281,498,500		86,500	283,018,250	June 30, 1940	7,847,501,324	59.46
$1,000	1,592,500	9,000	25,000	329,000	389,382,000		21,000	391,358,500	June 30, 1935	5,567,092,519	43.75
$5,000	100,000				3,135,000			3,235,000	June 30, 1930	4,521,987,962	36.74
$10,000	120,000				9,490,000			9,610,000	June 30, 1925	4,815,207,508	41.57
Fractional parts							62,627	62,627	Oct. 31, 1920	5,698,214,612	53.18
									Mar. 31, 1917	4,172,945,914	40.49
Total	32,541,129	2,161,589,354	1,141,886	321,148,399	26,329,345,210	132,565,876	61,745,287	29,040,077,141	June 30, 1914	3,459,434,174	34.90
									Jan. 1, 1879	816,266,721	16.76

[1] The money in circulation includes any paper currency held outside the continental limits of the United States.

[2] Based on Bureau of the Census estimates of population.

[3] Does not include gold other than that held by the Treasury.

[4] These amounts are not included in the total, since the gold or silver held as security against gold and silver certificates and Treasury notes of 1890 is included under gold, standard silver dollars, and silver bullion, respectively.

[5] This total includes credits with the Treasurer of the United States payable in gold certificates in (1) the gold certificate fund, Board of Governors, Federal Reserve System, in the amount of $18,283,837,300, and (2) the redemption fund for Federal Reserve notes in the amount of $845,262,955.

[6] Includes $74,000,000 lawful money deposited as a reserve for postal savings deposits.

[7] The amount of gold and silver certificates and Treasury notes of 1890 should be deducted from this amount before combining with total money held in the Treasury to arrive at the total amount of money in the United States.

[8] Revised.

[9] Lowest amount since Dec. 31, 1956.

[10] Highest amount to date.

NOTE.—There is maintained in the Treasury—(i) as a reserve for United States notes and Treasury notes of 1890—$156,039,431 in gold bullion; (ii) as security for Treasury notes of 1890—an equal dollar amount in standard silver dollars (these notes are being canceled and retired on receipt); (iii) as security for outstanding silver certificates—silver in bullion and standard silver dollars of a monetary value equal to the face amount of such silver certificates; and (iv) as security for gold certificates—gold bullion of a value at the legal standard equal to the face amount of such gold certificates. Federal Reserve notes are obligations of the United States and a 1st lien on all the assets of the issuing Federal Reserve bank. Federal Reserve notes are secured by the deposit by the Federal Reserve bank concerned, with its Federal Reserve agent, of a like amount of collateral consisting of such discounted or purchased paper as is eligible under the terms of the Federal Reserve Act, or gold certificates, or direct obligations of the United States. Each Federal Reserve bank must maintain reserves in gold certificates of not less than 25 percent against its Federal Reserve notes in actual circulation. Gold certificates deposited with Federal Reserve agents as collateral, and those deposited with the Treasurer of the United States as a redemption fund, are counted as part of the required reserve. Gold certificates as herein used includes credits with the Treasurer of the United States payable in gold certificates. Federal Reserve bank notes and national bank notes are in process of retirement.

Source: Treasury Department, Fiscal Service, Office of the Treasurer of the United States.

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Senator MALONE. What do you mean by redeemable notes, this $1 and whatever notes you mentioned that are redeemable; redeemable in what?

Mr. MARTIN. Well, all of our notes are redeemable.

Senator MALONE. In what?

Mr. MARTIN. They are backed——

Senator MALONE. By what?

Mr. MARTIN. Gold.

Senator MALONE. We have gone all through that. Let us not destroy that record, unless you want to start all over.

You have between 5 and 6 billion dollars worth of gold that you can call your own, if you continued to honor everything that could be turned into foreign nation dollar balances. Therefore, you do not have the money to do it, and it does not back it.

We all knew that, but I wanted you to say it.

I do not want to destroy the record; just let it alone.

Mr. MARTIN. All right.

Senator MALONE. You would have to reaffirm the record if we took time out and went over it again.

Mr. MARTIN. Sure.

Senator MALONE. All right.

In what, then, are these notes redeemable? I have a few banknotes here. I just got back from a trip so there cannot be many.

Mr. MARTIN. Well, they are legal tender.

Senator MALONE. For what?

Mr. MARTIN. They are legal tender for all debts and for payment of all obligations.

Senator MALONE. According to law.

Mr. MARTIN. Right.

Senator MALONE. I have a note in my hand, I have not read it. It is a $5 note, with Lincoln's picture, and it says, "United States Note, United States of America will pay to the bearer on demand five dollars." In what?

Mr. MARTIN. Well, that is just the credit of the United States.

Senator MALONE. You will give me another note just like it; will you not?

Mr. MARTIN. That is right, that you can use as legal tender.

Senator MALONE. But another note just like it is all I can get—no gold or silver?

Mr. MARTIN. By law.

Senator MALONE. You do not give me silver for this?

Mr. MARTIN. That is right. But you can get silver for that.

Senator MALONE. It does not say so.

Mr. MARTIN. No.

Senator MALONE. Would they have to pay in silver since the note does not say so?

Mr. MARTIN. I do not know that they have to.

Senator MALONE. It just says "United States of America, five dollars," on one side.

The other side, "United States note. United States of America will pay to the bearer on demand five dollars." It does not say in gold, copper, silver, tungsten, or anything else. If they paid me in silver, it would be just out of the goodness of their heart; would it not?

Mr. MARTIN. That is right.

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Senator MALONE. They do not have to. It will save time if you would just let me know about this. So the Treasury would just give me another piece of paper.

This $10 bill says the same thing.

This $1 bill says "Silver certificate, United States of America, one dollar in silver payable to the bearer on demand." I can demand silver for this note; can I not?

Mr. MARTIN. That is right.

Senator MALONE. How many of these notes, and of what denominations, are there in circulation?

Mr. MARTIN. I will have to get you the figures.

Senator MALONE. You can do that. It is not important in the testimony right now, but it is important to the record.

Mr. MARTIN. Right.

(The information referred to is as follows:)

The only kind of United States currency as to which a holder can demand redemption in silver is silver certificates.

There were $2,161,589,354 of these notes in circulation as of June 30, 1957. The denominations are shown in the statement inserted at page 3068.

Senator MALONE. I have a hundred dollar bill here. I never got home with that much money before in my life. It says: "Federal Reserve Note, United States of America, No. B17242743A. Will pay to the bearer on demand one hundred dollars."

Does that mean just another piece of paper if I turn it in?

Mr. MARTIN. It is a little bit more than just a piece of paper, but that is so.

Senator MALONE. What makes it more than just a piece of paper if that is all the United States Treasury will give me for it?

Mr. MARTIN. It is legal tender, but it is backed——

Senator MALONE. But you will not give me anything but another piece of paper for it.

Mr. MARTIN. That is right.

Senator MALONE. I cannot demand silver, can I?

Mr. MARTIN. I do not think you can demand silver for that, but I think they would probably give you silver dollars if they had them.

Senator MALONE. But I cannot demand it and I certainly cannot demand gold, because it is illegal to have gold in my possession?

Mr. MARTIN. I think—well, I will not say you can——

Senator MALONE. Will you answer that specifically in the record? If I could go up to the Treasurer of the United States and demand 100 silver dollars for that bill and get it, regardless? Is it the law or the goodness of his heart if the Treasurer paid me in silver? That is what I want to know.

Mr. MARTIN. I do not know what the law on it is, but I will get you the law on it, Senator.

Senator MALONE. How long have you been head of this Board?

Mr. MARTIN. I have been head of it since April 2, 1951.

Senator MALONE. You do not know what the law is on this money yet?

Mr. MARTIN. I do not.

Senator MALONE. Well, for your own information, as well as mine, I think we ought to make it of record, do you not?

Mr. MARTIN. We will be glad to put the law in.

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Senator MALONE. All right, then put the law in the record——

Mr. MARTIN. I have been over the law many times.

Senator MALONE. Yes, I know that, and I do not blame you for not remembering it. There are many things done here that are not thoroughly understood or they would not be done.

Would you, then, make it a part of the record, the amount of paper money in circulation and the kind, and what it is redeemable in by law, if anything—the greater part is just redeemable in more paper?

Mr. MARTIN. All right.

Senator MALONE. Whether it is in silver or just another piece of paper.

Mr. MARTIN. All right.

(The information referred to is as follows:)

Under the Silver Purchase Act of 1934, silver certificates are "redeemable on demand at the Treasury of the United States in standard silver dollars"; and silver certificates state on their face that there is on deposit in the Treasury of the United States "one dollar in silver payable to the bearer on demand." Consequently, the holder of a silver certificate has a legal right to present it to the Treasury and demand $1 in silver in return.

Federal Reserve notes were at one time redeemable in gold, but since 1934 the law has provided that they shall be redeemable in "lawful money." This means that the holder of a Federal Reserve note, upon presenting it either to the Treasury or to a Federal Reserve bank, has a legal right to demand in return only that which may be lawful money.

The term "lawful money" is generally regarded as meaning any medium of exchange which frequently circulates from hand to hand as money under sanction of law. There was a time when it was necessary to make a distinction between "lawful money" and "legal tender." Prior to 1933, only certain types of currency were declared by statute to be legal tender, that is, currency which a creditor is legally obligated to accept in payment of a debt. At that time, Federal Reserve notes and silver certificates were not legal tender. However, by the act of May 12, 1933, as amended by public resolution of June 5, 1933, it was specifically provided that "all coins and currencies of the United States (including Federal Reserve notes and circulating notes of Federal Reserve banks and national banking associations) heretofore or hereafter coined or issued, shall be legal tender for all debts, public and private, * * *."

Accordingly, while the holder of a Federal Reserve note who presents it for redemption may ask for a particular type of currency in exchange, and while the Treasury or the Federal Reserve bank may, if it desires to do so, comply with that request, the holder of the note has no legal right to demand a particular type of currency and must accept in exchange for the Federal Reserve note any lawful money in circulation, whether coin, United States notes, silver certificates, or other Federal Reserve notes.

Senator MALONE. I wish you would do something else. I asked the Secretary about the law on the silver purchase. Will you check it and, if the record does not already cover it adequately, will you do it?

Mr. MARTIN. Be very glad to.

Senator MALONE. I know in 1934, I had some hand in it. I was State engineer of my State at the time, and I was here on the proposed Boulder Dam project act, now named Hoover Dam, and when we were building that structure I was consultant to the Secretary of Interior on power. I worked on silver money bill. The law finally passed provided for the purchase of silver at a specified price up to a certain percentage of the gold in the Treasury, was there not, and that silver certificates would be issued redeemable in silver?

Mr. MARTIN. Correct.

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(The information referred to is as follows:)

The requested material regarding silver-purchase laws was read into the record by the Secretary of the Treasury, and is to be found beginning at page 512 of part 1 of the printed hearing.

Senator MALONE. Explain the provisions of the law, including the price.

Mr. MARTIN. I would be very glad to.

Senator MALONE. If there has been any variation in price, note it in the record.

Mr. MARTIN. Right.

Senator MALONE. It is 90½ cents now, is it not?

Mr. MARTIN. That is right.

Senator MALONE. You have not yet purchased silver up to the required percentage, have you?

Mr. MARTIN. No.

Senator MALONE. So until you do that, you do purchase silver at the established price whenever offered, domestic silver, is it not?

Mr. MARTIN. That is right. I will review the entire silver purchase.

Senator MALONE. I will appreciate it. Part 3 will include your testimony. I think you are doing a great service to the public in completing this record.

Mr. MARTIN. That is right.

Senator MALONE. There is a great public interest in just how our economic system is managed. People are beginning to suspect that the whole economic system is being juggled to fit a preconceived plan, but they are still hazy about the plan.

More about money. Several hundred years ago different forms of money were adopted. One hundred and eighty years ago, as far as America is concerned, the United States Congress adopted a money system, as the Constitution says it should.

Mr. MARTIN. Yes.

Senator MALONE. Why do you suppose this country and nations generally used gold and silver for money or to back up the paper in circulation?

Mr. MARTIN. It was practice, and——

Senator MALONE. Practice over the centuries?

Mr. MARTIN. Over the centuries. And it was convenient. It was easy to handle and easy to coin, and it had the qualities that were adaptable to money.

Senator MALONE. About half of the world, roughly, had always used silver for money; the other half of the countries used gold; had they not?

Mr. MARTIN. That is right.

Senator MALONE. So far as the memory of man spans the history of nations.

Mr. MARTIN. Right.

Senator MALONE. That is, the Orient and the Asiatic nations generally used silver; is that not right?

Mr. MARTIN. Right.

Senator MALONE. And Europe and Africa—about half the world had used gold; is that right?

Mr. MARTIN. I think that is right.

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Senator MALONE. That was Europe, Africa, and many other areas.

Mr. MARTIN. About 50–50.

Senator MALONE. In these nations in the Orient, including China—I was in Peking in 1948 when the Communists were 8 miles out—you can buy anything with silver, whether it had the stamp of any nation on it or not.

Mr. MARTIN. I do not think it is legal tender.

Senator MALONE. The legal tender may not be quite the term. The people will take silver for anything you want to buy; would they not?

Mr. MARTIN. You can use silver, and he will probably take gold, too.

Senator MALONE. You know he will take silver, because they have been doing it for 2,000 years of recorded history; do they not?

Mr. MARTIN. Well, you know the same about gold.

Senator MALONE. You do not in the Orient; do you?

Mr. MARTIN. Well, I am not as familiar with the Orient as you are, but I think that gold——

Senator MALONE. Of course, they will take gold for money, but they had little gold compared to the amount of silver for a couple of thousand years. If you have silver bullion, and they know it is pure, you can buy your way with; can you not?

Mr. MARTIN. Right.

Senator MALONE. Is that not one of the fundamentals?

Mr. MARTIN. It is one of the fundamentals.

Senator MALONE. You can buy anything with it; can you not?

Mr. MARTIN. Right.

Senator MALONE. They will take it because they have used it for centuries.

Mr. MARTIN. They will take it.

Senator MALONE. Is that not the reason we established silver as money as well as gold, because half of the world had used it for centuries?

Mr. MARTIN. Anything that people will take can be money.

Senator MALONE. Is there not another reason, that both silver and gold had a very limited production and, therefore, had an intrinsic value as well? The stamped value was generally in accordance with the amount available and the rate of production?

Mr. MARTIN. Correct.

Senator MALONE. You do know, like you do with gold, about how much silver there is in the world and the rate of production?

Mr. MARGET. We do not have any figures here, sir. The difficulty really is this: The reason why we can have a figure for gold, and we do not have a figure for silver, is that in most cases the silver is not legal tender, as the chairman said, and, therefore, even when we have figures with respect to the amount of silver production, it runs in terms of ounces rather than a certain number of dollars. It just follows from the fact it does not have a fixed price at the mint, so I am afraid we cannot give you the figures. I do not know of any figures.

Senator MALONE. You do have a fixed price at the mint?

Mr. MARGET. In this country we have it at 90½ cents.

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Mr. MALONE. 90½ cents at the mint. What you said was not exactly true. We should know the approximate amount of silver in the world and the rate of production.

Mr. MARGET. I would say this, that, speaking generally, the silver does not play the role that gold does in terms of a guaranteed fixed price to all comers, regardless. I am just merely saying that as a fact.

Senator MALONE. Was that the reason we made it against the law for an American citizen to own gold?

Mr. MARGET. No, sir. I just state that we are on the gold standard, not on a bimetallic standard, which would permit anybody to bring any amount of silver and be guaranteed a price.

Senator MALONE. We are, of course, not on a gold standard. The price of silver is guaranteed up to a certain percentage of gold held in the Treasury. You have never reached that percentage, have you?

Mr. MARGET. Well, it is the limitation that constitutes the difference between this system we have and the bimetallic system.

Senator MALONE. Will you make a part of the record here, so long as you have definite ideas on it, what is the percentage of gold, that you must buy the silver at 90½ cents per ounce? Will you just make it a part of the record?

Mr. MARGET. Yes, sir.

Senator MALONE. And over the years, since we passed the Silver Act in 1934 the Treasury has purchased silver at the fixed price. I helped pass the 1934 act.

(The information referred to follows:)

The roles of gold and of silver in the United States monetary system differ from each other as follows:

1. *Price.*—The United States Treasury buys and sells gold in transactions with United States producers and users, as well as with foreign governments and central banks, at the fixed price of $35 per ounce, minus and plus a handling charge of one-fourth of 1 percent. The Treasury buys silver from United States producers at the fixed price of 90½ cents, but is not generally prepared to buy silver from foreign producers at this price, and it sells silver to United States users at a price that may—and currently does—exceed the statutory buying price. Consequently, the price of gold in this country—and generally on the world market—does not deviate from the fixed price of $35 per ounce, but the market price of silver may—and currently does—exceed the fixed price of 90½ cents per ounce in the United States, and may be either lower or higher than that price on the world market.

2. *Freedom of market transactions.*—United States residents are not permitted to acquire, transport, import, or export gold—except under Treasury license or in amounts or forms that are economically insignificant. In contrast, they are permitted to acquire, hold, transport, import, or export silver in any way they wish. United States producers sell silver to the Treasury only when the price offered by the Treasury (see above) is higher than the market price, or when a sale to the Treasury is more convenient (e. g., because of the place of delivery) than a sale in the free market.

3. *Monetary and reserve function.*—Gold is the statutory reserve of all Federal Reserve notes, all Federal Reserve deposit liabilities, and certain minor types of United States currency. Silver is used in the coinage of subsidiary coins and silver dollars, and is the statutory reserve of silver certificates. On May 31, 1957, the face value of United States currency in circulation based on silver totaled only $3.6 billion, while the face value of United States currency in circulation based on gold totaled $26.4 billion, and Federal Reserve deposit liabilities totaled $20.3 billion. Similarly, the value of silver held as reserve against currency in the United States Treasury amounted to $2.4 billion, while the value of gold so held amounted to $22.1 billion.

4. *International functions.*—Gold is internationally used as a residual means of settling foreign balances; silver is not so used. For this reason, the United States Treasury is prepared to buy and sell gold for legitimate monetary pur-

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poses in transactions with all friendly foreign governments and central banks, and, in fact, such purchases and sales form the bulk of all gold transactions in the United States; in contrast, the United States Treasury as a rule does not engage in international silver transactions. Furthermore, the par values of all major world currencies are based either directly on gold or on the statutory gold parity of the United States dollar ($35 per ounce); the statutory silver value of the dollar ($1.29 per ounce) does not play any international role.

Senator MALONE. Let me repeat; I helped put it on the books. I worked with former Senator Wheeler at that time. How long have you been in Government?

Mr. MARGET. Relatively recently, as these things go.

Senator MALONE. How long?

Mr. MARGET. Counting my Army years——

Senator MALONE. Leave those out. I was in the Army, too, but it does not count for seniority in the Senate.

Mr. MARGET. I have been in Washington since 1950. I have been with the Federal Reserve Board since January 1950.

Senator MALONE. What did you do before that?

Mr. MARGET. Immediately before that, I was with the Marshall plan organization in Paris.

Senator MALONE. The what?

Mr. MARGET. The Marshall plan organization in Paris; prior to that, with the Army, and, before that, I was a university professor for many years.

Senator MALONE. Spending money for Uncle Sam all the time. [Laughter.] I never voted for the Marshall plan; I never voted for ECA. I stood on the Senate floor 4 hours on August 13, opposing billions to Europe and Asia.

I had intended to talk about 20 minutes, but the longer I talked the madder I got, remembering the puzzled look of the taxpayers at home when they read that they must support foreign nations in the interest of peace. Were you here all the time with the Marshall plan.

Mr. MARGET. Actually, no. I was there. I was in Paris shortly after it got organized. I might say, Senator, just as a matter of personal defense, that one of my jobs was trying to keep money from being spent.

Senator MALONE. Well, you were not very successful.

Mr. MARGET. I will grant that. [Laughter.]

Senator MALONE. I hope you are more successful in your present job. But you can help me by giving me the actual record, separate from your ideas. Give me your ideas, if you must, but I do not want them too mixed with the facts.

Mr. MARGET. Right.

Senator MALONE. I want to study the facts to adjust my own own conclusions. My conclusions may be different from some other members of the committee, but we ought to start with the same set of facts.

You agree with me?

Mr. MARTIN. I do.

Senator MALONE. The only way to get facts is from men who have them, and the Secretary of the Treasury has great confidence in you. That is a compliment. So this $26.5 billion, I think we settled that. The Federal Reserve notes, that is where this 25 percent of gold must be maintained; the coins, that is about $3.5 billion, which are either silver, nickel, or copper, and that is represented by those metals; is that right?

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Mr. MARTIN. That is right.

Senator MALONE. You are going to put that in the record?

Mr. MARTIN. I will put that all in the record; the breakdown.

(The following was subsequently received for the record:)

United States currency in circulation, June 30, 1957 [1] [2]

[In millions of dollars]

Gold certificates	33
Federal Reserve notes	26,329
Standard silver dollars	253
Silver certificates and Treasury notes of 1890	2,163
Subsidiary silver coin	1,315
Minor coin	474
United States notes	321
Federal Reserve banknotes	133
National banknotes	62
Total	31,082

[1] Outside Treasury and Federal Reserve banks.

[2] There are maintained in the Treasury (1) as a reservoir for United States notes and Treasury notes of 1890, $156,039,431 in gold bullion (2) as security for Treasury notes of 1890, an equal dollar amount in standard silver dollars (these notes are being canceled and retired on receipt); (3) as security for outstanding silver certificates, silver in bullion and standard silver dollars of a monetary value equal to the face amount of such silver certificates; and (4) as security for gold certificates, gold bullion of a value at the legal standard equal to the face amount of such gold certificates. Federal Reserve notes are obligations of the United States and a first lien on all these asserts of the issuing Federal Reserve bank. Federal Reserve notes are secured by the deposit with Federal Reserve agents of a like amount of gold certificates or of gold certificates and such discounted or purchased paper as is eligible under the terms of the Federal Reserve Act, or of direct obligations of the United States. Each Federal Reserve bank must maintain a reserve in gold certificates of at least 25 percent against its Federal Reserve notes in actual circulation. Gold certificates deposited with Federal Reserve agents as collateral, and those deposited with the Treasurer of the United States as a redemption fund ,are counted as reserve. Gold certificates, as herein used, include credits with the Treasurer of the United States payable in gold certificates. Federal Reserve banknotes and national banknotes are in process of retirement.

Senator MALONE. And, as a matter of fact, cold turkey, under custom of meeting foreign nation's dollar balance with gold payments, we do not have the 25 percent of gold to back up the $26.5 billion according to law; is that true?

Mr. MARTIN. If it were all drawn at one time.

Senator MALONE. Or over a reasonable period; we'd not have it?

Mr. MARTIN. That is right.

Senator MALONE. And so you would have to rush madly up to Congress and it would have to reduce the required percentage. The gold would be gone before you got here. That would be right; would it not?

Mr. MARTIN. Well, if we had not paid it out, it would not be gone.

Senator MALONE. But you do not own it. It is like a banker calling his deposits capitalization. You do not say that a bank could claim the deposits simply because they were in the bank?

Mr. MARTIN. No, that is correct.

Senator MALONE. Why do you then claim we own the gold when the foreign dollar balances can get it according to custom.

Mr. MARTIN. I think it is correct in that sense.

Senator MALONE. I think it is deceiving Congress and the people, because they had no idea that out of the nearly $70 billion in gifts to foreign nations that they have built up credits to claim all but $5¾ billion of the $24.2 billion that the United States owned in 1933.

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I want you to understand this is a most friendly cross examination, but the people have a right to know what the Congress and the Treasury and the Federal Reserve Board have done with their money.

Mr. MARTIN. Right.

Senator MALONE. Personally, I think you have done as well as could be done under the circumstances, which have been very bad, and deliberately so starting in 1933 when we left the gold standard and deliberately started an inflation period. It did not start yesterday. Since that time Washington has swarmed with people giving away Uncle Sam's assets.

We have given about $107 billion. If you would have subtracted that amount from the national debt, it would not look so bad.

We buy these nations every year with taxpayers' money—buying agreements they will not keep.

If we would concentrate on making our economic system work, and remain strong instead of dividing our wealth, no nation would start a war.

You know, nobody jumps on Jack Dempsey if they know who he is. That danger of losing a fight is what does it. Do you agree?

Mr. MARTIN. I do.

Senator MALONE. What is the difference between nations and individuals?

Mr. MARTIN. Well, I cannot make a distinction on a personality basis. I think some of the same elements exist; I agree with you on that.

Senator MALONE. Well, the further you go, the more you are going to think they are alike, and Russia or no other nation is about to start a war with us while we can win it. You are dividing the American markets of the workingmen and the small investors among the low-wage foreign nations.

You have milked them through their tax money, sending it to foreign nations.

I have news for you. When this economic dip comes this time you might wake up with the kind of government you think you are fighting.

Do you have any idea I could be too wrong?

Mr. MARTIN. All I can say, Senator, is I am going to do everything within my power——

Senator MALONE. I know you will.

How often do you review the territory west of the Potomac River?

Mr. MARTIN. I get out quite frequently.

Senator MALONE. Do you ever talk to anybody in business, or someone who has a job he is afraid of losing through loss of American markets to foreign low-wage nations?

Mr. MARTIN. I talk to quite a few of them.

Senator MALONE. I am glad you do.

I just returned from the west—I do that every month or oftener, because if you do not see the people making a living the hard way this Potomac fever is fatal.

In the beginning of your testimony you stated the objective of the Federal Reserve System operation is to "promote monetary credit conditions that will foster sustained economic growth, together with stability in the value of the dollar."

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Can you cite such statement of objectives in the Federal Reserve Act? What made you decide that should be your objective?

Mr. MARTIN. I think if you read the Federal Reserve Act, and take it in conjunction with the Employment Act of 1946, which was also the law, that those objectives are quite explicit.

Senator MALONE. You go beyond the Federal Reserve Act. The 1946 Employment Act is where you get this objective. You did not get it out of the Federal Reserve Act, did you?

Mr. MARTIN. Well, not line for line out of it. I supplemented it.

Senator MALONE. You read something in it that is not there? Then you coupled it with the 1946 Full Employment Act. How long have you been there? Since 1950?

Mr. MARTIN. I have been there since 1951.

Senator MALONE. Was the policy followed before you, generally, the same?

Mr. MARTIN. I think so.

Senator MALONE. So the Chairman before 1946, was doing practically the same thing—had the same objective. That would really be adding a managed economy to a managed currency. Where did he get the power to do that?

Mr. MARTIN. I think he got it out of the body of the testimony on the law, and the evolution of thinking, generally.

Senator MALONE. The evolution of thinking, but not an amendment of the law.

Mr. MARTIN. Not a specific amendment of the law.

Senator MALONE. Will you just cite the authority for what must have been the reason for adopting this as an objective, the objective of the System, which is to promote monetary conditions, as you say, that will foster sustained growth of the economy, together with the stability of the dollar?

Tell me just where that occurs in the Federal Reserve Act.

It is a very strange and dangerous power to put into 1 man's hands, or in the hands of a 7-man board affecting 170 million people.

It may come as a great shock to the people to find you have that power, or even to Congress that it gave you the power, if in fact anything shocks the Members of Congress. You will put it in the record; will you not?

Mr. MARTIN. I will.

Senator MALONE. Then you can tell me for the record how, taking the two acts together that you arrive at conclusion that you can manage the currency and the entire economy too. It may shock the country into a sense of responsibility to find that you are also managing the entire economy. You will put the explanation in the record.

Mr. MARTIN. I will.

(The information referred to follows:)

The Federal Reserve Act does not contain any provision specifically stating that the objective of the Federal Reserve System is to promote conditions that will foster sustained economic growth and stability in the value of the dollar. However, this objective is implicit in the title of the act and in policy directives contained in various provisions of the act; and, taking such directives together with the declaration of policy contained in the Employment Act of 1946, it is clear that the promotion of credit conditions conducive to economic growth and the maintenance of the stability of the dollar is one of the most important objectives of the Federal Reserve System.

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The Federal Reserve Act is entitled "An act to provide for the establishment of Federal Reserve banks, to furnish an elastic currency, to afford means of rediscounting commercial paper, to establish a more effective supervision of banking in the United States, and for other purposes."

The law provides that discount rates shall be established by the Federal Reserve banks, subject to review and determination by the Board of Governors, "with a view of accommodating commerce and business" (12 U. S. C. 357).

The Board is authorized to change reserve requirements of member banks "in order to prevent injurious credit expansion or contraction" (12 U. S. C. 462b).

The operations of the Federal Open Market Committee are subject to provisions of the law which require that the time, character, and volume of all purchases and sales in the open market "shall be governed with a view to accommodating commerce and business and with regard to their bearing upon the general credit situation of the country" (12 U. S. C. 263).

The board of directors of each Federal Reserve bank, in extending credit to member banks, is enjoined to consider "the maintenance of sound credit conditions, and the accommodation of commerce, industry, and agriculture"; and each Reserve bank is required to keep itself informed of the general character and amount of the loans and investments of its member banks "with a view to ascertaining whether undue use is being made of bank credit for the speculative carrying of or trading in securities, real estate, or commodities, or for any other purpose inconsistent with the maintenance of sound credit conditions" (12 U. S. C. 301).

In prescribing margin requirements for purchasing and carrying securities, the Board is required by the Securities Exchange Act of 1934 to consider whether such requirements are "necessary or appropirate for the accommodation of commerce and industry, having due regard to the general credit situation of the country" (15 U. S. C. 78g).

The various policy directives which have been given by Congress to the Board, the Open Market Committee, and the Federal Reserve banks are more fully discussed in Chairman Martin's replies to the 1952 questionnaire of the Subcommittee on General Credit Control and Debt Management of the Joint Committee on the Economic Report. These directives, as previously indicated, implicitly place upon the Federal Reserve System a responsibility for promoting monetary and credit conditions conducive to economic growth and maintenance of stability of the value of the dollar. That objective is supported by the declaration of policy contained in section 2 of the Employment Act of 1946, which reads as follows:

"SEC. 2. The Congress hereby declares that it is the continuing policy and responsibility of the Federal Government to use all practicable means consistent with its needs and obligations and other essential considerations of national policy, with the assistance and cooperation of industry, agriculture, labor, and State and local governments, to coordinate and utilize all its plans, functions, and resources for the purpose of creating and maintaining, in a manner calculated to foster and promote free competitive enterprise and the general welfare, conditions under which there will be afforded useful employment opportunities, including self-employment, for those able, willing, and seeking to work, and to promote maximum employment, production, and purchasing power" (15 U. S. C. 1021).

Senator MALONE. Are not the basic purposes of this act stated in the long title which reads:

An act to provide for the establishment of Federal Reserve banks, furnish an elastic currency to afford means of rediscounting commercial paper, establish a more effective supervision of banking in the United States and for other purposes—

and also in section 12 (a), part 3, devoted to general principles, in which it is said—

that time, character, and volume of all purchases of sales paper described in section 14 of this act as eligible for open-market operations shall be governed with a view to accommodating commerce and business with regard to their bearing upon the general credit situation of the country.

Now, is that what it says?

Mr. MARTIN. That is what it says.

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Senator MALONE. And you believe that?

Mr. MARTIN. Right.

Senator MALONE. But your interpretation of it is that you must "promote monetary credit conditions that will foster sustained economic growth"?

Mr. MARTIN. Right.

Senator MALONE. Would it not be more desirable to state that the objective of the System is to maintain the integrity of the United States dollar, its honesty and soundness?

Mr. MARTIN. I think you could have stated it more explicitly than in the present act.

Senator MALONE. You think it would be a good addition to the act?

Mr. MARTIN. I do not think it would be necessary.

I think the most necessary amendment is to make clear what I believe to be implicit in the Employment Act, but there has been some question about making explicit the stability of the dollar as well as devoting all of our energies to promoting employment, because I do not think you can separate the two.

Senator MALONE. When you promote employment, does it indicate to you that you shall print money to make it more available?

Mr. MARTIN. No, it does not.

Senator MALONE. To promote employment?

Mr. MARTIN. No. The phrases in the Employment Act "maximum production, maximum employment, maximum purchasing power" to me have to be——

Senator MALONE. Tied to a sound dollar?

Mr. MARTIN. That is right.

Senator MALONE. Your difficulty is that maintaining the honesty and soundness of the dollar and promoting full employment may not be compatible. Let me ask you, right at that point, if, as has been the case during the past 24 years, 53-percent reduction in the purchasing price of money is acknowledged, have we not really stolen the insurance value and the value of savings and lowered wages and pensions to that extent? Have we not done that?

Mr. MARTIN. I do not think our record is very good.

Senator MALONE. You do not think we should do that?

Mr. MARTIN. I do not.

Senator MALONE. Some complain bitterly. The administration complains about the raising of wages, the rise in pensions.

The President has on his desk today a pension bill for utterly disabled men, wheelchair cases, men who cannot walk.

We kicked it out of this committee, a 10-percent increase in those pensions, so that they could eat, because of this inflation.

So some White House spokesman indicates he might veto it. The President will never veto such a bill if he understands it, but if he does, it will pass over his veto, because it is right.

We have continued the inflation.

I say "we," simply because of my inability to stop it, since we took over in 1953. I have never voted for free trade, billions to Europe, or a raise in the debt limit. The inflation has continued; has it not?

Mr. MARTIN. Right.

Senator MALONE. And there is no sign of slackening it up, is there?

Mr. MARTIN. I think some progress has been made.

Senator MALONE. How? Tell us about it.

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Mr. MARTIN. I think, in the last couple of years, I think we have brought the problems of inflation to the attention of the public. I think——

Senator MALONE. There is no question about that.

The public is catching up with you. I agree with you, and maybe you do not know it, but the people are getting ready to reverse the trend.

Mr. MARTIN. Well, I am glad to hear it.

Senator MALONE. It might affect your job, because you have not stopped it, either.

Mr. MARTIN. That is correct.

Senator MALONE. My personal opinion is, for whatever it is worth, that we do not stop inflation, go back on that gold standard; stop this free trade with low-wage nations by refusing to extend the 1934 Trade Agreements Act in June next year; and stop this centralization of power in Washington; if we do not accomplish these things in the next 2 or 3 years, there will not be another Republican President in the life of the youngest Republican voter today. That is how serious it is, in my opinion.

They cannot touch you for 2 or 3 years.

Mr. MARTIN. Well, the Congress can abolish my job.

Senator MALONE. What does the Constitution say about the coining of money and the fixing of the value thereof?

Mr. MARTIN. The power is in the Constitution.

Senator MALONE. Where does it put it?

Mr. MARTIN. It puts it in the Congress.

Senator MALONE. Where is it now?

Mr. MARTIN. The Congress has delegated authority over the money supply to the Federal Reserve System.

Senator MALONE. In the Federal System?

Mr. MARTIN. That is right.

Senator MALONE. By virtue of the Federal Reserve Act?

Mr. MARTIN. That is right.

Senator MALONE. But we can abolish or amend the Federal Reserve Act any time we want to.

Mr. MARTIN. That is right.

Senator MALONE. Well, do you think that is a good idea?

Mr. MARTIN. To abolish it?

Senator MALONE. Yes.

Mr. MARTIN. No. We are trying to perform in the System so that you will not want to abolish it.

Senator MALONE. But Congress has nothing to do with it unless you amend the act, do they?

We can talk to you, but we cannot do anything through it. Your judgment cannot be questioned for anything done under that act, unless we amend it?

Mr. MARTIN. That is correct, but the act itself can be changed at any time.

Senator MALONE. Of course it can. But at the moment, Congress has not one iota of authority, except the authority to change the act, in the coining of the money and the fixing of the value thereof, do they?

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Mr. MARTIN. Well, the Congress decided this was a problem, that money will not manage itself, and so they set up this means of handling it.

Senator MALONE. They decided, too, that we should divide our markets with the nations of the world. Through the 1934 Trade Agreements Act they transferred the constitutional responsibility of Congress to fix the duties, imposts, and excises, to the President, with full authority to put it in Geneva, which he did do in 1947.

Now 34 competitive foreign nations are busily engaged in Geneva dividing the markets of the United States among them.

You said you did not know that, but you should know it?

Mr. MARTIN. I said I would study it. I did know it, Senator, but I have not reviewed it recently.

Senator MALONE. You did know it?

Mr. MARTIN. I did know it.

Senator MALONE. You think the act transferring that responsibility of Congress to Geneva is all right. It now expires in June 1958?

Mr. MARTIN. I would have to give it more study.

Senator MALONE. I wish you would, because I think we are going to see more of you later this year or early next year.

Mr. MARTIN. I am at your service.

Senator MALONE. I know you are.

I am friendly toward you. Like George Humphrey, I think you are doing the best you can. Who is responsible for the money system?

You say Congress is responsible. What does the Constitution say about it; do you remember?

Mr. MARTIN. I have not got the Constitution.

Senator MALONE. Would you quote it in the record exactly together with the act?

Mr. MARTIN. I would be glad to quote the Constitution for you, yes.

(The information referred to follows:)

Among other powers, section 8 of article I of the Constitution of the United States confers upon Congress the power "to coin money, regulate the value thereof, * * *." This provision, however, is not the sole basis for the power of Congress to legislate with respect to monetary and credit matters. That power is derived not only from the authority of Congress to coin money and regulate the value thereof, but also from the following provisions of the same section of the Constitution which authorizes Congress—

"To lay and collect taxes * * *.

"To borrow money on the credit of the United States.

"To regulate commerce with foreign nations, and among the several States * * *."

Senator MALONE. I will tell you what it says, but I want you to quote it because it will have more weight. It says in article I, section 8, that the Congress shall coin the money and fix the value thereof and of foreign coin. That is what it says; does it not? Is Congress doing it?

Mr. MARTIN. I think Congress is certainly watching the Federal Reserve System very carefully.

Senator MALONE. I do not think they have watched it at all. I think this is the first time Congress has looked at it for 24 years.

Mr. MARTIN. That is only the Finance Committee, Senator.

Senator MALONE. Yes; I know. We have done nothing about it, and we are doing nothing about fixing the value of foreign coin.

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All I would like to see, as long as we are off the gold standard, as they are, is that when you buy their currency or trade with them, you do it on the market value of their money in terms of the dollar.

Does that make any sense?

Mr. MARTIN. It makes good sense.

Senator MALONE. We are not doing it, are we?

Mr. MARTIN. Well, I think, generally speaking, we are trying to.

Senator MALONE. How are you trying, diverting on that for a minute?

Mr. MARTIN. We have been working as hard as we can toward general convertibility of currencies.

Senator MALONE. Of what?

Mr. MARTIN. All currencies.

Senator MALONE. Of paper?

Mr. MARTIN. Yes. I am talking about paper.

Senator MALONE. How would you have the convertibility of paper, and what would you convert it into, another piece of paper?

Mr. MARTIN. We are talking in terms of—yes, to dollars.

Senator MALONE. Just another piece of paper?

Mr. MARTIN. Yes. That is, in the parlance we are talking, that is all that is required, as long as it is legal tender.

Senator MALONE. Why, of course. So any schoolboy could do that, until it took a wheelbarrow load of it to buy a plate of ham and eggs.

Mr. MARTIN. As Mr. Marget points out, the International Monetary Fund has been working hard to abolish the differential between the black market and the official market, and we think that considerable progress has been made.

Senator MALONE. Of all the nations of the world.

Now, did you borrow some gold from the World Bank not long ago?

Mr. MARTIN. No.

Senator MALONE. About $100 million in gold, or something. Where did you borrow it?

Mr. MARGET. We did not borrow any gold.

Senator MALONE. Let us not get crosswise, because I am going to ask you to look that up.

Mr. MARTIN. We can get you the full transaction.

Senator MALONE. Well, you know there was a transaction?

Mr. MARTIN. Oh, yes, indeed.

Senator MALONE. But you got the gold from the World Bank?

Mr. MARTIN. That is right.

Senator MALONE. How did you get it?

Mr. MARTIN. From the Monetary Fund. Not the World Bank.

Senator MALONE. That is a technicality. You knew where you got it; you knew that, did you not?

Mr. MARGET. When you said "got it," it is the sale of gold from the Monetary Fund to the Treasury.

Senator MALONE. I am one of these people who asks questions until I get the facts.

Mr. MARTIN. We want to give you all the facts in the world.

Senator MALONE. As a matter of fact, you do know there is not an honest currency in the world, except Canada. Their dollar is priced above ours in the market?

Mr. MARTIN. Well, Senator, I could not say there is not an honest currency in the world.

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Senator MALONE. Well, they are not honest when they fix the value of their currency in terms of the dollar higher than the market price.

Mr. MARTIN. Well, there are managed currencies all over the world.

Senator MALONE. Answer that question.

Mr. MARTIN. What?

Senator MALONE. It is not an honest currency if the price fixed in terms of the dollar, according to their law or executive decree, is higher than the market price?

Mr. MARTIN. Well, that is a definition that you are giving. I think the word "honest"——

Senator MALONE. Well, you make your own definition. What is it?

Mr. MARTIN. Well, I say that the currency that is convertible, and has a legal backing and can be used for legal tender in a country, is perfectly sound as a currency.

Senator MALONE. I am talking about exchange in trade. For example, in Bolivia, when I was there in 1954, they said the dollar was worth 500 bolivianos. When on the streets you can get 1,700, do you say that is not a dishonest currency when they require all dollars to be turned in to the central bank at that price?

Mr. MARTIN. I would say that is currency that is being depreciated.

I do not like to use the word "honest" in that. I am not trying to quibble with you, but I think it is the depreciation of the currency. I do not like it at all, and you and I are in complete agreement.

Senator MALONE. It is a simple depreciation of the currency. It is a way of fixing the value for trade advantage.

If we want to trade badly enough with Bolivia, we make up the difference and call it a "dollar shortage." We give them an amount of money that makes the difference between the 500 and 1,700 bolivianos; isn't that about it?

Mr. MARTIN. That is right.

Senator MALONE. What do you call that except a dishonest currency?

I worked on the open range for ranchers in 1914, surveying and engineering; and I had a checkbook to buy a waterhole if we needed it, and the price was right.

Finally, the rancher said, "I don't mind buying them once, if they would stay bought, but somebody else comes in and files on the spread and you have to keep buying them every year."

That was his objection, and it was the soundest thing anybody could ever say; is it not?

Mr. MARTIN. That is right.

Senator MALONE. We are buying them every year; are we not?

What is that $3 billion or $4 billion foreign aid to be used for—to buy them every year?

I have never voted for billions of taxpayers' money to foreign nations. I am opposed to buying treaties and agreements that will be broken when the tugs tighten.

But, of course, your assistant would not have had that first job after he got out of the Army if Congress had not passed the Marshall plan. He might have to do to work. [Laughter.]

I would let all these people—these point 4 people—go back to work. Ninety percent of them could not hold a job in private business. It is a disgrace.

So you think it is an honest currency when nations fix a price on their currency in terms of the dollar higher than the market price?

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Mr. MARTIN. I deplore depreciation of the currency just as much as you do, sir.

Senator MALONE. Would you think it is only depreciation of the dollar if we said a dollar is worth a pound by law? What would you call it? Would you call it an honest dollar because a pound actually is worth $2.10 or $2.20, so we could say, by act of Congress, or we gave the President the power to say that a dollar is worth a pound.

Do you think that would be an honest dollar?

Mr. MARTIN. You have to subject that to the test of the market.

Senator MALONE. Well, if the market says that the pound is worth $2.20 and we passed a law saying that the dollar was equal to the pound, would that be an honest dollar?

Mr. MARTIN. I would not—I hate to use the word "honest," but it certainly——

Senator MALONE. What are we going to use in all this world mess? Maybe we ought to tell the people the truth once in a while. It would not hurt and might help.

Mr. MARTIN. I want to tell the truth.

Senator MALONE. Tell us what we ought to do. We might do that sometime.

Mr. MARTIN. I think it would be a mistake——

Senator MALONE. Do you think it would be a dishonest dollar?

Mr. MARTIN. I think it would be a dollar that could not be maintained.

Senator MALONE. Well, you could maintain it if there was another nation big and strong enough to pick up the difference, could you not, and that is what we are doing, and we have been doing it now for 12 years, picking up the difference between the market value and the value the foreign nations fix on their currency; we pick up the check.

The reason the system works is because we give them the money to make up the difference; to pick up the check; do we not?

Mr. MARTIN. We have been supplying some foreign aid.

Senator MALONE. Was that all you cared about it? You know more than that. Why not give me an answer?

Mr. MARTIN. Well, I simply cannot give you an answer that this has been a dishonest operation.

Senator MALONE. You just hate to say that; do you not?

Well, I do not. And if we fixed the value of the dollar and said it was worth—well, you say now bolivianos are 14,000 to the dollar, suppose we said in a law or gave the President power to say that a dollar is worth 100,000, and on the streets it was 14,000, would you say it was an honest dollar?

Mr. MARTIN. You could not determine the value of the dollar by decree.

Senator MALONE. Congress can do it—we just have not done it—and we have signed a contract with the Monetary Fund not to change anything without their consent. However, foreign nations do it to us.

Mr. MARTIN. It changes all the time.

Senator MALONE. The foreign nations do get away with it under the provision of the Monetary Fund exceptions on account of dollar shortage or dollar balances. And we gave them the $70 billion since World War II with which to do it. Your man was with the Marshall

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plan giveaway. We give them the money. You know that, do you not?

Mr. MARTIN. I never thought of Arthur as the man who gave it away.

Senator MALONE. Of course. How else would he eat, unless somebody gave him a job? [Laughter.]

Now, tell me. We are just wasting time. I know you know more than that.

Mr. MARTIN. Well, I am sorry, Senator, but I cannot agree with you that this is a dishonest transaction.

Senator MALONE. It is not dishonest to have a dollar turned in for 500, when there are 1,700 coming for it; it is not dishonest?

Mr. MARTIN. You are talking about the boliviano, now; I am talking about the dollar.

Senator MALONE. I am asking the questions.

Why do you not get the number of bolivianos for the dollar or in trade what it is worth on the market in trade, or in terms of gold or silver, instead of the price fixed by the central bank of Bolivia?

Mr. MARTIN. I think over a period of time the values are determined by the market.

Senator MALONE. You must know better than that. It has not happened since World War II at all, and really since we went off the gold standard. You are in the business. You are top man in the great Federal Reserve Board. I am just a bystander. Even I know better than that.

What do you think the trick phrase "dollar shortage" was created for by the London bankers, the catch phrase to sell our people the $17 billion Marshall plan in 1948? That, you remember, was going to be the end of all such gifts—just as was the $3¾ billion to England in 1946 the first time.

Do you know what the Secretary of State testified to right here before the committee in 1955? He said it had to be permanent. That is what he said, and you did not know that? Tell me, did you?

Mr. MARTIN. Yes. Well, I knew that the Secretary of State was up here testifying.

Senator MALONE. Did you know what he said?

Mr. MARTIN. I have not reviewed his testimony.

Senator MALONE. Will you take my word for it, that he thinks it ought to be permanent? He wants it for 3 years now—this year. You did not know that?

Mr. MARTIN. You are talking about the Marshall plan?

Senator MALONE. All of the plans—from the $3¾ billion gift to the International Cooperation Administration (ICA) all to make up the difference called the dollar shortage by the London bankers.

You did not know what it was for?

Mr. MARTIN. I followed all of the debate, and all of the discussion as carefully as I could.

Senator MALONE. Well, I will give you an idea. They were and are fixing the price of their money in terms of the dollar higher than the market price. Their money meant nothing in grams of gold, or ounces of silver. We have been giving them gold for dollar balances—and billions to make up the difference in the value they arbitrarily fix on their money in terms of the dollar, and the free market price.

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Do you know that with Marshall plan gift money they could buy our gold, by building up dollar balances?

Mr. MARTIN. Yes.

Senator MALONE. Then we deliberately gave our gold away, did we not?

Mr. MARTIN. Some of the Marshall plan aid went into the reserves of the foreign countries.

Senator MALONE. Well, it is not the Marshall plan now; it is Mutual Security and ICA—International Cooperation Administration.

Mr. MARTIN. Right.

Senator MALONE. I have news for you; this is exactly what happens: our Government sent this money to foreign nations—who in turn fix a price on their money in terms of the dollar greater than it is worth on the open market, therefore they cannot get a dollar at the market price for it; then they call it dollar shortage. You know that; do you not?

Mr. MARTIN. Yes.

Senator MALONE. All right.

Senator BENNETT. This witness has been here for 3 hours and a half, Senator. Do you want to give him a little recess?

Senator MALONE. Yes, I would like to.

Senator BENNETT. Off the record.

(Discussion off the record.)

Senator MALONE. By the stability in the value of the dollar in this reference I made to your testimony, do you not refer to a stable index of prices rather than the value of the dollar?

Mr. MARTIN. Yes, I think so.

Senator MALONE. In other words, if it is going to be a managed dollar, what you really mean is that you have no method of measuring it on anything else, because you will not pay anybody but foreigners in gold, you will not pay an American citizen in gold, you will put him in jail if you find him with a piece of it in his pocket; that is right, is it not?

Mr. MARTIN. That is right.

Senator BENNETT. Senator, for the record, did they not change that, allowing him to have $100 worth?

Senator MALONE. They may have, but it would only be a token gesture.

Senator BENNETT. Would you like to ask the witness that?

Senator MALONE. Yes.

Did they change it, so that a small amount might be retained?

Senator BENNETT. A small amount; I think it was $100.

Senator MALONE. What was that change for, just so they could not put you in jail if you had a pocketpiece?

Mr. MARTIN. I think so, under the rule of reason.

Senator MALONE. What difference does it make for the purpose of this examination?

Mr. MARTIN. I do not think it is very pertinent.

Senator MALONE. It makes no difference. You make a jail bird out of an American citizen for having something that you gave away free to a foreigner.

Mr. MARTIN. That would be a mistake.

Senator MALONE. Well, we do it, do we not? Are we not giving the money to them, money, handing it to them, as we did Marshall plan

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money, as we did the ECA money, and 3 or 4 other funny names, and through those giveaway organizations they built up a dollar balance?

Mr. MARTIN. They did.

Senator MALONE. All right.

And we give foreigners something then and make it a jail sentence for an American to buy; is that right?

Mr. MARTIN. We do. The Congress does it as part of a policy.

Senator MALONE. Of course, I do not blame you. Do you think I am blaming you for this?

Mr. MARTIN. I do not.

Senator MALONE. You know better than that.

All I want you to be is frank and make a good record, so that a fellow out there in the cow country, my country, who wants to read this record, and some of them may do it, will have some idea of what is going on, and will not have to read a book, as your partner suggested.

I guess that is the reason most all of these ex-Cabinet officers and others have written books when they get out. They write a book, nearly all of them. Very few read the books, and if they do, they would not know anything about the subject, because the so-called editors do not themselves know.

If somebody would write a real book about this monetary system and tell the truth, they would do a great service to this country. That is what we are trying to do in the record.

Now, it is the index that you are tying all of this to.

How many commodities are there in this index?

Mr. MARTIN. Well, I do not know the index. Do you know the price indexes that we use?

Mr. NOYES. I assume he is referring to the consumer price index.

Mr. MARTIN. Yes. We are talking about purchasing power?

Senator MALONE. When you say it is worth 47 cents, as was testified to here, 47.5, what is it based on, the commodity index?

Mr. MARTIN. We will put the description of our index completely in the record.

Senator MALONE. All right. That is all we need, just what it is, how many commodities, and how you weight it.

Mr. MARTIN. Right.

(The information referred to follows:)

THE CONSUMER PRICE INDEX

The Consumer Price Index prepared by the Bureau of Labor Statistics measures the average change in price of the goods and services bought by families of city wage earners and clerical workers. The complete title of this index, popularly referred to as The Consumer Price Index, is Index of Change in Prices of Goods and Services Purchased by City Wage-Earner and Clerical-Worker Families.

The index reflects retail price changes of foods, clothing, housefurnishings, fuel, and other goods; fees paid to doctors and dentists; prices in barbershops and other service establishments; rents; rates charged for transportation, electricity, gas, and other utilities, etc. Prices are those charged to consumers, including sales and excise taxes.

Prices for these goods and services are obtained in 46 cities so selected that their populations are representative of the entire population of the 3,000 cities in the United States. Prices in all 46 cities are then combined into the national index.

The index measures the effect of price changes on the cost of the goods and services in the family "market basket." The contents of the "market basket"—that is, the quantities and qualities of goods and services that represent what

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families bought in 1951–52—is assumed to remain the same, so that the change in cost from month to month is the result of changes in prices. The index does not purport to measure the changes in spending of families that result from changes in their standards of living. It measures only the change in spending caused by changes in prices.

The index covers approximately 300 items, with food and apparel accounting for somewhat more than half of this number. A recent tabulation prepared by the Bureau of Labor Statistics indicates the relative importance, in December 1956, of major groups of goods and services represented.

Composition of Consumer Price Index

Group	*Relative importance*
All items	100.0
Food	28.7
Apparel	9.2
Housing	33.1
Rent	5.9
Other shelter	12.4
Fuels, gas and electricity	3.2
Housefurnishings	6.2
Household operation	5.4
Transportation	11.2
Medical care	5.4
Personal care	2.2
Reading and recreation	5.1
Other goods and services	5.1

The price changes of the various items from 1 month to the next are weighted by their relative importance in the preceding month. The calculating is done for individual cities, and each city is weighted in proportion to the wage-earner and clerical-worker population it represents in the index, based on 1950 census figures.

Retail prices used in the calculation of the index are for detailed specifications of goods and services, and include sales and excise taxes. When an article can no longer be priced, a substitution is made (1) of another article which is adequately described by the same specification, or (2) of an article serving the same purpose but described by a different specification.

Revisions in the index have tended to improve its usefulness as a measure of price changes affecting the families of wage earners and clerical workers. The most recent revision, in January 1953, consisted mainly in the addition of small cities, the updating of the "market basket" to a more recent and hence more representative period, and an increase in the number of items priced.

Among the important uses of the Consumer Price Index two have attracted considerable attention. One is in connection with labor-management contracts involving automatic wage adjustments to changes in the price index. The other is the use of the index to estimate changes in "purchasing power of the dollar."

The notion of the "purchasing power of the dollar" is really just another way of looking at price changes. If, for example, measurements of prices show a doubling of average prices over a period of time, the same fact may be stated in terms of a reduction of one-half in what the dollar will buy. Measurement of changes in the dollar's purchasing power must be based on an index of average changes in prices and the Consumer Price Index published by the Bureau of Labor Statistics is probably the index most frequently used.

To calculate the purchasing power in 1956 of the 1929 dollar, one divides the price index for 1929 (73.3) by the index for 1956 (116.2), which equals 0.631 or 63.1 cents. It is apparent that this is the reverse of the procedure to calculate the change in consumer prices from 1929 to 1956—which would be 116.2 divided by 73.3, an increase of 58.5 percent.

Calculated in the same fashion, the purchasing power in 1956 was 47.6 cents for the 1933 dollar, 54.1 cents for the 1941 dollar and 82.2 cents for the 1947 dollar. Stated in terms of average change, prices in 1956 were 110.1 percent higher than in 1933, 84.7 percent above 1941, and 21.7 percent above 1947.

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Senator MALONE. Another thing was, a very smart thing, you are now basing this index price of the dollar on 1948, is that right?

Mr. MARTIN. 1947–49.

Senator MALONE. What was the idea of changing it from 1934, to make it look better?

Mr. MARTIN. To bring it closer to contemporary times.

Senator MALONE. Sure.

If you changed it to 1950, it would be still closer to contemporary times and the index would probably show a purchasing power of around 80 percent or more, would it not? It would look pretty good. I guess you will do that one of these days, will you not? You can fool the young people and the older ones won't count.

Mr. MARTIN. We put into the record that the stability from April 1951 to April 1956 was pretty good, a pretty good record, generally speaking.

Senator MALONE. What was it? What was the decrease in value of the dollar?

Mr. MARTIN. It was about 1 percent a year during that period.

Senator MALONE. What has it been since then until now?

Mr. MARTIN. Well, it has gone—it has gotten away from us there, that is what I was talking about earlier.

Senator MALONE. About 3 percent?

Mr. MARTIN. Yes; it is over 3 percent.

Senator MALONE. What has it been since we took over in 1952 until today, that is what I am interested in getting into this record.

Mr. MARTIN. I think we have got a table in the record already, but we will put 1952 in.

Senator MALONE. That is all right, put it in the record.

Mr. MARTIN. Certainly.

Senator MALONE. Complete the record.

Mr. MARTIN. We will be glad to.

(The document referred to follows:)

In December 1952 the BLS Consumer Price Index was 114.1 percent of its 1947–49 average; in July 1957 it was 120.8. In this period, then, average consumer prices rose 5.9 percent. The wholesale price index for all commodities in December 1952 was 109.6 and in July 1957 it was 118.1; this is a rise of 7.8 percent. The index of wholesale prices for commodities other than farm products and foods rose from 112.9 in December 1952 to 125.6 in July 1957, or by 11.2 percent. In other words, the purchasing power of the dollar for city wage-earner and clerical worker families (which is the group to which the Consumer Price Index relates) has declined 5.6 percent in the past 4½ years. In markets for all wholesale commodities the purchasing power of the dollar has declined 7.2 percent, and in markets for wholesale commodities excluding farm products and foods the dollar now buys 10.1 percent less than at the end of 1952. Most of this price increase has taken place in the past 2 years.

Senator MALONE. What do you say it is offhand from 1952 to 1957 at the present time?

Mr. MARTIN. I think it would be 5 percent, about 5 percent.

Senator MALONE. Well, is that 5 years, four and a half?

Mr. MARTIN. That is from 1952 to 1957, which would be 5 years. Most of it is in the period from April 1956 to——

Senator MALONE. It is not 5 years, because 1957 is only half gone. It would be four and a half years, would it not?

Mr. MARTIN. Four and a half years.

Senator MALONE. You say 5 percent?

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Mr. NOYES. Just about.

Senator MALONE. One and a quarter percent a year?

Mr. NOYES. There was practically none from 1953 to 1955.

Senator MALONE. I do not care about that. I am talking about what we have done since we have been here. Is that higher or lower than from 1934 to 1952?

Mr. RIEFLER. It would be lower.

Mr. NOYES. It would be a lot lower than from 1934 to 1952; yes, sir.

Senator MALONE. Well, 1934 to 1952——

Mr. NOYES. Per year—wait a minute; I will have to check that, I cannot figure that that fast, sir.

The index increased from 57 to 113 from 1934 to 1952, and that is——

Senator BENNETT. It is double, if it were 114, it would be exactly double.

Mr. NOYES. It has doubled in 18 years.

Senator MALONE. How much is that a year, then?

Mr. NOYES. About 2 years——

Mr. RIEFLER. It would be double in 35 years, if it were 2 percent, so that it would probably be 3.

Senator MALONE. Two percent; so we cut it to about 1½ percent per year, have we not?

Mr. MARTIN. Right.

Senator MALONE. And it is getting bigger. The last year climbed to 3½ percent. Have you any reason to suppose it is not going to be bigger next year?

Mr. MARTIN. I find these hearings encouraging, of course, as an indication it will not get bigger.

Senator MALONE. Hearings are not going to have anything to do with it unless the top men change their ways.

Congress has nothing to do with the Federal Reserve Board unless they amend the law. That is right, is it not?

Mr. MARTIN. Well, Congress, has a great deal to do with how much is spent by the country.

Senator MALONE. I went all through that once with the Secretary, and if you want to bring it up again, you may do it. The White House dictates what Congress appropriates within 3 percent, according to the 24-year record. We do not have the guts to do anything about it.

Mr. MARTIN. I will take your word for it.

Senator MALONE. No. Look it up, and I will be very happy to have your comment. I have commented on it a good many times on the Senate floor and elsewhere.

Now, can a highly stabilized index of prices rest upon a multitude of economic maladjustments, or would that result in an unstable index of prices?

Mr. MARTIN. I do not know how good our index of prices is, consumer prices.

Senator MALONE. I am talking about the change, not what you use as a foundation or any criterion, and then, of course, that is only a reference.

When you change from 1934 to 1947, why, you are just fooling the public that much more, but it sounds a little better because the deterio-

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ration is less. When you are ready, you can move it up to 1950, and say that compared to 1950 we have an 80-percent dollar, and that will sound even better.

It looks like we are improving it, but we are not, and I believe the public is catching up with you, and if we do something about it soon, there may be blood, political blood, all over the place.

Mr. MARTIN. I hope we will educate the public and they will get it exactly.

Senator MALONE. You do not need to educate the public. They are 10 years ahead of you already—you need to educate the officeholders.

Mr. MARTIN. That is fine.

Senator MALONE. What you need to hold this inflation is a standard—an international yardstick—so that when you trade money with a foreign nation, you trade on grains of gold and ounces of silver.

If you know a better standard than gold and silver, you have not suggested a better way.

Mr. MARTIN. You certainly need standards.

Senator MALONE. Now, you need what?

Mr. MARTIN. Standards.

Senator MALONE. Good. You do, but you have none, do you?

Mr. MARTIN. Well, I think we have got some standards.

Senator MALONE. What are they? I would be very much interested in knowing about them.

Mr. MARTIN. I think gold is a standard.

Senator MALONE. A standard? It is nothing but a commodity now. You are not on a gold standard except with foreigners, after you give them the paper dollars to buy gold.

You print money and give it to them, or give them the credit. Then they can take that credit, or dollars, and come back and get the gold. That is all you do.

You will put me in jail if I have over $100 of it, or any American citizen. That is right; is it not?

Mr. MARTIN. That is right; it is a relationship that you use.

Senator MALONE. What is your relationship, and how do you say you are on a gold standard? I just cannot go for that.

Mr. MARTIN. Well, our relationship is to $35 an ounce, which is an arbitrary——

Senator MALONE. That is right; you buy the gold for that, but you know nobody in the United States can produce it for that, so you are safe. Foreigners can produce it for $35 an ounce. You would, of course, buy Russian gold if it came in? You would buy it, would you not?

Mr. MARTIN. We would buy it, probably.

Senator MALONE. Well, they can produce it at $35 per ounce. I have information for you; they do not pay very much in the way of wages. They are paying about 700 or 800 rubles per month, and that, according to the proper exchange of 16 rubles to the dollar, would be about $50.

Mr. MARTIN. Rubles.

Senator MALONE. Rubles per month, and while it costs me $40 a day to stay at a hotel and eat with my wife, they had a 4-to-1 rate on a dollar, just about as honest as Bolivia, not quite as honest as England, but on the same principle.

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It is worth about 16, which would have made it about $10 or $12 a day, and would have made some sense.

They are eating well, wearing warm clothes.

Mr. MARTIN. The standard of living seems to be rising?

Senator MALONE. Yes. It is so much better than it was under the czars, and much better than it was 5 to 10 years ago. There will be no effective revolt.

Further, no one thinks about it, but the little Balkan countries have never been free. They have been between Turkey, Germany, and Russia about 2,000 years, and if you turned them loose, it is like turning a minnow loose in a catfish pond—it is just a question of which one gets him.

Mr. MARTIN. Right.

Senator MALONE. Turkey controlled Bulgaria for 500 years. Sweden controlled Finland. Poland controlled Moscow. Turkey has overrun the Georgian and Armenian Republics many times in the last 100 years.

They have controlled each other all over these years. So now we are going to furnish plenty of money so everybody is going to eat well and be happy. That is everybody but our own people.

These index prices depend upon a number of factors, do they not, including rate of production, but not on gold at all?

If you want to value your managed dollar, on the weighted price, you might have a drought which would change the relationship, is that not right?

Mr. MARTIN. Well, the price of gold still remains at $35——

Senator MALONE. I am talking about the index prices. Gold price has no effect since you cannot get it.

Mr. MARTIN. Well, the index has to be related to something, and it is related to gold.

Senator MALONE. I agree with you, it must be related to something.

Mr. MARTIN. It is related to the price of gold.

Senator MALONE. No, it is not, except that the price of the dollar is related to the index price, and you will buy an ounce of gold if somebody offers it, even if it is Russia, for $35, but you will not let a citizen of this country have it—so it has no effect on commodity prices. We went all through that, did we not?

Mr. MARTIN. We did.

Senator MALONE. All right.

Then the index, the prices, what are there, approximately 35 or 40 of these commodities?

Mr. NOYES. Much more than that.

Senator MALONE. How many?

Mr. RIEFLER. Well, the Wholesale Price Index now is several hundred; it has been revised.

(The following was subsequently received for the record:)

WHOLESALE PRICE INDEXES

The Bureau of Labor Statistics regularly compiles and issues three measures of price movements in primary markets: (1) The comprehensive monthly index; (2) a weekly estimate of what the monthly index would be if all the prices in the monthly index were collected and tabulated each week; (3) a daily index based on the prices of 22 commodities traded on organized markets or exchanges.

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MONTHLY INDEX

The Wholesale Price Index is a general purpose index designed to provide a continuous monthly series showing price changes, singly and in combination, for all commodities sold in primary markets of the United States. The index is based on a sample covering 2,000 separate commodities.

"Wholesale" as used in the title of this index refers to sales in large lots, not to the prices paid or received by wholesalers, distributors, or jobbers. The price data used in constructing this index are those which apply at primary market levels—that is, the first important commercial transaction for each commodity. Most of the quotations are the selling prices of representative manufacturers or producers, or prices quoted on organized exchanges or markets.

Transportation costs are included in the index only insofar as they are directly included in the primary market price. Usually, prices are selected f. o. b. production or central marketing points, in order to avoid direct reflection of changes in transportation costs in the index. Delivered prices are included only when the customary practice of the industry is to quote on this basis. Subsidies and direct excise taxes are similarly excluded from the index as far as possible; these are not considered part of the "price" as defined above for purposes of the Bureau's index.

New items are not included in the index until they have become established both technologically and in the market. During their first few years of production, the changes in the price of such items may reflect product changes rather than those price changes which the index is designed to measure. In the developmental stage, too, the sales volume of these new items is usually too limited to influence the index appreciably.

In general, the prices used in the index are selected to conform with the concept of seller's net realization per unit of precise specification. As far as possible, the commodities are priced at the focal point of price making. Machinery, therefore, is priced f. o. b. factory; grains on the organized exchanges; fresh produce at central auction markets, etc. Net realization, as defined by market practice, means actual sales of precisely defined commodities, less normal discounts, in approximately similar quantities to similar classes of buyers—it does not mean an average realized value per unit for a range of similar commodities. In other words, net realization means the price for a steel girder of precise size, shape, and quality to a precise class of buyers at a precise shipping point—not for a range of girders, buyers, or shipping points.

The classification system of the Wholesale Price Index is essentially based on products or commodities rather than on industry, source, or end use. It does not exactly match either the Standard Industrial Classification, the Standard Commodity Classification, or the United Nations Commodity Classification. However, regroupings of the current classification can be made which will closely approximate any of these three classifications. The basic index is divided into 15 major groups and 88 subgroups.

The index can be recomputed in accordance with other classification systems. A special regrouping for market analysis developed by the Federal Reserve is published in the Board's monthly chart book. As currently constituted, the indexes shown are, in effect, summaries of the rather detailed "economic sector" indexes which were recently developed by the Bureau of Labor Statistics.

As in all official United States index measures, the base period for the Bureau's Wholesale Price Index is the average of of 3 years, 1947, 1948, and 1949. The basic weights for the index are total transactions as reported in the Census of Manufactures for 1947. Data for agricultural and extractive industry products were obtained from the Agriculture and Minerals Yearbooks for 1947; import data cover the year 1947, as reported by the United States Department of Commerce.

It is the intention of the Bureau of Labor Statistics to review the entire weighting pattern approximately every 5 years. Benchmark data from the 1954 Census of Manufactures will be utilized when it becomes available. In 1955, BLS introduced revised weights based largely on the limited information of the Census of Manufactures Annual Surveys. In addition, the BLS reviews detailed weights within the product classes and whenever necessary introduces new weights at the beginning of any year. New weights are not allowed to affect the level of the index in the month in which the change is made, and index users are notified of changes; an overlap index using the old weights is computed in order to measure the effect of the new weights. Beginning with the final Wholesale Price Index for January 1955, weights are based on the average of the estimated dollar values of primary market transactions in the years 1952 and 1953.

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The relative importance of the major groups of the Wholesale Price Index in December 1954 based on the latest weighting structure is shown in the following table.

Composition of Wholesale Price Index

Group	*Relative importance, December 1954*
All commodities	100.0
Farm products	10.8
Processed foods	13.7
Textiles and apparel	8.3
Hides, skins, and leather products	1.4
Fuel, power, light materials	9.0
Chemicals and products	6.5
Rubber and products	1.8
Lumber and wood products	2.7
Pulp, paper, and products	3.7
Metals and metal products	13.6
Machinery and motive products	17.1
Furniture and household durables	4.1
Nonmetallic minerals	2.1
Tobacco manufactures and bottled beverages	2.4
Miscellaneous	2.8

WEEKLY INDEX

The weekly index represents the Bureau's best estimate of what the comprehensive index would be if all 5,000 individual quotations for the approximately 2,000 series were collected each week, and if the complete index were calculated. The weekly index is based on actual prices for fewer than 200 commodities and estimated prices for all others. It is calculated as a percent change from the latest monthly index and converted to index form for publication. As soon as a comprehensive index is published for any month, all weekly indexes falling in that month are replaced by the monthly index. No attempt is made to maintain a continuous series by correcting these indexes.

DAILY INDEX

The Bureau of Labor Statistics, as part of its general program for maintaining the currency of its various price indexes, maintains a daily index designed to measure the price trend and movement of these commodities which, as a result of daily trading in fairly large volume of standardized qualities, are particularly sensitive to factors affecting spot markets and trade's estimates of current and future economic forces and conditions. The daily index is based on the prices of 22 commodities, including 9 foodstuffs and 13 industrial materials.

Senator MALONE. What is the other index?

Mr. RIEFLER. The cost-of-living index. I do not know, they have a great many prices in there.

Senator MALONE. You are going to give me both of them for the record?

Mr. RIEFLER. Yes.

Senator MALONE. I am glad it was mentioned, and how it can be changed.

Mr. RIEFLER. But they have added commodities to them over the years.

Senator MALONE. And how you change it by adding commodities from time to time. How often do you make this computation, maybe once a year or twice a year? Whenever you do?

Mr. MARTIN. Right.

Senator MALONE. But the index of those prices, whatever those commodities are, is affected by a lot of things besides any price of gold or anything else, are they not? I mean, their production, the

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amount and rate of production, and general economic conditions are involved?

Mr. MARTIN. Yes, indeed.

Senator MALONE. Many factors?

Mr. MARTIN. Many factors.

Senator MALONE. That is right.

Now, is not the concept of economic equilibrium a better criterion as to the proper trends of an economic system than is a sustained economic growth? In other words, is there not a better concept, is not the concept of economic equilibrium correct, to let there be a gold standard, or something back of it, so an American can share in it? Would it not be better than trying to follow the will-o'-the-wisp of an index price that is affected by so many factors?

Mr. MARTIN. Well, it is just a measurement that we use.

Senator MALONE. I know that. But what you are trying to do, and I asked you that first, what you consider the objective to be, and you said you judged the amount of money in circulation to sustain economic growth.

The objective of the system is always the same, you said, to promote monetary and credit conditions that would foster sustained economic growth, and establish the stability in the value of the dollar. I hope we do not have to cover that again. It has nothing to do with the index. You have tied a managed economy to the managed currency.

The index is probably the result, but whether conditions, and working conditions, are involved. There are so many other factors, too, are there not?

Mr. MARTIN. There are.

Senator MALONE. You are going to tell us why you are trying to manage the economic system as well as the currency, under what authority, and whether the Federal Reserve Act gave you that authority.

Mr. MARTIN. Right.

Senator MALONE. Now, you have said that price stability is essential to that sustained economic growth.

Now, is not the nature of business expansion such that prices tend to rise, particularly if the expansion follows a business recession or a depression?

Mr. MARTIN. Yes, there is—I think you are trying to get the maximum stability here. This is not a precise mathematical formula.

Senator MALONE. Here is where you and I part company, and I want you to know that for the record.

Mr. MARTIN. Yes.

Senator MALONE. And that is Congress should set down a principle under which its citizens may operate. Then they according to their individual judgment, can invest their money, sell their property or stock and do anything they want to do with their money and time. Cumulatively then the judgment of 160 million people, maybe 170 million now, their collective judgment would, in that event, determine the economic structure and conditions, if it were based on a principle of law and not the judgment of one man or of seven men—to change the rule while the ball is in motion, would it not?

Mr. MARTIN. In the overall.

Senator MALONE. Yes.

Mr. MARTIN. Yes.

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Senator MALONE. What we are doing, we have one man sitting here as chairman of the Federal Reserve Board who is judging and making decisions on how much money ought to be in circulation at a given time, for something he is pleased to call "sustained economic growth"—when that very objective may not be compatible with the real objectives of the Board, stability in the value of the dollar.

Is that not a cause for instability in business rather than stability, because after he has invested his money on his own judgment on a principle, then you change the rules while the ball is in motion, and he is dead?

Mr. MARTIN. I do not think we are very far apart, Senator.

Senator MALONE. Well, I am against anybody, any one man, or any seven-man board, having the authority to turn the managed currency into a managed economy—and nail down all the "safety valves" of a free competitive economy.

If a principle is adopted by Congress as to the amount or percentage of gold or silver behind the money, any citizen can read and judge his business accordingly. Let the market be the barometer with the principle of law behind it. However, under present conditions you invest your money, then the Chairman of the Federal Reserve Board, here in Washington, says that more or less money must be put in circulation and the interest rate changes and breaks him. He could make a profit paying 4 percent, but he is broke paying 5 or 6 percent.

So the man in Washington thinks it would promote stability of industry if he would print another $1 billion; so he puts it out. That is what you have testified to.

Mr. MARTIN. But if he prints another $1 billion, and thereby depreciates the currency——

Senator MALONE. That is what you are doing; is it not?

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

Senator MALONE. Well, it has depreciated 53 percent in 24 years.

Mr. MARTIN. No, I think we are supplying some additions to the money supply for growth in the economy, but I do not think we can hope to have stability if we do not recognize what the price relationships are.

Senator MALONE. You are managing the economy as well as the currency. Who is "we" in that regard?

Mr. MARTIN. Well, I mean everybody. I do not mean the Federal Reserve Board here or the Congress.

Senator MALONE. You are the one who does it; are you not?

Mr. MARTIN. No.

Senator MALONE. Who does it? Who recognizes this great factor that you need another $1 billion in circulation——

Mr. MARTIN. I think——

Senator MALONE. Under the law?

Mr. MARTIN. Well, under the law we have the responsibility for managing the money supply.

Senator MALONE. You have the responsibility of reducing it or increasing it; do you not?

Mr. MARTIN. We have the responsibility.

Senator MALONE. Because you think that in 1946, they added a law that added to the Federal Reserve law that allows you to judge the amount of money they need in circulation to expand industry; do you not?

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Mr. MARTIN. No. I think we had the authority before 1946.

Senator MALONE. But anyhow you have that authority now coupling the two acts?

Mr. MARTIN. Right.

Senator MALONE. If you judge the monetary system, the business system—economic system of the country needs $1 billion more of printed money or $2 billion more, $1 billion less or $2 billion less, you can do that, can you not?

Mr. MARTIN. That is what a managed currency system is.

Senator MALONE. You are in favor of it?

Mr. MARTIN. Yes. I think the history of the 1860's, the 1870's, the 1880's, during which the people finally agreed to accept the hazards of a managed currency in the Federal Resreve Act, were such, I think we ought to put all the safeguards we can around the exercise of those hazards, but you and I disagree as to whether they are necessary.

Senator MALONE. The Federal Reserve Act was passed in 1913; and there is evidence that many people who thought the Federal Reserve Board was good in the beginning changed their minds, but too late. I do not say there should not be a Board as yet—but they certainly should not manage the economy.

I am trying to complete this record so we can study it.

Mr. MARTIN. Right.

Senator MALONE. There will be 15 Senators sitting around the table discussing the evidence after it is all in.

I will be one of them.

Mr. MARTIN. And if we should not be in existence, why, I am the first one——

Senator MALONE. Right now you raise considerable doubt whether you should be.

Mr. MARTIN. Well, it is entirely your prerogative to have those doubts.

Senator MALONE. It is. You just answered the question to my satisfaction that you now have the power to judge the adequacy of the money supply in circulation, and that you can regulate it, reduce it, or increase it in accordance with what you think may be the future demands of the economic system.

Mr. MARTIN. The Congress gave us that authority and the Congress can take it away from us.

Senator MALONE. That is right. That is just what I wanted to know.

Congress, of course, is to blame. They are to blame for free trade, "funny money," and billions to Europe. They can blame nobody else. You cannot blame the White House, because the Constitution does not say that Congress, not the White House, has the power to appropriate money.

The Constitution says that the President shall report to the Congress the state of the Nation; that is what it says.

Mr. MARTIN. Right.

Senator MALONE. And it does not say he shall write any legislation. It does not say that you have to vote for anything he sends up here. That is something thought up during the last 24 years. That was not thought up under our administration, but we just have not had the guts to stop it.

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You have also stated here in the prior record, that the price stability is essential to sustainable growth.

Now, in the nature of business expansion, such prices do tend to rise, particularly if expansion follows a business recession or depression.

I asked you something about that before, but do you believe that the Congress of the United States, and the Federal Reserve Act of 1946 gave you full authority to judge, through your own Board as to the amount of money in circulation, needed to support what you called substainable economic growth?

Mr. MARTIN. I think that the Federal Reserve Act, and the Employment Act, both, gave us that authority. I think we have a managed currency, and the Congress can take it away if they want to.

Senator MALONE. And you have parlayed a managed currency into a managed economy. I am glad you are throwing it back in our teeth. You can document it, as you said you would.

You also have said that inflation is the rising cost of living. Of course, we just generally make that remark. But why confine the inflation to a rising cost of living, rather than apply it to a rise in prices in general, as measured by the index of so called wholesale prices?

If inflation is to mean a rise in the cost of living, why not use those words, the latter words, and discard the confusing word "inflation"?

Is that clear what I am trying to ask you?

Mr. MARTIN. Not quite.

Senator MALONE. Let me go over that again.

Now, what do we call it? We call it inflation, and it covers a multitude of sins.

That means when you buy a pound of meat, that should cost 50 cents a pound and it costs $1.25, and the wages are not quite up to it that is an example of the cost of living.

We are living on a war economy now. That is the way we are holding our standard of living.

$40 billion a year, $37 billion for the national defense spending, and $3 billion or $4 billion or $5 billion, to go to foreign nations to buy our goods. It is a good system, as long as somebody can pick up the check, but folks at home are getting tired of it.

Now, this rising cost of living, why confine it then to inflation? Why don't we just call it, just use the rising cost of living so as to indicate what the dollar is worth?

Mr. MARTIN. I think that is perfectly proper.

Senator MALONE. You also indicated, or seemed to imply that savings should equal investment demands.

So long as the banks operate on a fractional reserve system, can an investment properly exceed savings, so long as the borrowers repay the loans when they mature? Just what did you mean that the investments must equal the savings, if you did say that?

I have read the record you made.

Mr. MARTIN. I did not say that it should equal.

Senator MALONE. The investment demands, as I understood——

Mr. MARTIN. But I said you should not use bank credit, which is using new money to replace, to take the place of a deficiency of savings when it comes to long-term investment.

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Senator MALONE. Why shouldn't you, if I suddenly make up my mind to go back into business, and I am able to go to a bank and can sign my note to borrow $10,000, why could I not invest that in my business again? What is the matter with it?

Mr. MARTIN. Well, I think the simplest way of putting it is the difference between long-term capital and short-term capital.

The banks, the commercial banks of the country are in business, they receive your deposits, as well as create deposits by making loans to you, and they should not be using short self-liquidating paper. They should not be using it to put up a factory or a building that will require 20, 25 years to pay out. That should come out of savings.

Senator MALONE. That may be true, but suppose amortization payments take care of it—you are familiar with amortization?

Mr. MARTIN. That is right.

Senator MALONE. As all engineers and lawyers are—suppose we put up a plant that is going to take 25 years at 4 percent a year, and you know we are going to pay 4 percent, or 3 percent interest, the bank is willing to loan that money to me, or any other citizen, with proper safeguards, like other signatures to the note. What is the matter with it?

Mr. MARTIN. I do not think that is what the bank is for. I think you ought to go to the capital market and sell some bonds. If you want to engage in that type of activity, I think that when the bank is using the deposits of all of us, and I think that it has to be in business to turn this money over, I think what we are trying to do here is to get some capital, which is capital formation, which comes from the flow of savings.

Senator MALONE. All right.

Suppose I have good credit, I have savings of 25 percent, or whatever it is, back of this business. What makes your statement hold water that you should not loan a man money when they know they cannot lose on the loan, that they have their notes secured?

Mr. MARTIN. You will get that money in the capital market.

Senator MALONE. I used to build roads, and I would get a bond, maybe I did not have that much property, or did not have savings, and I had to put up bond for $150,000, then other signers of the bond would make it safe.

What is the matter with it?

Mr. MARTIN. I do not say that it matters. I say there is a limit beyond which you cannot stretch bank capital, and you can get this money, and we have in this country—we are very fortunate in this country in having a good capital market, a well-developed capital market.

Senator MALONE. It is better since they found out if they leave it in the bank it decreases in value every year; does it not?

Mr. MARTIN. The capital market?

Senator MALONE. Yes.

Mr. MARTIN. I think——

Senator MALONE. It would encourage people who sell securities, because investors know they are going to lose money if they leave it in the bank.

Mr. MARTIN. It is because we do not want you to lose money if you leave it in the bank that we do not want the banks to engage indefinitely——

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Senator MALONE. Who is "we"?

Mr. MARTIN. I am talking about everyone.

Senator MALONE. You are talking about the Federal Reserve that does not want people to do that; are you not?

Mr. MARTIN. No, I am talking about a whole community.

Senator MALONE. Did Congress say that in the act?

Mr. MARTIN. Congress has not spelled out short-term and long-term capital, but I think it is implicit in the Federal Reserve Act.

Senator MALONE. Tell me how?

Mr. MARTIN. I am going to tell you in this statement how, but I think the statement today——

Senator MALONE. I understand that, and that you have the authority to keep the banks from making a safe loan on that basis, so there is no chance of losing a depositor's money at all, whether it is 10 days or 10 years.

But I referred you to a job, because I have gone through it many times, and I did not have the money to put up a bond, but somebody thought I knew how to build the road, and they were willing to sign it, and they had the property, so they knew it was going to be done.

So what happened? The money was there. Whether it was $100,000, $200,000, $50,000, or whatever it was, it was there. What is the matter with it?

Mr. MARTIN. Supposing all the banks of the country had nothing but 20-year loans? Where would they get the money to pay off the deposits?

Senator MALONE. No bank would endanger its position. Leave something to the bankers' judgment.

I am talking about allowing the people collective judgment to control the market for money on principle.

Mr. MARTIN. I think the people are running the market on a principle.

Senator MALONE. The people are waking up. they may be doing just that relatively soon.

Mr. MARTIN. Fine. I want it, too, Senator.

Senator MALONE. What you are telling me today is you do not want these banks to make these safe loans on their own judgment, but you, as Chairman, can determine whether the economic system needs $2 billion or $5 billion, or $10 billion more or less money for what you believe, in your judgment, after the evidence is all in, just like the Secretary of the Treasury fixing the interest rate, after the evidence is all in, you make the decision; do you not?

Mr. MARTIN. We have today in this country a managed currency, and the Congress has authorized and approved the Federal Reserve Act.

Under the Federal Reserve Act——

Senator MALONE. Answer my question.

Mr. MARTIN. That is the only way I can answer it.

Senator MALONE. "Yes" is the answer; is it not?

Mr. MARTIN. "Yes" is the answer, exactly.

Senator MALONE. Of course. That saves our time.

That is a 7-man Board, you told me, and you are the Chairman, and if I hear right, that 7-man Board goes along pretty well when you decide.

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Mr. MARTIN. You do not hear right, then, Senator. [Laughter.]

Senator MALONE. I heard the Secretary of the Treasury here, and I have heard a good deal of testimony and I have been watching you for a long time at a distance, and for about 11 years pretty closely, but you do have the authority to judge what the industrial structure of, the economic structure of this country is going to need for its proper future growth, and issue the money that you consider necessary; do you not?

Mr. MARTIN. We have, under the Federal Reserve Act, taken into account the needs of commerce, industry, agriculture, for money, and we have a responsibility to manage the money supply.

Senator MALONE. And the Treasury has the right to fix the interest on Government bonds and you have the right to fix the amount of money in circulation?

Mr. MARTIN. No. We and the Treasury together have to use the market, which is made up of the thousands of individuals in this country, as to whether they will or will not——

Senator MALONE. I hope you do not tear down what the Treasury finally, after about half an hour, said, "Yes," to "Are you the sole judge of what interest should be fixed on these bonds?" Mr. George Humphrey finally said he was the sole judge.

The Secretary of the Treasury said he received information from many places and people, but he was the sole judge, and you have already affirmed that. That is right; is it not?

Mr. MARTIN. But supposing his judgment turns out to be wrong, then he does not sell them?

Senator MALONE. All right. He does not sell them. His judgment is bad, but nevertheless it is his judgment alone in the final decision?

Mr. MARTIN. He exercises judgment, but if he fails——

Senator MALONE. He may be out of a job.

Mr. MARTIN. He is out of a job; that is right.

Senator MALONE. He did fail to stop inflation and he is gone. However I think he did well with the bad deal we took over when he came in.

Mr. MARTIN. He did very well.

Senator MALONE. I would rather you did not make a speech now, because I am going to stay here until you answer these questions.

Mr. MARTIN. I will stay here all night, Senator.

Senator MALONE. I know you will.

It is his sole judgment as to what interest finally, after he has asked you, if he wants to, and everybody else he wants to ask, but he finally fixes that 5, 4, 3, 6 percent or whatever it is, on an issue of bonds, does he not?

Mr. MARTIN. It is his sole authority to place——

Senator MALONE. That is right.

Mr. MARTIN (continuing). To place on the Treasury issue a rate.

Senator MALONE. Now that is settled again. It is you and your seven-man board who have the sole authority, after all of the factors you take into consideration are completed, as to how much money should be in circulation?

Mr. MARTIN. To regulate the money supply.

Senator MALONE. You are the sole judge?

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Mr. MARTIN. Well, the Federal Reserve System has the responsibility of managing the money supply.

Senator MALONE. I do not care how long you stay here. Unless you answer the question as to whether you have the sole authority to fix the money supply.

Mr. MARTIN. I said that the Federal Reserve System.

Senator MALONE. Yes. That is good enough. That is very much to the point. The Board has the final say.

Now, you said, you referred to, the current demand pulls, the cost push of rising prices. I do not understand that too well.

Is it not a simple fact in economics that prices, except when fixed by Government, are the result of forces of both supply and demand?

Mr. MARTIN. They are.

Senator MALONE. What are these demand pulls, and cost pushes that you use? They are new to me.

Mr. MARTIN. Those are phrases that I thought were descriptive, and I said earlier that I do not think it makes any difference whether it is the wage push or the cost push or the price push. It is the interaction of costs and prices, which is the factor that makes for inflation.

Senator MALONE. Now, then, Mr. Chairman, what you probably mean is the law of supply and demand, if allowed to operate.

Mr. MARTIN. I will not quarrel if you want to discard those phrases.

Senator MALONE. That is much better.

The factors are supply and demand, which, if left alone, will take care of it.

Mr. MARTIN. That is right.

Senator MALONE. The facts are now, however, with $37 billion a year, we are buying much of the American output, much of which would be on the civilian market, for national defense; are we not?

Mr. MARTIN. We are buying a great deal of this material.

Senator MALONE. Sure we are; and, therefore, we have what you might call a synthetic market and the supply and demand in civilian life is completely upset.

Mr. MARTIN. There is no question of the fact that we have this large armament plan——

Senator MALONE. We are living on a war economy. We have not let the water settle in 24 years—starting with WPA; WPA in the early thirties. It merged into World War II, then Korea, and simultaneously the worldwide "WPA" starting with the $3¾ billion loan to England, the Marshall plan, and preparation for war.

Mr. MARTIN. All right. War economy means that there are no offsetting civilian goods for the purchasing power that is created through those expenditures.

Senator MALONE. That makes it a little complicated, but I think your statement adds up all right. In other words, if suddenly starting tomorrow we stopped spending national defense money for 60 days, what do you think would happen in this country?

Mr. MARTIN. I do not know. If you had a sudden cessation of—we have gone through this—a sudden cessation on anything in the spending stream——

Senator MALONE. Not on anything. I am talking about the $40 billion we are sending abroad and spending here for national defense, half of which we are wasting maintaining foot soldiers in 73 nations

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throughout the world, 5 air corps, and terriffic waste in other departments. But the $40 billion a year that we are putting out for goods, if you quit spending it, what do you think would happen?

Mr. MARTIN. There would be a decline in business and an adjustment in business.

Senator MALONE. You think there would be just a decline and just an adjustment?

Mr. MARTIN. I think we would absorb it. It depends upon how long you are going to do it and it depends upon how permanent the operation is.

Senator MALONE. Well, according to the Secretary of State, he wants the billions of taxpayers' money to Europe and Asia to be permanent, all the taxpayers' money all over the world, a division of the wealth, presumably to the point where the nations of the world are living alike, including the United States.

Of course, when I think that out of the 2.5 billion people in the world, we have 170 million or thereabouts, that to distribute our wealth is like pouring a glass of water in the city reservoir, that is about what it is like; don't you think?

Mr. MARTIN. I think there is some of that element in it, but the point you are making about dropping $40 billion out of the spending stream at any given time means a dislocation in the stream.

Senator MALONE. That is right. It would just be a question of the extent of the dislocation.

Mr. MARTIN. That is right, in my judgment.

Senator MALONE. And it might be pretty severe, might is not?

Mr. MARTIN. It could be pretty severe if it came in one big drop.

Senator MALONE. Well, if it came in a year or 2 years, it could be very severe, could it not?

Mr. MARTIN. It could be very severe in that time.

Senator MALONE. Couldn't it result in a panic?

Mr. MARTIN. It could; yes. If you dropped that amount out, it could. It is very difficult to make adjustments in a spending stream of that magnitude that quickly.

Senator MALONE. Now, in another place you said that aggregate demand is in excess of the aggregate available of these resources at existing prices. What is the effect?

Mr. MARTIN. That is why prices are going up.

Senator MALONE. How is the general law of supply and demand going to operate and control when someone is sitting at the top in Washington judging if you need another billion dollars in circulation or take a billion out of circulation which may at any time dislocate the whole principle of the law of supply and demand.

Mr. MARTIN. If we managed this money supply reasonably well we won't be precise in it. You will find that supply and demand on the edges will always be perfectly apparent.

What would be happening if we were supplying more money than has been supplied to the extreme today we would have a substantially greater increase in prices than we have had, and it would therefore be much more apparent to everyone than it is now, and it is already apparent to you, Senator, that we have inflation which is reducing the purchasing power of the dollar.

Senator MALONE. That is a matter of judgment.

Mr. MARTIN. That is right.

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Senator MALONE. I am not judging that part of it now. I am trying to clarify the record. If Congress laid down a principle like it did 180 years ago and the principle carried through 1933, that a definite adequate percentage of gold must be behind the issued currency, 40 percent for a long time, then individual citizens could judge what to do?

Mr. MARTIN. Until 1945 it was 40 percent, and in 1945 it was reduced to 25 percent.

Senator MALONE. It was a little later than 1945; wasn't it?

Mr. MARTIN. No, it was in 1945. I will check it.

Senator MALONE. 1945; you are correct. I thought you meant the same time we went off the gold standard. You are correct about the time the gold reserve was reduced.

Mr. MARTIN. Right.

Senator MALONE. Didn't we then abandon the only principle we ever had that 40 percent in gold must be behind the currency?

Mr. MARTIN. From the start of the Federal Reserve Act to 1945——

Senator MALONE. To 1945?

Mr. MARTIN. It was 40 percent against notes and 35 percent against deposits and it was changed in 1945.

Senator MALONE. To 25 percent?

Mr. MARTIN. Right.

Senator MALONE. Because we were running short of gold?

Mr. MARTIN. That is right.

Senator MALONE. If we keep shoveling out the gifts in money to foreign nations we are headed for another reduction to 10 percent or less one of these days; are we not?

Mr. MARTIN. I hope not.

Senator MALONE. The testimony looks bad; doesn't it?

Mr. MARTIN. I don't think it looks as bad as you think.

Senator MALONE. We established the amount of gold we can rightly call our own. If the demands are made for gold in the regular manner by foreign-dollar balances and you paid it out as you customarily do, and you say it would be a debacle, probably a depression, if you stopped such payments; the foreign-dollar credits outstanding, you would have under $6 billion of gold in the Treasury of the United States.

Mr. MARTIN. That is right.

Senator MALONE. It is anybody's judgment as to what these so-called allies might do if and when they suddenly decide that their interests have changed. That happens every few days in Europe and Asia—you are aware of these changes; aren't you?

Mr. MARTIN. I am.

Senator MALONE. Anyway, to clear the record, you had the 40 percent of gold behind the currency from the time the Federal Reserve bank was created in 1913?

Mr. MARTIN. That is right.

Senator MALONE. What principle of banking utilizing gold was in use prior to that time?

Senator MARTIN. Prior to 1913?

Mr. MARGET. May I answer this question?

Senator MALONE. Yes.

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Mr. MARGET. We had no central banking system prior to that, and the only type of banking that was under national legislation was the national banks. We had no central bank. The backing of the currency then was basically certain specified issues of Government bonds except for a small cash reserve.

Senator MALONE. There was no gold required at all?

Mr. MARGET. The gold certificates of course always were in the System. Gold certificates were issued against gold which was sold to the United States Treasury.

Senator MALONE. Did you have to have hundred percent gold for each gold certificate?

Mr. MARGET. Yes, sir.

Senator MALONE. What percentage of the money issued was gold certificates?

Mr. MARGET. I would have to look that up as of 1913.

Senator MALONE. Would you do that for 25 years before 1913?

Mr. MARGET. Yes, sir. We can do that.

(The following was subsequently furnished for the record:)

Percentage of total currency in circulation consisting of gold certificates for 25 years before enactment of the Federal Reserve Act

June 30—	Total currency in circulation (millions)	Gold certificates in circulation (millions)	Ratio (percent) of gold certificates to total currency in circulation	June 30—	Total currency in circulation (millions)	Gold certificates in circulation (millions)	Ratio (percent) of gold certificates to total currency in circulation
1889	$1,380	$117	8.48	1902	$2,279	$306	13.43
1890	1,429	131	9.17	1903	2,400	377	15.71
1891	1,497	120	8.02	1904	2,553	466	18.25
1892	1,601	141	8.81	1905	2,623	485	18.49
1893	1,597	93	5.82	1906	2,775	517	18.63
1894	1,661	66	3.97	1907	2,814	600	21.32
1895	1,602	48	3.00	1908	3,079	783	25.43
1896	1,506	42	2.79	1909	3,149	815	25.88
1897	1,641	37	2.25	1910	3,149	803	25.50
1898	1,838	36	1.96	1911	3,263	930	28.50
1899	1,904	33	1.73	1912	3,335	943	28.28
1900	2,081	201	9.66	1913	3,419	1,004	29.37
1901	2,203	247	11.21				

Source: Banking and Monetary Statistics, published by Board of Governors of the Federal Reserve System.

Senator MALONE. My point is, to build this record, that until 1933 a gold certificate and a silver certificate, if we had them, was redeemable in gold and silver?

Mr. MARGET. Yes, they were.

Senator MALONE. You could go to a bank and get the silver or the gold coins?

Mr. MARGET. Yes. Either the bank or the subtreasury would give them to you. This is prior to 1933, sir.

Senator MALONE. You could get the hard money, the gold or the silver?

Mr. MARTIN. Right.

Senator MALONE. Then people had confidence in their money system—you could get a $20 gold piece for a gold certificate, if you had the money, and rub a couple of them together in your pocket and you felt like it was good United States money.

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Mr. MARTIN. You have a lot of them out in your country still?

Senator MALONE. Not gold pieces.

Mr. MARTIN. Silver dollars?

Senator MALONE. They give you the paper stuff and you can get no gold at all—and silver for only a part of it. It is nothing. It promises to pay you—and you testified to it, just another piece of paper. Yet you can put out another billion of it if you believe it is needed for "sustained economic growth."

Mr. MARTIN. That is right.

Senator MALONE. So there is really nothing behind the money but promises to pay in more paper and you are the judge as to how much paper is to be in circulation. An American citizen cannot get gold and can only get silver for silver certificates.

And you also know that foreign nations can get the gold with the dollar balances built up through gifts of taxpayers' money. If an American citizen takes any of their money now, he cannot get the corresponding grains of gold and ounces of silver represented. Up to 1933 he knew he could do that. We don't know that now, do we?

Mr. MARTIN. We still have a currency that is based on metal, on gold.

Senator MALONE. On what?

Mr. MARTIN. On gold.

Senator MALONE. In these foreign countries?

Mr. MARTIN. I am not talking about foreign countries.

Senator MALONE. Our currency is not based upon gold when you cannot get gold for it. However, I am talking about dealing with an individual in a foreign country. I deal with him, I go to his country and I give him some American money or I give it to the customhouse or I give it to the bank. I get a piece of paper in return, a rag or piece of metal; it represented before 1933 a certain number of grams of gold or ounces of silver.

Mr. MARTIN. Right.

Senator MALONE. I could come back to the United States with pieces of foreign paper and go to a bank and they might take it at a severe discount. You know what you can do with the paper money of most foreign countries now. I could tell you, but it might not look nice in the record.

Mr. MARTIN. There are different types of paper money from abroad. I brought back some Swiss francs the other day and I converted them in New York.

Senator MALONE. You can do that. The Swiss have been smart. They have a little more horsesense. I might as well let you answer this now. Do you have any way of knowing how many numbered investments and how much money is represented, brought into the United States in Swiss francs and invested in American stock?

Mr. MARTIN. No, I don't.

Senator MALONE. Does anybody know?

Mr. MARGET. The Federal Reserve bank acts for the Treasury in trying to get figures with respect to investments here, but we are not able to go beyond any information that the Swiss choose to give us. You may know that we provided some answers just on that point; perhaps we might insert that in the record.

Senator MALONE. I remember that. I am coming to it again because the Secretary of the Treasury said you would have to get the

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rest of the information from the Chairman of the Federal Reserve Board. I have a long memory.

Mr. MARGET. When the vice chairman of the Federal Reserve Board, Governor Balderston, was testifying before another committee.

Senator MALONE. I did not sit with that committee.

Mr. MARGET. We can provide for this committee, sir, the answer to the questions on that point.

Senator MALONE. What was the question?

Mr. MARGET. The question was, What role does the Federal Reserve System play in collecting information with respect to investments——

Senator MALONE. Can you demand that information from any reliable source?

Mr. MARGET. Well, we simply ask the banks and the brokers who handle those things to give us the information, and we cannot go beyond what they choose to give us.

Senator MALONE. If they do not choose to give it to you, you can not get it?

Mr. MARTIN. No, sir.

Senator MALONE. I wish you would expand on this, Mr. Chairman. Do they handle their deposits, from which these investments mainly are made in numbers and not names, so that all you know is a number?

(The following was later received for the record:)

The statement of the Vice Chairman of the Board of Governors of the Federal Reserve System, Mr. Balderston, has been published on pages 95–97 of the hearings before a subcommittee of the Committee on Banking and Currency on S. 594, S. 1168, and S. 1601 (May 22, 1957).

Mr. MARTIN. I think that is correct.

Senator MALONE. You can't get the name of the depositor?

Mr. MARTIN. We can't compel the Swiss to give us that.

Senator BENNETT. Just for the record as a member of the Banking and Currency Committee, we have verified this situation. The Swiss banks are forbidden by law to reveal the name of anyone having an account in a Swiss bank.

Senator MALONE. I knew that. I wanted the Chairman to say it for the record.

Mr. MARTIN. I do, indeed.

Senator MALONE. They have sense enough to protect their own economy and as a result of that law and many other protective devices their franc is worth par or more and may be worth a good deal more even in dollars before we are through?

Mr. MARTIN. It is a very strong currency.

Senator MALONE. There is something else we all know, we just do not know the extent of it. Every dictator in the world, everybody who thinks he might have to move out fast and maybe a good many people of the United States who have more confidence in Swiss money than United States currency, have money in those banks; isn't that right?

Mr. MARTIN. That is right.

Senator MALONE. They have been smart enough to stay out of every war and become a depository, a central banking system for all people, including the dictators and kinds who are liable to have to make a quick move.

Mr. MARTIN. They have become the depository for the world.

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Senator MALONE. They are smart and they are always neutral. They know nobody will drop a bomb on them because they would destroy the money they have deposited there; isn't that about right?

Mr. MARTIN. I don't know that.

Senator MALONE. You have told me enough to show that you do know it.

They are smart enough to stay out of these cock-eyed trade wars in Europe that have been going on for 2,000 years. We got into one in 1917. That was my war. We went in on England's side in a 40-year trade war with Germany. We have utterly and completely destroyed the only nation on two different occasions that could hold Russia in check. We do not need a pound of anything through the Suez Canal. We can produce everything we need in the Western Hemisphere we need for war and peace. But what we need to know about our own system now is whether it is good to have one man sitting in Washington at the head of a Federal Reserve Board determining whether the business in Nevada or New Jersey or any other State should have more or less money in circulation for what he is pleased to call "sustained economic growth," or whether there should be a principle by law such as we had before 1933. People can read and understand a principle set down by law.

They can then invest their money on their own judgment of conditions without having a bureaucrat making a decision in Washington, destroying them while the ball is in motion. The record in this investigation should help. Do you think it has any merit?

Mr. MARTIN. I believe in free enterprise.

Senator MALONE. Of course you do. But we do not have it any more.

Mr. MARTIN. I think the Congress decided—and I think they were wise in it—that the growth of this country required some management of the money supply, that money would not manage itself.

Senator MALONE. I understand what you think. The Federal Reserve Board has very clearly parlayed managed currency into a managed economy. Congress can do something about it should we so decide, and that is what this hearing is about. Personally, the more I see of Washington, the less authority I want here to make arbitrary decisions.

What I like to see is a principle established by law, then if a business does not work out under that principle after a citizen has invested his money, time, or work, he will take it. But it is bitter medicine to have it destroyed from here by the decision of an allwise officeholder. That is why I am in the Senate because I did not believe in a lot of the managed economy and international division of the taxpayers' money that Washington has been conducting for 24 years.

Mr. MARTIN. I think the responsibility of managing the money supply is a very real one and a very important one.

Senator MALONE. I think it should be done on a principle, not the judgment of one man. You cannot stop with a managed currency, it continues into a managed economy.

Mr. MARTIN. I think we are trying in the Federal Reserve to operate it on a principle.

Senator MALONE. No, you are trying to do what you have testified you were permitted to do under the act, and that is to judge how much money ought to be in circulation for a sustained economic growth,

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which is a very different thing. The amount of money in circulation determines its value; you agree with that, do you not?

Mr. MARTIN. In accord with the principle of the laws of supply and demand, we don't think we can force values or make values.

Senator MALONE. My friend, I have news for you. Anybody that is able to judge the effect of the law of supply and demand ahead of time is a rich man. He does not have to hold some funny job. That is where we leave the track. People buy and sell stock on their judgment of the supply and demand; don't they?

Mr. MARTIN. They do.

Senator MALONE. And they take into consideration somebody might be promoting it, so they buy a herd of cattle or steers to feed and they take a chance that they are going to make money. But if somebody in Washington decides there is too much or too little money in circulation and breaks the market, he is broke. Maybe the judgment of the buyer was right, but his judgment would not mean anything in the face of Washington juggling the money supply.

Mr. MARTIN. I think you have it out of perspective.

Senater MALONE. It could be, but investors in mining, livestock, and general producers cannot anticipate what a man in Washington may do.

Mr. MARTIN. That is all I am trying to comment. The Congress has placed a very real and very important responsibility on the Federal Reserve for managing the money supply.

Senator MALONE. That we know, but it did not stop there——

Mr. MARTIN. Maybe they were unwise in doing that?

Senator MALONE. I think they well may have been.

Mr. MARTIN. But it is here. We try to exercise the authority which the act gives us and we believe we can only be successful in exercising it, when we recognize that the law of supply and demand is operating and we don't try to——

Senator MALONE. Now my friend, you know that I realize that what you say is true, and I believe you to be an honest man. You are doing the best you can, but you cannot by any manner or means judge what the law of supply and demand will be, considering all these factors for a year ahead. No one can. But a principle laid down by Congress where people can invest their money on their own best judgment, and with a hundred million people doing that, it adds up to an economic structure, a system.

Suddenly we want a managed currency, a managed economy. Washington wants free trade so that when a citizen invests his money in a zinc mine in Utah, or a tungsten mine in North Carolina, or a textile plant, 34 foreign competitive nations sitting in Geneva can break these investors by the simple procedure of continuing lowering the duties or tariffs formerly used to equalize the domestic and foreign labor costs.

So the investor is broke through no fault of his own, is he not?

Mr. MARTIN. That is correct.

Senator MALONE. I doubt the advisability of leaving the American investor at the mercy of a Washington officeholder, or in the hands of foreign competitors.

I had a visit with the British Secretary of the General Agreement on Tariffs and Trade organization containing the 34 foreign competitive nations. I had a nice visit with him. They are regulating our

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foreign trade in Geneva—dividing the American markets between them.

As long as you can sit in Washington and regulate the amount of money in circulation—and 34 competitive foreign nations can sit in Geneva and regulate the amount of protection furnished an investor or working man from foreign sweatshop labor—then Americans are just about up the creek without a paddle, are they not?

Mr. MARTIN. But our intention is never to that point.

Senator MALONE. Your intention is good. Hell is paved with them. I never intimated your intention was not right. I say you cannot do it. It is impossible for any one human to judge the future for 170 million people. The Constitution never contemplated such a thing. It was written to prevent just such a situation.

Mr. MARTIN. So far as the money supply is concerned, Senator, prior to the Federal Reserve Act we had a series of money panics.

Senator MALONE. Of course, we did, and we are riding for a worse one. You know it as well as we do.

Mr. MARTIN. We will certainly do everything we can in the Federal Reserve to prevent it. I don't think we will be unsuccessful.

Senator MALONE. Instead of preventing it, you are hastening it by inflation, trying to judge the amount of money needed for "sustained economic growth."

Mr. MARTIN. I can't agree with you.

Senator MALONE. I live 3,000 miles west of the Potomac River. I just returned from a visit there. What do you think I went out there for? To see for myself the effect of the actions of Washington and Geneva on the economy of the United States. I can show you whole communities dependent upon mining, textiles, pottery, chemicals, and hundreds of other products.

Mr. MARTIN. Dried up by lack of money?

Senator MALONE. Dried up because they cannot operate on inflated prices in competition with $2 foreign labor.

The Federal Reserve Board can print more money because they think it is needed for a "sustained economic growth."

In Geneva they can lower the duties or tariffs to assist undeveloped nations.

The two of you are invincible in the destruction of the American workingmen and investors. The State Department says that Mexico buys more from us than we sell to them, and, therefore, if we try to save an American miner by adjusting the tariff to equal the differences in the wages and the cost of doing business here and in Mexico, Mexico might not approve, if we try to keep our own people employed. We must give them the American market to hold their friendship. We must keep our own people unemployed. Then the State Department proposes to appropriate more of the taxpayers' money, so that when these communities dry up, on account of the "free trade" policies then they would train these workingmen for other jobs and compensate stockholders. That is the way they do it in Russia, only they don't ask for a congressional act.

Your Federal Reserve Board prices American producers out of the world markets through a managed currency and a managed economy.

In Geneva 34 foreign competitive nations are busy dividing the American markets among them by continual lowering of American duties or tariffs through multilateral trade agreements.

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Congress is sending the American taxpayer's cash to European and Asiatic nations through the Marshall plan, ECA, mutual security, and ICA.

The Import-Export Bank, the International Fund, and two other international organizations largely financed by Uncle Sam are busily engaged in promoting American investments abroad to use the sweatshop labor and import the goods here. It is tough for an American workingman or investor to win.

Senator BENNETT. Senator, it is 6:30.

Senator MALONE. I told the chairman I would finish today. Mr. Martin is willing to stay. If you are not, I will guarantee you we are not going to burn the building.

Senator BENNETT. How much longer do you think you will be?

Senator MALONE. I have several questions and the simpler they are answered, the sooner we will complete the hearing.

Mr. MARTIN. I am perfectly agreeable.

Senator BENNETT. Do you want to recess?

Mr. MARTIN. I am agreeable.

Senator BENNETT. Do you want to recess?

Senator MALONE. No, sir; I don't want to detain you or anybody else.

Senator BENNETT. O. K.

Mr. MARTIN. I have complete confidence in Senator Malone.

Senator BENNETT. It isn't a question of confidence.

Mr. MARTIN. I know that.

Senator BENNETT. I have been thinking of the convenience of the witness and the fact that he has been here now about 7 hours.

Senator MALONE. If he would like to come back in the morning, I would be agreeable.

Mr. MARTIN. I would rather finish tonight because I have a meeting tomorrow at 10 o'clock where the Reserve bank presidents are coming from all around the country.

Senator MALONE. We are all busy tomorrow and would like to finish today.

Senator BENNETT. I will leave the gavel in Senator Malone's hands.

Senator MALONE. Thank you.

Senator BENNETT. And assume that before you and Senator Malone die of hunger——

Senator MALONE. We would not mind if we missed a couple of dinners; it might keep our weight adjusted.

Senator BENNETT. As long as it is not a drain on the money supply.

Senator MALONE. We will manage.

Now we are ready to complete the hearing.

Now you also said in your former testimony that "there is no validity in the idea that inflation once accepted can be confined to moderate proportions," that was your testimony wasn't it?

Mr. MARTIN. That's correct.

Senator MALONE. What do you think will have to be done to reverse the trend that you have already testified has been increasing during the last year?

Mr. MARTIN. I spelled that out in my opening statement, Senator.

Senator MALONE. Yes. Just condense it.

Mr. MARTIN. Yes, sure. I think we have to have a larger budget surplus than we have had. We have to cut Government expenditures

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and have a larger budget surplus than we have had or have in prospect and I think we have to have the Congress and the Board and the Treasury, all of us, constantly looking at every Government program that comes up in terms of the fact that we have an inflationary period that we are in and definitely convince people that we are going to do something about it.

Senator MALONE. What do you mean by a larger budget surplus, appropriate more money?

Mr. MARTIN. No, I mean not appropriate more money.

Senator MALONE. You mean cut down the appropriation and cut down expenditures?

Mr. MARTIN. That's right.

Senator MALONE. Are you talking about expenditures within the United States?

Mr. MARTIN. I'm talking about all expenditures, public and private.

Senator MALONE. I have been talking about useless public expenditures in foreign nations.

Mr. MARTIN. Public expenditures. It is overall.

Senator MALONE. You want us to cut down in domestic spending as well as the foreign?

Mr. MARTIN. Right.

Senator MALONE. What would you do with this expenditure—since World War II, we have put out about $70 billion to foreign nations, starting with the lend-lease and the 1946 "loan" to England, it adds up to about $107 billion. We are still supporting these nations, that is what I called visiting our star boarders first, you know?

Mr. MARTIN. Right.

Senator MALONE. What would you stop spending first? Would you stop spending building projects in this country under the 55-year principle of irrigation and reclamation—and flood control projects, under the 75-year principle under the Army engineers? Would you cut down domestic expenditures for the benefit of the American people—in favor of continuing payments to foreign nations?

Mr. MARTIN. I am not competent to answer that. I am talking about the necessity of having a larger budget surplus in a time of high activity and intense utilization of resources such as we have had. I haven't reviewed the program of the Government and I don't think——

Senator MALONE. I think it would be good if you reviewed the whole picture.

Mr. MARTIN. I don't think I am asked in my job to tell the Budget Bureau or tell the President, or the Congress what they should or should not appropriate.

Senator MALONE. You made a statement that these expenditures should be cut. Before you make such a statement, I think you ought to know what the administration is doing.

Mr. MARTIN. I am talking about it as a general principle and we agree that general principles are important.

Senator MALONE. What we have left, if any.

Mr. MARTIN. I am little more optimistic than you are.

Senator MALONE. You have just testified that there is none in your business, it is a matter of the judgment of the Board. That is not a principle. Suppose you accepted a better job tomorrow and somebody else came in, you know there might be a very wide difference in

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policy, might there not? And you are very likely to be supplanted by 1960 if we keep this up.

Mr. MARTIN. I am likely to be supplanted at any time.

Senator MALONE. Of course.

Mr. MARTIN. That's right.

Senator MALONE. And you are not likely to be there too long?

Mr. MARTIN. That's right.

Senator MALONE. Suppose someone came in with a different judgment that more or less money ought to be in circulation, the citizens of this country would be subject to quite different conditions; would they not?

Mr. MARTIN. There would be a change.

Senator MALONE. Is there any reason why he couldn't do that under the law?

Mr. MARTIN. You mean if he had my job?

Senator MALONE. Yes.

Mr. MARTIN. None whatever.

Senator MALONE. I think we are getting closer together. In other words, the Government of the United States should be run on principle, not on individual judgment, and subject to the current whims or judgment of the current officeholders.

Mr. MARTIN. I think the Federal Reserve Act is a combination of government by law and government by men.

Senator MALONE. In such a case the government by man dominates. For the last 25 years we have definitely drifted toward a government by men. The President judges whether we ought to be in the zinc business in the United States or not. He is the judge as to whether we ought to be in the textile business in the United States or not, with the State Department working through Geneva dominating the situation. The State Department has 1 member out of a 35-member committee sitting in Geneva and they agree upon multilateral agreements lowering tariffs, each with 1 vote. You are not in the zinc-lead business. You are not really in the textile business. Five thousand products will be injured when we substantially reduce the war economy.

You are saying there is $50 billion of American capital already invested abroad using the cheap labor and importing the goods. In addition, we have put in $70 billion of taxpayer moneys to build these plants in low-wage countries so they can manufacture this stuff with $2 labor and bring it in here and put the American workingmen on the street and the investor out of business.

I do not believe we will extend the 1934 Trade Agreements Act when it expires in June of 1958. The regulation of our foreign trade will then revert to the Tariff Commission, an agency of Congress, to adjust the duties or tariffs to take the profit out of the low-cost foreign labor at the water's edge.

You say you do not accept the idea of inflation but you go along with it on a managed currency.

Mr. MARTIN. We not only don't accept it but we do everything in our power to resist it.

Senator MALONE. But you have it.

Mr. MARTIN. We have not been entirely successful.

Senator MALONE. It is increasing, isn't it?

Mr. MARTIN. No.

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Senator MALONE. You testified that it has increased by 3 percent last year.

Mr. MARTIN. I don't think the record of the last year is very good; I agreed with you on that.

Senator MALONE. Neither do I.

I do not think any man in the world could exercise such judgment successfully. We have an official in the White House, the Director of Defense Mobilization. He determines the short amortization tax writeoffs. It is his sole decision to make. I don't think any man in the United States should have that authority. And we did arrange to stop it in 1959. It came out of this committee. That office approved more than $40 billion of such tax writeoffs.

Probably not more than 10 percent of the Washington employees could make a living in business—in a private business. You know that better than I do. But they can make the rules for the man who has his blood money in a business under which he must succeed or go broke.

This is out of your field. But it is just another example of Government by men.

Now, is it a fact that prices couldn't get so far out of hand, even with poor management and the use of credit, when a currency is redeemable in gold as they can under a managed currency when the currency is not redeemable; isn't that a fact?

Mr. MARTIN. I don't think that the redeemability in gold is the controlling——

Senator MALONE. Any kind of hard money?

Mr. MARTIN. Is the controlling factor in whether prices get out of hand or not.

Senator MALONE. You don't believe it is.

Mr. MARTIN. No. I think you can have a collapse—when we went off the gold standard it was fundamentally because of the collapse that was imminent because it was too great for people to accept.

Senator MALONE. What do you think it is going to be next time?

Mr. MARTIN. I have no idea, Senator, but I assure you that we will do everything we can in the Federal Reserve to have a money supply that will retain its value and contribute to stability. That's all I can give you. It is a pious hope, a pious wish.

Senator MALONE. You don't think it helps it any to have it redeemable?

Mr. MARTIN. I don't think that would alter——

Senator MALONE. You see, Mr. Chairman, maybe you forget it, you have been here east of the Potomac for quite a while. If you have a shortage of some product, the price goes up, making it profitable; people will enlarge their plants if they know the principle, the rules are going to be the same.

But if they knew that after they invest this money that you, sitting in Washington, can destroy the feasibility of the business by printing more money or decreasing the supply, then their investment is gone and with it the confidence in the system.

I am talking about 5,000 different products. If there is a shortage of anything, and people know the principle under which they are operating, they soon make up the supply. No matter what it is, it may be corn or wheat; isn't that right?

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Mr. MARTIN. That's right.

Senator MALONE. If the Government officials stay out of it, the law of supply and demand takes over if there is a principle of law. But to have a Government official arbitrarily changing the rules while the ball is in motion—there is a difference, isn't there?

Mr. MARTIN. I think there is a difference. It might be wise to go back to a laissez faire system.

Senator MALONE. What is that?

Mr. MARTIN. I use that loosely; just let nature take its course.

Senator MALONE. That is not what I have said. What I have said is have a standard and a principle and have redeemable currency. Do you call that laissez faire, or whatever it is?

Mr. MARTIN. What are you going to redeem it at; at some price.

Senator MALONE. Let Congress fix the redeemable figure as they always did. They represent the people. You do not represent anybody.

Mr. MARTIN. I represent the Congress.

Senator MALONE. You do. Maybe you think you do.

Mr. MARTIN. We were appointed by the——

Senator MALONE. By whom?

Mr. MARTIN. By the President with the consent of the Senate, under the act.

Senator MALONE. Who turns the President down? We approve any presidential appointment if his character is good.

Mr. MARTIN. Under an act passed by the Congress of the United States.

Senator MALONE. That is right. What is the use of borrowing money and going into the zinc business when a multilateral trade agreement made in Geneva can break the business? We used to produce two-thirds of the zinc they use in this country. We produce about a third of it now, or did until recently—now the mines are down.

We have a State Department with one thought, and that is to distribute the markets of the United States among the low-wage nations of the world. The testimony is there. Dulles said, sitting in that chair, that if in the President's judgment the international situation would be bettered by allowing an American industry to go broke through low-wage, foreign competition, then it would be shut down, under the 1934 Trade Agreements Act. Foreign trade should be regulated on the principle of fair and reasonable competition and let the Tariff Commission recommend the tariff to do the job. But the Tariff Commission should not decide whether they believe a certain American business ought to operate—like you are deciding how much money ought to be in circulation for "sustained economic growth."

You do not believe that redeemable currency would affect the situation?

Mr. MARTIN. Not as you have outlined it; no, sir.

Senator MALONE. Then, in another place, you say you "do not favor high interest rates." Why should we not favor the high interest rates that the Secretary has fixed? That is a question to you.

Mr. MARTIN. I don't think there was any alternative to his raising the interest rate. My point was that I would hope that in the long run that the interest rates would not have to rise.

Senator MALONE. You would hope. But what would you do about it, if they did not buy your bonds on the market?

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Mr. MARTIN. If the Treasury didn't sell its bonds?

Senator MALONE. Yes.

Mr. MARTIN. You wouldn't do anything about it?

Senator MALONE. You would raise the rate of interest until they were sold on the market?

Mr. MARTIN. That is the Secretary of the Treasury's.

Senator MALONE. That's right. But my question was you don't favor the high interest rate, so what do you favor in order to sell the bonds? Print more money?

Mr. MARTIN. No. I was merely talking about it as a general idea, Senator.

Senator MALONE. Well, of course, we can just make a flat statement and walk away from it, but they have to sell the bonds, do they not?

Mr. MARTIN. They have to sell the bonds and, under present conditions, they have had to pay higher interest rates.

Senator MALONE. You agree with that, so why do you say you are not in favor of it?

Mr. MARTIN. I was talking that it would be my hope that they would be able to sell bonds at a lower interest rate.

Senator MALONE. That is a better word. But you don't know they can't.

Mr. MARTIN. Not at the present time; that is correct.

Senator MALONE. We watched this thing from the beginning.

You remember when they, our Government, went off the gold standard, immediately the dollar started to cheapen, didn't it?

Mr. MARTIN. Yes; I believe it did.

Senator MALONE. They started to print money. The worst kind of inflation. People began to complain when the money bought less. The propaganda came from Washington by the ton that a dollar is a dollar, do you remember?

Mr. MARTIN. That's right.

Senator MALONE. The only people to whom a dollar is a dollar is the bank; isn't it? They loan you $5; all they want is $5 back. If you deposit $5, they will give you $5 back. Whether it buys 20 percent of what it would purchase when you gave it to them, makes no difference to them, does it?

Mr. MARTIN. No.

Senator MALONE. A dollar is a dollar?

Mr. MARTIN. That's right.

Senator MALONE. But is it a dollar to the man who put it in and left it a few years and then takes it out to buy something or to put the children in school?

Mr. MARTIN. No. That is why we want to preserve the purchasing power of the dollar.

Senator MALONE. Do you remember the propaganda 10 feet deep all over the country in the thirties that a dollar is a dollar, what are you complaining about?

Mr. MARTIN. I don't remember.

Senator MALONE. How old are you?

Mr. MARTIN. I am 50.

Senator MALONE. It came along in the thirties. You should remember. I remember it. I was State engineer in my State then. I said yes, a dollar is a dollar in paper money but if it will just buy

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half as many groceries, it won't do you very much good unless you get your wages raised. That was a correct statement; wasn't it?

Mr. MARTIN. Yes.

Senator MALONE. We are still using these catch words and phrases such as the "dollar shortage," "trade not aid," and destroying our own country.

You treat inflation in another place as a rise in prices rather than a rise in cost of living. What is the use of the word inflation when you can describe it as manifested by the forces with which we are dealing, that is the prices?

Mr. MARTIN. Right.

Senator MALONE. In your judgment it would be better to recognize what is happening?

Mr. MARTIN. Right.

Senator MALONE. Get away from this general term?

Mr. MARTIN. Right.

Senator MALONE You say there is no question that the Federal Government and the American people pulling together have the power to stabilize the cost of living? Just how would they do it on managed currency?

Mr. MARTIN. On managed currency?

Senator MALONE. Yes.

Mr. MARTIN. By holding the line on the supply of money.

Senator MALONE. Who is going to hold it?

Mr. MARTIN. The Federal Reserve Board.

Senator MALONE. Have they done it?

Mr. MARTIN. Not as effectively as they should.

Senator MALONE. What are you going to do about it?

Mr. MARTIN. Try to do better.

Senator MALONE. How long have you been in there?

Mr. MARTIN. Six years.

Senator MALONE. Since 1950?

Mr. MARTIN. Six years.

Senator MALONE. It is quite a while; isn't it?

Mr. MARTIN. That's right.

Senator MALONE. What has been the matter?

Mr. MARTIN. We have been doing the best we can.

Senator MALONE. What defeats you?

Mr. MARTIN. There were other things besides credit and money.

Senator MALONE. What was it?

Mr. MARTIN. We referred to the budget. We referred to the management of the debt.

Senator MALONE. That is up to the Treasury; isn't it? Their raising of the interest rate threw you out of gear; is that right?

Mr. MARTIN. That is a relationship.

Senator MALONE. Well, now you know as a matter of fact, it is impossible to have a free economic system under a managed currency and a managed economy. As a matter of fact, under present conditions unless a young man inherits the money, he can't borrow it and pay it back even if his business makes money, with the income tax and everything the way it is, you know that; don't you?

Mr. MARTIN. I follow you.

Senator MALONE. Then we fixed our young people up, so there are only two things for them to do. They can either get on civil service

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and a job with the Government or a State or they can go to work for a corporation that is big enough and spread wide enough so it can write off enough of these income taxes to keep in business?

Mr. MARTIN. I think you are unduly pessimistic.

Senator MALONE. I am not pessimistic. I am talking about the actual condition.

Mr. MARTIN. I think there are thousands of people today that are now in neither category that are making a pretty good living.

Senator MALONE. I wish you would describe one of them. How would you do it, if you don't inherit the money and must go to a bank and borrow the money you need to go into a business, how will you pay it back?

Mr. MARTIN. Out of your business.

Senator MALONE. Yes.

Mr. MARTIN. By engaging in a business as thousands of individuals have done and earning the wherewithal to pay it back.

Senator MALONE. How are you going to get it out of the income after the Government takes its cut?

Have you ever studied it?

Mr. MARTIN. Yes; I know a great many individuals who have done it.

Senator MALONE. You know a great many individuals who have made deals on a capital-gains basis. But I doubt very much if you know of anybody running a straight business and borrowed all the money they needed for it, paid the interest and principal back without some kind of a deal—probably legal but getting a capital gain or getting into a deal in a foreign nation where you don't have to pay the American taxes. You deduct the taxes you pay to the foreign nation from anything you might have to pay here. You know that, don't you?

Mr. MARTIN. Right.

Senator MALONE. Maybe you better study the possibility of a young man going into business for himself. That is one reason I ran for the Senate. I got so mad at what was being done. I am madder now than I was then. It is worse for us to do it. We ought to know better.

You stated, too, that Congress should declare the stabilization of cost of living as a primary aim of the Federal economic policy. How would they do that?

Mr. MARTIN. I have already commented on the budget surplus and I think that if all of these programs that come before the Congress are examined in terms of what they do to the price level, or might do to the price level, I believe there is the power in the Federal Government to stabilize things.

Senator MALONE. But we should declare in a law—why do you have to declare it? Wouldn't common horsesense make it an objective to keep the dollar stabilized so a man working hard for his money could put $2 in the bank and next year it is worth $2 in purchasing power?

Mr. MARTIN. Common horsesense would certainly declare it.

Senator MALONE. Why do you want to pass another law? You have about 10 times as many laws now as you need.

Mr. MARTIN. Perhaps another law would not do it. I was merely making a hortatory statement on this point. The point I am trying

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to get at was recently people have doubted whether the Government really meant business with respect to——

Senator MALONE. To inflation. I think we are going the way Germany went and it may not be too long unless Congress reinstates the sound money standard. Otherwise we will pay our debts like the great humorist, Will Rogers, said who fell in a plane up in Alaska, "We will pay the mortgage off opossum." The $280 billion debt that way. That is where it looks like we are headed with our managed currency.

Mr. MARTIN. I hope you are wrong, Senator.

Senator MALONE. What is the use hoping when nobody seems to be doing anything about it on principle. They want to get it in their own little hot hands to manipulate it, manage it. You testified that it should continue until the world settles down.

What is this money business for? What is the purpose?

You have currency.

What is it for?

Mr. MARTIN. For goods and services. For exchange.

Senator MALONE. So if you want to buy a bottle of milk you don't have to lead the old cow along, you can buy it with something we call money. Then money represents stored labor.

Mr. MARTIN. That's right.

Senator MALONE. Then if a man is working hard and he wants to take a vacation and wants to go into a business 10 years ahead or 20 years or whenever it is, and he is saving money for a purpose and all the time the Government is cheapening it through inflation; what are you doing to him?

Mr. MARTIN. You are talking about him saving money and you are cheapening it.

Senator MALONE. Yes.

Mr. MARTIN. You are making it less valuable; you are taking money away from him.

Senator MALOE. You are stealing him?

Mr. MARTIN. You are stealing it from the thrifty; right?

Senator MALONE. Then we understand each other perfectly. Late in World War II, I was consulting engineer to the Senate Military Affairs Committee. I am the one they sent in behind the Japs in Dutch Harbor and then out to MacArthur in 1943. I watched this silly procedure start in 1933 in Washington and continue for 24 years. They sold Government bonds. They at one time sold a 10-year $1,000 bond for $750; remember that? Your memory isn't very good.

Mr. MARTIN. I have a poor memory.

Senator MALONE. You don't remember that. Have you got any advisers here that remember it?

Mr. NOYES. It is the straight E-bond.

Mr. MARTIN. You are talking about E-bonds.

Senator MALONE. Government bonds.

Mr. MARTIN. Right. $750 for a thousand-dollar bond. We still do that, incidentally.

Senator MALONE. Are you aware or do you know that at the end of the 10-year period the thousand dollars wouldn't buy as many groceries as the $750 did when the investor put his money in it.

Mr. MARTIN. I am aware of that.

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Senator MALONE. We stole part of their money through a deliberate managed currency.

Mr. MARTIN. I think "stealing" was a strong word. We were fighting a war and we took out part of the cost of the war in inflation.

Senator MALONE. Deliberately?

Mr. MARTIN. I don't think we did it deliberately.

Senator MALONE. I think they were stealing part of it, and I think we still are stealing part of the investor's money in the same manner. I don't think you want to. But under the system you support we are doing it. It doesn't make any difference whether you have good intentions; you are still stealing it.

Mr. MARTIN. There's less money than there was before. I think the word "steal" is too harsh with respect to what happened during the war.

Senator MALONE. I have to use the language that I understand my people understand and there is no excuse of continuing a system that adds up that way.

Mr. MARTIN. Right.

Senator MALONE. If a man figured out a private business on that basis, he would go to jail. If you carry on the same way for another 10 years, how much are you writing off that bond in purchasing power, at 3 percent a year?—30 percent it sounds like, and you are still doing it.

Mr. MARTIN. That's right.

Senator MALONE. That saves us a lot of time.

Mr. MARTIN. That is what we want to stop.

Senator MALONE. Don't elaborate and we won't have to go into it again. If you do, we will have to go through it again. I think it is worse for a government to take the money from its people in peacetime—you said we were winning a war. There might be some excuse then, but not now. Without going into the things I saw in the South Seas and in Alaska and later in 1947 in these European countries—the waste. It has gone down now. No use talking about it. I am talking about the future. And we haven't helped it much.

Now you said the goal is price stability. It is a desirable goal. Why isn't a desirable goal the maximum economic harmony resting upon an honest and sound currency? Still talking about the possibility of having a backing for the currency so you know the purchasing power you can get at the bank window when you go back 6 months or 6 years from the time of deposit. Why isn't that the best way?

Mr. MARTIN. I think the end result is the same. You are just defining it differently than I do.

Senator MALONE. You testified that you can't go back on any real money standard, gold standard, until 7 or 8 of the main nations in Europe have straightened out. If you studied it, you know they will never do that.

Mr. MARTIN. I merely stated that we can go back on redeemability; that I don't think it would be wise to go back to redeemability of gold at the present time.

Senator MALONE. Redeemability of currency in gold? You now redeem paper money in other like paper money.

Mr. MARTIN. All right. I don't think it would be wise and I don't think it is necessary. I don't think it is essential. You think that it is and I think we just——

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Senator MALONE. I am not arguing with you. I am just asking the questions.

Mr. MARTIN. Right.

Senator MALONE. You don't think it is necessary.

Mr. MARTIN. No, sir.

Senator MALONE. But you are doing it with foreign nations. You are paying out the gold to them for the paper money and credit that we give them without any payment at all. Aren't we?

Mr. MARTIN. We are settling our international balances in gold.

Senator MALONE. So you are on a gold standard with everybody but the American people?

Mr. MARTIN. I used the phrase "modified gold standard."

Senator MALONE. You modified it only with your own citizens?

Mr. MARTIN. That's right.

Senator MALONE. You are paying off your dollar balances in gold just as you did for more than a century and a half; aren't you?

Mr. MARTIN. That's right.

Senator MALONE. What is the matter with an American citizen? What happened to us in America so we are no longer trustworthy, we can't be trusted to have the gold money? What is the matter with us? Why do you want to separate us from the real money and only pay it to the foreigners?

Hand them the paper money and credit to start with and then they build up credit balances and come back and get the gold. Everybody knows that and you have substantiated it. What is the matter with Americans?

Mr. MARTIN. I don't think there is anything the matter with Americans.

Senator MALONE. Why can't you treat them at least as well as the foreigners? After all, you have to get back to bedrock on this thing.

Mr. MARTIN. We made a conscious decision in the Gold Reserve Act and subsequently I think we could go back to redeemable at the present time, if you will, full redeemability in gold and it wouldn't make any difference.

Senator MALONE. You could do it right now if you wanted to.

Mr. MARTIN. That's right. I don't think it would make any particular difference at the moment. I would not advocate it as a necessary policy at the moment.

Senator MALONE. Why, if you could do it, why not?

Mr. MARTIN. I think it is a matter of judgment. A lot of people think you couldn't. I have only one judgment on it.

Senator MALONE. Go ahead.

Mr. MARTIN. That is all I want to say. I am just talking about my judgment.

Senator MALONE. That's right. I want your judgment—you are the one managing the currency.

Mr. MARTIN. If you took the circle of the advisers in the Federal Reserve Board you would find differences of opinion among them.

Senator Malone. Yes. I am afraid you are pretty close to right since you have dissipated your gold supply; but you started with $22,400 million worth of gold—didn't you?—and you are ending up with $5,700 million right now that we really own, if we are honest with ourselves. You say we have possession of it. Suppose a banker told

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you "I have $15 million that I own in this bank"; and that is the amount of deposits; what would be your next question? What is your capitalization, paid in? Then, what makes you think you own the depositors' money? The remainder is simply depositors' money. Then it doesn't make much sense. You have really less than $6 billion worth of gold against $28 million of deposits. That is one of the reasons you cannot go back on the gold standard; is it not?

Mr. MARTIN. I don't think the amount of gold you have as a reserve is what makes it possible to be on a standard or not. Reserves are not figured in mathematical terms. I think that is one of the differences between us, Senator.

Senator MALONE. You are the banker—I am asking the questions. I am trying to find out what you believe.

Mr. MARTIN. I have told you what I believe. I do not believe that it is the amount of gold that is required. I think it is the stability of your currency and the confidence that there is in your currency.

Senator MALONE. We do not have stability. Suppose you have $20 billion—is it $28 billion or $30 billion in circulation—$26½ billion against $5.7 billion in gold, the rest is silver or other kinds of money. You have $26½ billion of money in circulation and to be safe you need enough gold so that the folks know they can get it for the paper and are not likely to demand more than you have, isn't that what the 40 percent or 25 percent is for, if you are on gold standard—redeemable in gold?

Mr. MARTIN. But if you don't have confidence in the currency of a country it does not make any difference how much gold you have.

Senator MALONE. How can you have confidence if you know the gold is not there. What inspires confidence in the currency?

Mr. MARTIN. It is one of the elements in the confidence.

Senator MALONE. The people haven't any confidence now. So if you wanted to go on the gold standard and everybody knew you had 40 percent back of it in gold and maybe some of us would go in and get a hundred dollars or a thousand dollars if we could raise that much paper money just to feel it, and see it. We would soon get tired of that and put it all back. All we would want would be a couple of $20 gold pieces to rub together if you knew you could get it any time then you would leave it in the bank. I have news for you. If they don't think they can get it, they will all come in at once and you couldnt' pay it. That is the difference.

Mr. MARTIN. No, not if they all come in at once.

Senator MALONE. And if 25 percent of them came in you couldn't pay it, could you, with your own gold, if you were on a gold standard?

Mr. MARTIN. We would have to suspend the reserve requirements, but we could.

Senator MALONE. You would come to Congress and it wouldn't be a question whether we wanted to do it or not. It would be a situation that we are facing.

Mr. MARTIN. Right.

Senator MALONE. I must get at it and it will save your time and mine. Isn't that a good reason why you can't go back on the gold standard. You don't have it. You would either have to turn us or the foreigners down and under the present policy you know who you will turn down, the citizens of the United States. The State De-

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partment will raise —— if you turned the foreigner down. But they would like very much to turn a citizen down—and put an industry out of business such as machine tools, zinc, lead, tungsten, textiles, chemicals, crockery, and hundreds of other products in favor of foreign cheap-labor imports. It certainly wouldn't make any difference to the State Department if you came to Congress here and asked to stop payment to American citizens, but they would never let you stop payment in gold to a foreign nation until the last gold dollar went down the drain.

I can hear Mr. Dulles sitting there begging with tears in his eyes, begging, "Don't stop payment to Yugoslavia in gold. Tito would not like it."

Mr. MARTIN. I have not heard the Secretary.

Senator MALONE. I have told you what he testified to on the subject of foreign trade—that in his judgment—the President's, of course, but he is the one doing it—if it is for the overall good of the United States in the President's (Dulles)—if the President believes that it is to his best overall foreign interests of America, to shut American industry down in the United States and import the goods from the cheap-labor countries, he can do it. Do you know he testified to that?

Mr. MARTIN. No.

Senator MALONE. Then you testified that all but $5.7 billion of our gold had foreign-dollar balances against it—and to refuse to pay it might cause a depression. That is what you testified to. The two of you together make a good team. Not because of you and Mr. Dulles, but it is because of the power that Congress gave the two of you.

Now it is beginning to catch up with us. It isn't your fault. There is no man in the world who has that kind of judgment or any combination of men. It is only when Congress lays down a principle for the country and 160 million people investing their money on their judgment under a principle that you can have a free economy.

You have safety valves under the principle, there can be receiverships, there can be bankruptcies, but we closed all the safety valves a long time ago and left the Washington bureau to judge what should be done. Do you still think we have a free economic system? Do you still think it is, with the safety valve tied down?

Mr. MARTIN. We haven't had a completely free economy for a long time.

Senator MALONE. That answer saves time and we are not headed for a free economy now, either. Do you think we are? Unless we get down to bedrock and realize what we are doing and go back to the Constitution of the United States, do you think we are headed for a free economy?

Mr. MARTIN. I think we are headed for a freer economy than we have had.

Senator MALONE. You stated too that Congress and the Executive can take steps to insure that free and vigorous competition is maintained in all segments of our economy, is a bedrock of our free-enterprise system.

Are there not areas such as those occupied by national monopolies, including public utilities, competition that cannot operate to a social benefit? Isn't that true also in areas occupied by the Government, post office, other things, conservation of natural resources, what do you mean by that statement?

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Mr. MARTIN. I refer specifically to the antitrust laws.

Senator MALONE. I am glad you do. Because if they are properly enforced that is the way to do it. If the antitrust laws are properly enforced, then untie the safety valves and install a sound base for our money. I am glad you made that explanation.

How do you believe that you are still under a free economy when Congress transferred its constitutional responsibility to regulate foreign trade in the hands of the President, with full authority to put that responsibility under 34 foreign competitive nations in Geneva, Switzerland, where it now resides? That means the flexible duty or tariff adjustment to regulate foreign trade; article I, section 8. How is a free United States economy to operate in Geneva?

Mr. MARTIN. I can't define it for you.

Senator MALONE. You can what?

Mr. MARTIN. I can't define it for you, sir.

Senator MALONE. Nobody else can either, except that it leads to utter destruction. It affects your business, whether you understand it or not. Then we have 4 organizations—you have testified to that; so did the Secretary; so did Burgess; 5 with the Secretary of Commerce, who are making it their business to encourage American capital to go abroad and build these plants, ship the cheap-labor goods back here in competition with our high standard of living produced products.

You know that; do you not?

Mr. MARTIN. Right.

Senator MALONE. Do you like that?

Mr. MARTIN. I think they serve a useful purpose.

Senator MALONE. In what way?

Mr. MARTIN. These institutions, I think, the International Bank, the Monetary Fund, the International Finance Corporation now, the Export-Import Bank have all contributed to the development of a sound, two-way foreign trade.

Senator MALONE. What is the second way? I know about the first way. The cheap-labor goods coming here, but we subsidize much of our goods going abroad through cash payments and selling at the world price with our taxpayers making up the difference.

Mr. MARTIN. I meant purchases and sales by two-way. I think we have been earning money as well as—and the loans are being repaid, and will be repaid, in most cases, to these institutions.

Senator MALONE. Do you know that American workingmen are out of work throughout the United States the minute the Government quits spending the $40 billion national-defense money; they are on the street because they are already supplanted by the low-wage countries' products. Do you know that is not a fact?

Mr. MARTIN. I do not know it is not a fact.

Senator MALONE. If that is a fact, do you think it is good?

Mr. MARTIN. If it is a fact, it is not good.

Senator MALONE. You will find out soon enough that it is a fact. The President of the United States—determined by a Secretary of State sitting in with 34 foreign competitive nations in Geneva—has the authority to continue to lower the tariffs or duties, already far below any equalization of wages.

Now, you said "in all these ways" which you have outlined, and we have discussed most of them today, "if we have the will to set

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the face of the Nation so resolutely against inflation as to keep that enemy from our gates." That is a fine-sounding phrase. Do you have anything to add to what you said?

Mr. MARTIN. I am afraid not.

Senator MALONE. I think that seems to imply that the enemy is not already within the so-called gates. What are we doing? Do we shut our eyes to the fact that the index of wholesale prices started at 50.1 in 1939 and is 118 for June 1957?

Mr. MARTIN. No; I don't want to shut my eyes to that.

Senator MALONE. That is a fact; isn't it?

Mr. MARTIN. That is a fact.

Senator MALONE. Still going on.

Mr. MARTIN. Still going on.

Senator MALONE. Hasn't reduced the rate much in the last year; in fact, inflation increased more than 3 percent?

Mr. MARTIN. It could have been a lot worse.

Senator MALONE. If we Republicans hadn't taken it over and managed it, it would have been a lot worse.

Mr. MARTIN. I can't put it in political terms.

Senator MALONE. That is what you better start doing. I have news for you. If you think Republicans ought to stay in office, you had better start.

I am curious about how the economy operates under your organization. No one below an officer in your organization or a bank understands how the banks handle the money with the Federal Reserve.

Now, in the general discussions, the reasons for and effects of the rising discount rates of the Reserve banks, does not much of this discussion overlook the fact that member banks obtain a larger proportion of their reserves by means of the float—reserves against uncollected checks and draft—than by rediscounting with and obtaining advances from the Reserve banks?

Mr. MARTIN. I think they obtain some of their reserves that way, but float is only temporary.

Senator MALONE. That is your answer?

Mr. MARTIN. That is my answer.

Senator MALONE. Would you like to enlarge on it? I would be happy to have you do that when you correct your testimony.

Mr. MARTIN. All right.

Senator MALONE. Is it a fact that you can deposit Government bonds, and you will advance a certain amount of money on the face value of those bonds to a bank, and those bonds may be paying 2, 3, or 4 percent, or whatever they bear, and when they get the cash for the bonds, they loan them at the current rate of interest for loaning money; is that right?

Mr. MARTIN. That's right.

Senator MALONE. Then they can bring in certified loan paper that is judged to be good. If the bank has a good reputation and you trust the bank, or its evaluation is high enough so that they are responsible, they can deposit those checks and notes and other material and get further money that they can loan and collect 6 or 8 percent, whatever the rate is; then they bring their notes in and get the money again and loan it again; is that right?

Mr. MARTIN. They can't do it twice.

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Senator MALONE. Bring the notes in after they have deposited the bonds and secured the money for them. Then they can bring the notes in and get further credit?

Mr. MARTIN. They can bring in paper, commercial paper; they can bring in loans. They can bring in Government securities, and they can get advances from us through the discount procedure.

Senator MALONE. I want to understand it. First, if a bank with sufficient capitalization has a hundred thousand dollars in Government bonds, they bring it in, and they get a hundred thousand dollars?

Mr. MARTIN. Roughly.

Senator MALONE. If they are paying 4 or 5 or 3 percent to you; they can loan it at their going rate of 6, 7, or 8 percent, can they not?

Mr. MARTIN. Whatever they charge.

Senator MALONE. Then when they get the notes for those loans and that bank is responsible—I will ask the next question to determine how you do that—but up to a certain amount they can leave the notes and the paper and get additional money, can they not.

Mr. MARTIN. They can't leave it there permanently. They have to take it back.

Senator MALONE. I didn't ask you about permanency. They can do it, can they not?

Mr. MARTIN. They can do it only for a limited period of time.

Senator MALONE. What is that limit?

Mr. MARTIN. Fifteen days is about as long as we advance though the discount window. Usually 2 or 3, as Mr. Riefler points out.

Senator MALONE. That opens up a new field. How long do you advance the money on Government bonds?

Mr. MARTIN. Same period of time. There is no difference.

Senator MALONE. Then you return the Government bonds in 15 days and they give you the money?

Mr. MARTIN. That's right.

Senator MALONE. What interest do you charge?

Mr. MARTIN. That is, at the present time, we are charging 3½ percent in some banks and 3 at some banks.

Senator MALONE. Who sets that interest rate?

Mr. MARTIN. The interest rate is set by the board of directors of the individual Reserve bank, but it must be approved by the Federal Reserve Board here in Washington.

Senator MALONE. In other words, you are in control?

Mr. MARTIN. We are in control.

Senator MALONE. Whatever you want that interest to be, that is what it will be, if they want to do business with you.

Mr. MARTIN. It is our decision.

Senator MALONE. That saves a lot of time. I am interested in that short term. I didn't understand that there was any such short term in Government bonds; let's start that way. If they are deposited with you or with a Federal Reserve bank, the bank then can use that money, or do they issue some kind of money against it?

Mr. MARTIN. No.

Senator MALONE. How does it work?

Mr. MARTIN. They get a credit for their reserves with us, and they can, therefore, expand their loans by that amount.

Senator MALONE. But only for 15 days.

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Mr. MARTIN. Only for 3 days, in most instances; 15 days. We have a fractional reserve requirement. If they have these reserves, they can expand their loans by up to——

Senator MALONE. What good would that do them, to have the money for 15 days to loan to somebody else? How does it work? Tell me. How does a bank loan money against these Government bonds?

Mr. MARTIN. To the customer?

Senator MALONE. Yes.

Mr. MARTIN. It is not loaning them to the customer against the Government bonds. It needs additional reserves. It comes to us because we are a reserve institution, and we supply them a credit which is reserves which they can then use for loans to their customers.

Senator MALONE. What is that credit? What is it against?

Mr. MARTIN. The credit that we give them?

Senator MALONE. Yes.

Mr. MARTIN. We can create that credit within the limits specified in the Federal Reserve Act.

Senator MALONE. What is that? Suppose there is a bank capitalized at a million dollars. They have the Government bonds and good collateral. How do you furnish them money, and up to what extent and under what conditions?

Mr. NOYES. Well, if they want to—if they need additional reserves, they can come to the discount window and we will lend them, if they have suitable collateral, and we give them a credit on our books for the reserves.

Senator MALONE. Up to what amount on a bank capitalized at a million dollars?

Mr. RIEFLER. There is no strict rule. The bank is supposed to pay it off very quickly.

Senator MALONE. Give me an idea.

Mr. RIEFLER. Usually, it is a small part.

Senator MALONE. What is your name?

Mr. RIEFLER. My name is Riefler.

Senator MALONE. What is your position?

Mr. RIEFLER. I am assistant to the Chairman.

Senator MALONE. Good. Go ahead.

Mr. RIEFLER. It is usually for a small part of their reserve account.

Senator MALONE. What is a reserve account?

Mr. RIEFLER. Every bank is required to hold reserves against its deposits.

Senator MALONE. What is the percentage that they are required?

Mr. RIEFLER. Eighteen in the central Reserve city banks, 16 in the Reserve city banks, and 12 in the country banks.

Senator MALONE. Like the gold used to be. A certain amount of gold to back it up, on the theory that there wouldn't be more than that many depositors ask for their money at one time?

Mr. RIEFLER. That was the idea in the beginning. They have to hold that reserve as a balance in the Federal Reserve bank.

Senator MALONE. How does a bank operate? Suppose they take this money. They are capitalized at a million dollars. Does that mean there is a million dollars paid in?

Mr. RIEFLER. Sometimes they have a million. A bank capitalized at a million dollars would probably have $15 million to $20 million of deposits. Against those deposits they would have to hold reserves.

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Senator MALONE. They hold a reserve of 16 percent against $20 million?

Mr. RIEFLER. Against their demand deposits. On time deposits, 5 percent.

Senator MALONE. How do they pay it?

Mr. RIEFLER. They have loans and investments.

Senator MALONE. You have to have money to have loans and investments. How do they get their money from the Federal Reserve against which they work?

Mr. RIEFLER. They bring into the Federal Reserve a piece of eligible paper, Government securities, usually, but it can be a promissory note of a good firm.

Senator MALONE. What do you do?

Mr. RIEFLER. The Federal Reserve will lend to them at the discount rate.

Senator MALONE. Three and a half percent.

Mr. RIEFLER. Yes. And that will be credited to the deposit account of that member bank?

Senator MALONE. For how long?

Mr. RIEFLER. Practically all of them are on a 15-day maximum, but they are allowed to pay it off before the 15 days, and they usually pay it off quickly.

Senator MALONE. What about a long-term loan, say a year's loan?

Mr. RIEFLER. There is never that.

Senator MALONE. Is there any way at all that they work against this Federal Reserve credit in issuing any kind of money?

Mr. RIEFLER. There is this deposit money, if you call deposits money, which we do frequently, because the checks are used in place of money in paying bills and things. We call deposits money. A bank can go out and lend as long as it has reserves that meet its reserve requirements.

Senator MALONE. Sixteen percent.

Mr. RIEFLER. Yes; so, in the system as a whole, there is a buildup of credit at six times roughly the amount of reserves, but any individual bank can't do that; that is something that happens because various banks are making loans and receiving deposits.

Senator MALONE. You mean only a member of the Federal Reserve System can do that?

Mr. RIEFLER. No; all the banks can do that.

Senator MALONE. They can all do that?

Mr. RIEFLER. Yes.

Senator MALONE. So, if they are capitalized for a million dollars, they have, we will say, $15 million for deposit; that is what you said?

Mr. RIEFLER. Fifteen to twenty.

Senator MALONE. How much money could they loan?

Mr. RIEFLER. They can loan—they would have then, say, $15 million of deposits, plus a million of capital. That would be $16 million of liability. They would have to carry against that 2 to 2½ millions of reserves, depending on where they were, and the rest would be loans and investments.

Senator MALONE. Then you could loan $12 million to $13 million in investments against this $16 million of deposits?

Mr. RIEFLER. It would be something like that.

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Senator MALONE. How does the Federal Reserve bank work, then? What good is it to this bank? That is, to have these deposits to do this business? How do you operate?

Mr. RIEFLER. The bank gets a deficiency of reserves, for any number of reasons; usually because the depositors have written checks against the deposits and they have gone to another bank and they have to make good immediately to the other bank. That comes out of the reserve account. Then they will come into the Federal Reserve to get that money to keep that reserve legal. They will immediately try to pay off the money. They will collect loans as they come due, or they will sell some other piece of paper in the market and do something to pay that off. Because it is understood those discounts should be temporary.

Senator MALONE. If they have to come back in 15 days, do you reloan it, if it is necessary, in case they are sound?

Mr. RIEFLER. It can happen, but it is understood that these loans should be temporary for the accommodation of all the banks. The Federal Reserve funds are not supposed to take the place of the capital of the bank.

Senator MALONE. A million dollars, you can have any amount of deposits with a million-dollar capitalization.

Mr. RIEFLER. The examiners are careful though not to have the equity get too thin.

Senator MALONE. You can get $50 million of deposits if you have the confidence of the public.

Mr. RIEFLER. The examiners would insist on their raising more capital.

Senator MALONE. What is the capital percentage?

Mr. RIEFLER. The old rule of thumb used to be 10 percent. It isn't that any longer. It is lower than that. It is 6 and 7 in a great many cases.

Senator MALONE. It is like the gold reserve, changed from 40 to 25 percent. What is the insurance on the depositors? Is it $5,000?

Mr. RIEFLER. $10,000.

Senator MALONE. That is the limit. If a bank with a million dollars——

Mr. RIEFLER. $10,000 each depositor.

Senator MALONE. Anyone over that loses that if it doesn't come out in the wash.

Mr. RIEFLER. Yes.

Senator MALONE. But each depositor is up to $10,000?

Mr. RIEFLER. Yes.

Senator MALONE. And there is no part of it cumulative payments; that much or less whatever the individual deposit happens to be?

Mr. RIEFLER. An individual depositor can have deposits in more than one bank. If he splits his deposits among several banks he can get protection for more than $10,000.

Senator MALONE. If a man has $5,000 as far as the credit to that deposit there is only $5,000, they don't hold over another five to go to other depositors?

Mr. RIEFLER. No.

Senator MALONE. Let me ask you a question that many people do ask. What is the reason since—I am asking this for the record, Mr. Chairman—what is the reason that we issue bonds and pay interest

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on the bonds, if these bonds are handled as you say as collateral for these banks and all this sort of thing, what would happen if the bank, if the Government of the United States took up a certain amount of these bonds by simply issuing money to take up the bonds under the Federal Reserve as you say you can do. You can issue a certain amount of money.

You have no authority to issue money in lieu of bonds. There is no such authority in the Federal Reserve, is there?

Mr. RIEFLER. We can buy bonds in the open market.

Mr. MARTIN. We can buy them in the open market at any time.

Senator MALONE. You can issue more money if you want to so the effect is there is a certain amount of bonds you can buy. But they pay interest to you when you buy them?

Mr. MARTIN. That's right.

Senator MALONE. Which would be the same as if they didn't bear interest at all?

Mr. MARTIN. Right.

Senator MALONE. Suppose you did that on a hundred million dollars, what would be the effect on the monetary system?

Mr. MARTIN. It would definitely be inflationary, you would remove that amount from the stream.

Senator MALONE. Explain it to me for the record.

Mr. RIEFLER. You would be paying for them with reserves.

Senator MALONE. Printing the money and bringing in the bonds.

Mr. RIEFLER. And that would be inflationary?

Senator MALONE. How?

Mr. RIEFLER. Because there would be more money out.

Senator MALONE. They do deposit bonds and loan more money in any case. That is to say——

Mr. RIEFLER. They can borrow for a very few days.

Senator MALONE. They can bring in notes and do the same thing and the whole structure is based on deposits of confidence in the banking business and the Government guarantees it, $10,000, that is the way it works.

Mr. RIEFLER. Yes.

Senator MALONE. Tell me exactly how it would be inflationary if we retired $10 million worth of bonds a year by judging the amount, even if you needed an amendment to the act to buy that many bonds and take them off the market each year, how would it be inflationary?

Mr. MARTIN. These bonds are issued by the Treasury because they have a debt. They want to spend the money. If we purchased the bonds and canceled the bonds, we will have created that amount of money without in any way affecting the Treasury debt. That could do nothing except to add to the money supply and wouldn't in any way minimize the debt which the Government has.

Senator MALONE. If you printed the money and took up the bonds, it would reduce the debt. But what you are saying is that the Government must sell the bonds and pay interest on them to stabilize the money system?

Mr. MARTIN. Exactly.

Senator MALONE. Just like any individual?

Mr. MARTIN. Exactly.

Senator MALONE. What does it mean in this language that you are going to get exactly and I have quoted it the way I remember it, that

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the Government can issue money and fix the price thereof according to the Constitution. When was this system adopted of issuing bonds and paying interest?

Mr. MARTIN. Oh, yes; right from the early days.

Mr. RIEFLER. From Alexander Hamilton.

Senator MALONE. Didn't we do it differently in the Civil War?

Mr. RIEFLER. They printed some money there, the greenbacks and then they had inflation.

Senator MALONE. Wasn't it worse than we are having now?

Mr. RIEFLER. It was a bad one.

Senator MALONE. Would you when you review this testimony if you could make it a little clearer, Mr. Chairman, as to just the system used in the Federal Reserve banks—and there are banks that are not members of the System; aren't there?

Mr. MARTIN. Right.

(The following was subsequently furnished for the record:)

BANK BORROWING AT FEDERAL RESERVE BANKS

Commercial banks are required by law to hold minimum reserves equal to a stated fraction of their deposit liabilities. Member banks of the Federal Reserve System, which have about 85 percent of the demand deposits of all banks in the United States, must hold their legally required reserves in the form of deposits with Federal Reserve banks.

The occasion to borrow from a Federal Reserve bank usually arises from the need to replenish reserves when they have fallen below the required level. In effecting such borrowing, a member bank may rediscount one or more of its customers' notes with a Reserve bank, or it may give its own note to a Reserve bank, using paper from its own holdings as collateral. The second procedure, known as an advance, has become the usual method for extending credit to a member bank. It differs from the first in form but not in substance. In either case the Reserve bank gives the member bank credit in its reserve account for the amount of the accommodation and thereby increases the reserve deposit which the member bank holds at the Federal Reserve bank. For this service the Reserve bank charges interest at a rate known as the discount rate.

In recent weeks, member-bank borrowing at the Reserve banks has averaged about $1 billion. Such loans generally take the form of advances on the promissory note of the member bank with a maturity of not more than 15 days and secured by the deposit or pledge of United States Government securities.

There is no specific quantitative limitation on the amount a member bank may borrow from its Federal Reserve bank. However, access to the Federal Reserve discount facilities is a privilege of membership in the Federal Reserve System granted in the light of the following general guiding principles, as set forth in the foreword to regulation A of the Board of Governors:[1]

"Federal Reserve credit is generally extended on a short-term basis to a member bank in order to enable it to adjust its asset position when necessary because of developments such as a sudden withdrawal of deposits or seasonal requirements for credit beyond those which can reasonably be met by use of the bank's own resources. Federal Reserve credit is also available for longer periods when necessary in order to assist member banks in meeting unusual situations, such as may result from national, regional, or local difficulties or from exceptional circumstances involving only particular member banks. Under ordinary conditions, the continuous use of Federal Reserve credit by a member bank over a considerable period of time is not regarded as appropriate."

[1] Under the last paragraph of sec. 13 of the Federal Reserve Act, a Federal Reserve bank has authority to make advances for periods not exceeding 90 days to individuals, partnerships, and corporations (including member and nonmember banks) on their promissory notes secured by direct obligations of the United States. However, it is not the practice to make advances to others than member banks except in unusual or exigent circumstances. In the last 10 years, advances to nonmember banks under this authority have aggregated only $1 million. Sec. 19 of the act prohibits a member bank from acting as the medium or agent of a nonmember bank in applying for or receiving discounts from a Federal Reserve bank except by permission of the Board of Governors. No request for such permission has been made since the early 1920's.

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Member banks generally are reluctant to borrow from a Federal Reserve bank, or to stay long in its debt. In part, this reluctance results from the disposition of depositors, especially business and financial depositors, to be critical of borrowing on the part of individual banks. Another consideration is a purely operating one, namely, that borrowed funds are more expensive than funds obtained through deposits, and usually cost a bank as much as, or more than, it would give up in earnings through the sale of some of its holdings of prime short-term paper. Accordingly, when member banks are obliged to borrow, they feel under pressure to restrict their lending or to readjust their investment positions in order to pay off such indebtedness as soon as possible.

Member bank borrowing from the Federal Reserve bank for the purpose of expanding loans and investments, therefore, would seldom be encountered. This does not mean, however, that the effects of discounting are localized and do not reach outside the borrowing bank to influence total bank credit. Such borrowing adds to the supply of reserves for the banking system as a whole. Therefore, use of the borrowing facility by member banks has an important bearing on the effectiveness of system credit policy.

The policy of the Federal Reserve with respect to member bank borrowing expresses itself not only in granting or discouraging loans but also in the rate charged for discounts and advances. As a general rule, when the Federal Reserve is of the opinion that expansion in the flow of credit and money should be encouraged in the public interest, it reduces its discount rate in relation to prevailing market rates. When it believes that expansion should be checked, it raises the rate in relation to these rates.

Senator MALONE. Can they deal with you if they are not a member of the System?

Mr. RIEFLER. If they are not members of the System, they can't except in an emergency but they can borrow from correspondent banks that are members of the System.

Senator MALONE. Then it is like our dollar balances, they really come home to roost in the last analysis if they get in trouble?

Mr. MARTIN. That's right. I will put that in the record in the running statement.

Senator MALONE. Just how a bank operates, just what this matter of Federal Reserve loans to banks and banks to customers amounts to, how they can borrow against deposits, what the capitalization has to be?

Mr. MARTIN. All right.

Senator MALONE. And I would like this very much for a public that I am very sure is going to read some of this testimony.

Mr. MARTIN. All right.

Senator MALONE. There is nothing more mysterious than money to anyone that is not connected with the System.

That is, when you get into the detail as to how the matter is handled through the banks and your organization.

What authority is there in the Federal Reserve Act for the creation of reserves for member and nonmember banks against checks and uncollected drafts, what is that authority in your Reserve Act?

Mr. NOYES. I think we better submit that.

Mr. MARTIN. I will have our legal department get that for you.

Senator MALONE. They can do that right soon so that it will be part of the printed testimony?

Mr. MARTIN. Surely.

Senator MALONE. In all the specifications in the act as to how member banks can add to their reserves or have them add to it, is there any statement that they be given reserves free of charges against uncollected checks and drafts?

Mr. MARTIN. That's the same question.

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Senator MALONE. In its annual report for 1916 the Federal Reserve Board stated at page 170:

It is manifest that items in process of collection cannot lawfully be counted as part of the minimum reserve to be carried by a member bank with its Federal Reserve book.

Are you familiar with that provision?

Mr. MARTIN. Right.

Senator MALONE. How do you explain the connection? How are those things done?

Mr. MARTIN. That is the same thing. We will cover it.

Senator MALONE. All right.

Now, has the act been amended in any similar way since 1916 to make that statement inaccurate today? That is what you are going to give me.

Mr. MARTIN. Right.

Senator MALONE. Cite the amendment if there is any.

Why are not the schedules of deferred availability items, deferred reserves made to conform to the average time required to collect checks and draft, thus also eliminating what is referred to, is it, as the float?

Mr. MARTIN. We are having a real study of that made at the present time, Senator, to see whether we can improve those schedules.

Senator MALONE. Would you elaborate on that business in your correction of the testimony?

Mr. MARTIN. We will be glad to.

Senator MALONE. The status of the investigation and what it is pointing toward.

Mr. MARTIN. The status of the investigation and what it is pointing toward?

Senator MALONE. That's correct?

Mr. MARTIN. Right.

(The several preceding questions are covered by the attached insert.)

In 1938 the Federal Reserve banks' deferred availability schedules for the crediting of checks received for collection ran up to a maximum of 8 days. Member banks were required to sort their checks according to the days of availability given in the Federal Reserve banks' time schedules. Most checks, however, were collected and credited within 2 days. Federal Reserve float in 1938 amounted, on a daily average basis, to $9 million.

In September 1939 the maximum deferred availability period was reduced to 3 days. This action was designed to give member banks more prompt credit for checks deposited for collection and to reduce substantially the amount of work required in sorting and preparing checks for deposit with the Federal Reserve banks. In 1940, the first full year after the maximum 3-day deferment schedule had been adopted, Federal Reserve float averaged $57 million.

During the war years, float rose quite rapidly to a maximum daily average of $468 million in 1945. This increase was the result of factors not directly related to the adoption in 1939 of the maximum 3-day deferment. For one thing, between 1938 and 1945, the volume of checks handled by the Federal Reserve System (excluding Government checks) increased greatly; the dollar amount (which, of course, is directly reflected in the amount of float) increased from $232 million to $563 million, or nearly 150 percent. Other important factors in the increase of float were the rapid turnover of personnel during the war period and the difficulty of obtaining and training adequate and qualified replacements, the need for additional equipment, and various delays and irregularities in transportation.

In the postwar years Federal Reserve float declined substantially in spite of the continuing increase in the volume of checks handled. In 1949 the Federal Reserve banks handled 1.848 million checks (other than Government checks) with a face value of $758 billion, representing increases over 1945 of about 40 and 35 percent, respectively. Federal Reserve float in 1949 averaged $369 mil-

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lion, a reduction of 21 percent from 1945. This decrease in float, despite an ever-increasing inflow of checks, was made possible by speedier collections, which, in turn, reflected increasing availability and greater use of air transportation, a much improved personnel situation, and increasing availability of needed equipment.

In 1949 System officials began studying the possibility of further simplifying the collection process, reducing further the amount of work required of member banks in sorting and preparing checks deposited for collection, and bringing about a greater degree of uniformity in the Federal Reserve banks' collection schedules. After extensive consideration and discussions with representative bankers, it was concluded that the System would be justified in adopting a maximum deferment availability period of 2 days, and this was put into effect in January 1951.

Following this action Federal Reserve float increased substantially, and for the year 1951 it averaged $1,016 million. From this relatively high figure, float declined to $737 million in 1954, and then rose to $902 million in 1955 and $1,138 million in 1956.

The Federal Reserve authorities have been concerned with this rise in float, primarily because it creates problems in connection with very short-time fluctuations in the supply of reserves. Over any period of time of more than a week or two, the effect of a sustained increase or decrease in float can easily be offset by open-market operations. To the extent possible even short-term variations in float are taken into consideration along with all other factors affecting the availability of member bank reserves. By means of open market operations System authorities endeavor to adjust the supply of reserves—no matter what their source (or the need for member banks to borrow to obtain reserves) in accordance with the degree of monetary ease or restraint deemed appropriate at the time. Thus, the average volume of float outstanding over a given period is largely balanced by adjustments in the System's open-market portfolio. However, wide and unusual variations in float occasionally supply or absorb more reserves than may be considered desirable and thus raise difficult operating problems for brief periods.

For these reasons the System authorities in the fall of 1956 instituted a special study of float. The study group has submitted its report and findings, together with a suggested program, which is now under consideration by System operating officials. One of the significant findings is that the average level of float and day-to-day variations are related in such a complex fashion that any one step directed toward reducing the average level of float might result in wider fluctuations and aggravate operating problems. This situation reflects the fact that float is not the result of any single factor. It is the net result not only of differences between availability schedules and actual collection times, but also of other important factors which differ from one day, week, or month to another, and from one Federal Reserve bank to another. For example, because of the widely fluctuating volume of checks deposited in the Federal Reserve banks, there is a piling up from time to time of a tremendous volume of checks at one or more of the Reserve banks. This necessitates holding over a substantial number of checks for processing on the next day, with a resultant increase in float, due simply to sheer physical inability to handle the volume even with an around-the-clock operating staff. The very arrangements which, on the average, result in more expeditious collection of checks and which underlie the earlier availability schedules, sometimes give rise to serious operating problems. Thus, air transportation, which is now in general use and reduces average collection time between Federal Reserve districts, makes day-to-day performance much more dependent on weather conditions than when railroads carried the bulk of checks between distant points.

The program suggested by the study group for reducing the level and fluctuations in Federal Reserve float includes examination into the possibility of more direct and expeditious routing of checks from the time they are deposited by payees in their banks to the time they are presented to the drawee banks; the possibility of further development and use of electronic equipment for the processing of checks; the cost and feasibility of providing sufficient staff, space, and equipment to avoid holding over checks until the next business day; and a review of the present deferred availability schedules of the Federal Reserve banks to determine to what extent it would be practicable and desirable to have them conform more nearly to actual collection times.

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That the task of reducing the volume and fluctuations in Federal Reserve float is a big one and not susceptible of quick and simple solution may be surmised from the fact that, on an average business day in 1956, Federal Reserve banks and their branches handled around 15 million checks and money orders amounting to well over $4 billion. One Federal Reserve bank alone (New York) had a daily average check volume approaching in number 2½ million items and in amount $1 billion. The problem is greatly magnified by the wide fluctuations in the daily volume of checks deposited in the Federal Reserve banks.

Senator MALONE. Now are these schedules shortened beyond the average time of collection as a part of the easy-money programs of the Federal Reserve System, particularly after 1940 and 1950? You had a chart, page 32–b in the pamphlet that you submitted. Bank reservation, Federal Reserve Bank in New York, November 1953, and what is this method, to ease the money by this method?

Mr. MARTIN. It was not designed to create easy money. It is a collection operation, and this study that I am telling you about that we are working on now is designed to improve those schedules so there won't be the amount of the float that there has been.

Senator MALONE. You are going to elaborate on that?

Mr. MARTIN. Right.

Senator MALONE. Were not the time schedules for deferred availability items so well matched with the average time required to collect checks and drafts before 1939, that the float was an item of very small importance? In other words, did this develop after 1939?

Mr. MARTIN. In recent years that is gotten—the spread has become greater and that is one of the reasons why we are having this current review.

Mr. RIEFLER. Part of the problem is just the terrific volume of business being done. It is getting the checks through the machine.

Senator MALONE. I can see how that would be. There is some of it fictitious. Government business and everything else. If the float then could be kept down or eliminated, is it not a fact that it can be kept down or eliminated now by lengthening the time schedules on deferred availability items until they equal on an average the uncollected items, that is something you are finding out; is it?

Mr. MARTIN. That is what we are working on, to improve the schedules .

Senator MALONE. And you will elaborate on that when you come to it?

Mr. MARTIN. Right.

(The following was subsequently furnished for the record:)

LEGAL AUTHORITY FOR "FLOAT"

The legal basis for the inclusion of the amount of uncollected checks in the reserve balances of member banks is to be found in provisions of the Federal Reserve Act relating to the clearing and collection of checks by the Federal Reserve banks.

The deposit balance carried by a member bank with its Federal Reserve bank serves a dual purpose. It includes the minimum reserve balance required by the law to be maintained by the member bank with its Federal Reserve bank; but at the same time it constitutes a checking account through which the member bank is enabled to arrange for the collection of checks. This dual aspect is recognized by the provision of the Board's regulations which is the immediate basis for the inclusion of float in a member bank's reserve balance. Section 2 (c) of the Board's regulation D, relating to reserves of member banks, provides that "cash items forwarded to a Federal Reserve bank for collection and credit cannot be counted as part of the minimum reserve balance to be carried

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by a member bank with its Federal Reserve bank until the expiration of such time as may be specified in the appropriate time schedule referred to in regulation J."

The Board's regulation J which governs the clearing and collection of checks by the Reserve banks, requires each Federal Reserve bank to publish a time schedule showing the time as of which any item sent to it will be counted as reserve and become available for withdrawal or other use by the sending bank. The regulation provides that the sending bank will be given either immediate credit or deferred credit in accordance with such time schedules. Pursuant to the regulation, all Federal Reserve banks have time schedules outstanding which indicate those items for which immediate credit will be given and those for which credit will be given on a deferred basis. The present maximum deferment time is 2 days.

The authority for these provisions of regulation J is derived from sections 16 and 13 of the Federal Reserve Act. Under section 16 each Federal Reserve bank is required to receive at par from member banks checks and drafts drawn upon any of its depositors; and under section 13, the Reserve banks are authorized to receive checks and drafts from their member banks and also from nonmember banks that maintain balances sufficient to offset items in transit. In addition, section 16 expressly provides that the Board of Governors "shall make and promulgate from time to time regulations governing the transfer of funds and charges therefor among Federal Reserve banks," and that the Board may exercise the functions of a clearinghouse or may "at its discretion * * * designate a Federal Reserve bank to exercise such functions, and may also require each such bank to exercise the functions of a clearinghouse for its member banks."

Pursuant to these provisions of the law, the Board in its regulation J has authorized the Reserve banks to prescribe rules governing the details of their operations in the clearing and collection of checks and, as previously noted, has required the Reserve banks to publish time schedules. The time schedules, including the present 2-day maximum deferment time, are for the primary purpose of facilitating and expediting the collection of checks through the Federal Reserve System; and it is apparent that such provision for availability of credit to member banks after the 2-day deferment time is distinctly for the benefit, not only of the member banks, but of the business community and the public at large.

It is clear, therefore, that the provision for the 2-day maximum deferment time is a valid exercise of the collection and regulatory powers of the Federal Reserve System. To the extent that this provision results in the inclusion of a certain amount of uncollected items in the reserve balances of member banks the result is merely an incident to the proper exercise of the System's collection functions.

The reserve provisions of section 19 of the Federal Reserve Act require each member bank to maintain with its Federal Reserve bank "an actual net balance" equal to its prescribed reserve. When the term "actual net balance" was first incorporated in the law in 1917, Representative McFadden stated during the debates that the amendment would require member banks to "carry the float"; and in its 1916 Annual Report the Federal Reserve Board referred to the amendment as preventing items in process of collection from being counted as part of the minimum reserve required to be carried by a member bank with its Federal Reserve bank. In 1926, in the case of *Pascagoula National Bank* v. *Federal Reserve Bank of Atlanta* (11 F. 2d 866 (C. C. A. 5th (1926)), cert. den. 271 U. S. 685), a Federal circuit court of appeals declared that "so far as a balance is represented by uncollected checks on other banks received from a depositor it could not well be considered to be either actual or net." This statement of the court, however, was clearly dictum, since the only question at issue before the court was whether a Reserve bank could be required to give immediate credit for checks sent to it by a member bank.

Whatever significance might once have been attached to statements made in Congress with reference to the 1917 amendment or to the dictum of the court in the Pascagoula case, the legal situation has been materially altered since that time. Later enactments of Congress have definitely recognized a substantial change in the concept as to the purpose of bank reserves. Their original purpose of providing liquidity and enabling banks to meet withdrawals has been largely overshadowed by their purpose as a means of credit control; and, as an incident to this change in concept, the Board has been vested with broad

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authority to regulate reserves in order to accomplish their present objectives.

By amendments to the law in 1933 and 1935, Congress has conferred upon the Board express authority to define certain terms contained in section 19 of the Federal Reserve Act and "to prescribe such rules and regulations as it may deem necessary to effectuate the purposes of this section and prevent evasions thereof." The Board has further been authorized to change reserve requirements of member banks in order to prevent injurious credit expansion or contraction; and the report of the House Banking and Currency Committee on the Banking Act of 1935 stated that the Board was given this increased authority because it was felt that "it is essential to give the Board more authority in controlling credit conditions." These and other provisions broadening the authority of the Board over reserve requirements of member banks did not exist at the time of the 1917 amendment to the law or at the time of the decision in the Pascagoula case.

In the circumstances, the present purport of the phrase "actual net balance" must be considered in the light of the broad regulatory authority given to the Board for the purpose of accomplishing the objectives of the reserve provisions of the law. Considered in this light, the present practice of allowing the inclusion of float in reserve balances as an incident to the exercise of the System's unquestioned collection and regulatory powers—a practice which has been followed since 1939 with the knowledge of Congress—does not contravene the reserve provisions of the law.

Senator MALONE. Did not the drafters of the Federal Reserve Act intend that reserves of member banks should be real rather than fictitious reserves resting in part on uncollected checks and drafts?

Mr. MARTIN. I think they did, that is one of the reasons we are making the study.

Senator MALONE. Does not corrected administration of the Federal Reserve Act require that the float be eliminated and if not why employ deferred availability schedules at all?

Mr. MARTIN. I will cover that in this statement.

Senator MALONE. June 16, 1933, Congress amended section 7 of the Federal Reserve Act dealing with the division of earning of the Reserve banks terminating the right of the United States Treasury to participate in earnings of those banks. Since 1946, that is beginning with 1947, the Reserve Board has been turning over 90 percent of Reserve bank earnings to the Treasury despite the provisions of section 7. Now, where do you find the authority to do that, or in fact are you doing it?

Mr. MARTIN. That was discussed with the chairman of both the House and the Senate Banking and Currency Committees by one of my predecessors and he had their assent for this method. However, we prefer now to return to the franchised method and in the Financial Institution Act which has been passed by the Senate we still revert——

Senator MALONE. By the Senate?

Mr. MARTIN. By the Senate of the United States.

Senator MALONE. How can it become a law without it passing both Houses?

Mr. MARTIN. It is in the House now. It has already passed the Senate.

Senator MALONE. That would make this legal, would it?

Mr. MARTIN. That is right.

Senator MALONE. Do you think it is a good thing, that it ought to be made legal?

Mr. MARTIN. I think it would be desirable, it would be better.

Senator MALONE. You think that prior to this they thought they found their authority in section 16, paragraph 4; is that the correct reference notice?

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Mr. MARTIN. I believe that is the correct citation, sir.

Senator MALONE. Relating to interest levied on issuance of Federal Reserve notes?

Mr. MARTIN. That is right.

Senator MALONE. The Board calls this gift of earnings interest on Federal Reserve notes under section 10; is that right?

Mr. MARTIN. That is right.

Senator MALONE. Is there reason to think that Congress intended to use section 16 to nullify section 7?

Mr. MARTIN. I don't think that is reasonable. I think the proposal now adopted by the Senate will correct any question on this.

Senator MALONE. It will give you additional authority to correct this situation?

Mr. MARTIN. That is right.

Senator MALONE. Was it not the purpose of section 16, paragraph 4, to give the Board authority to put a burden on the issuance of the Federal Reserve notes as a companion instrument of credit control to a raising of discount rates of the Reserve banks?

Mr. MARTIN. I don't know what the original purpose was, but I will cover that in reviewing it.

Senator MALONE. All right. Does not Counsel for the Reserve Board state in a memorandum to Paul M. Warburg of the Board on October 15, 1915, that the nature and purpose of the authorized interest charge on Federal Reserve notes was one of the instruments of credit control?

Mr. MARTIN. I assume he did if you have a reference there. We will check it.

Senator MALONE. All right. I don't expect you to remember every provision, but I want the record built up correctly. Did not the Reserve Board up to 1947 speak the intended meaning of section 16, paragraph 4, if you know?

Mr. MARTIN. I am not familiar with the period. I wasn't in the System at the time.

Senator MALONE. Is there anyone here familiar with it?

Mr. RIEFLER. I wasn't with the System either, but I think all the question means is that the interest rate was not levied on Federal Reserve notes until it was decided after the consultations you spoke about.

Mr. MARTIN. Right.

Mr. RIEFLER. To return surplus earnings to the Treasury.

Senator MALONE. Then you can enlarge on that subject?

Mr. MARTIN. Right.

Senator MALONE. When you look it over.

Mr. MARTIN. Right.

Senator MALONE. When Chairman Eccles stated that he intended to use section 16, paragraph 4, to override the intent of Congress as written in section 7 of the act, did he not say—

Although the authority in the original act to charge a rate of interest on notes in circulation that was unsecured by gold, was not meant for that particular purpose—

I am still quoting—

our lawyers advise us that the Board could use that authority.

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I have a memorandum here from one of the lawyers on that question. Was that statement made and was that a principle that was adopted at that time?

Mr. MARTIN. Yes. Chairman Eccles consulted with the chairmen of both the House and Senate Banking and Currency Committees and elaborated at that time what the position of the Board was. I will have to review what he actually said.

Senator MALONE. Will you do that?

Mr. MARTIN. Yes.

Senator MALONE. Does not Mr. Eccles state that he recognizes section 16, paragraph 4, was not intended to be used for the purpose of giving away 90 percent of the earnings of the Reserve bank; did he say that?

Mr. MARTIN. I do not know whether he did or not, but I will check it.

Senator MALONE. Now, will you, Chairman Martin, supply the committee with a memorandum that Mr. Eccles referred?

Mr. MARTIN. All right.

(The following was subsequently furnished for the record:)

From a review of the Board's files, we believe that the material on this subject referred to by Mr. Eccles at a hearing before the House Banking and Currency Committee in 1947 was the following internal memorandum prepared by the Board's General Counsel:

"IMPOSITION OF INTEREST CHARGE ON OUTSTANDING FEDERAL RESERVE NOTES

"*Legal authority.*—The fourth paragraph of section 16 of the Federal Reserve Act provides that a Federal Reserve bank 'shall pay such rate of interest as may be established by the Board of Governors of the Federal Reserve System on only that amount of such notes [Federal Reserve notes] which equals the total amount of its outstanding Federal Reserve notes less the amount of gold certificates held by the Federal Reserve agent as collateral security.'

"It is true that the primary intent of Congress in placing this provision in the law seems to have been to provide a means of controlling the expansion of Federal Reserve notes, but the legislative history indicates that a minor consideration at least was possible revenue to the Government. At any rate, the provision of the law is explicit and appears to give the Board full authority to impose an interest rate on outstanding Federal Reserve notes (less the amount of gold certificates securing them) whenever it considers it advisable to do so. The law does not specifically state to whom the interest shall be paid by the Federal Reserve banks, but it is reasonable and logical to conclude from the legislative history of the matter that the payment is to go to the Government."

Senator MALONE. Is it not a fact that the banks have given $2,449,620,651 or 90 percent of Federal Reserve earnings to the United States Treasury during the years 1947 to 1956 despite the fact that Congress in section 7 terminated the right of the Treasury to participate in those earnings?

Mr. MARTIN. I will have to check the figure, but we did it under the authority that I have cited, and which we will review.

Senator MALONE. You can elaborate on it. You will note the capital accounts of the Reserve banks have $3,658,839,651 instead of $1,209,219,000 at the end of 1956, had the Board administered the act as written or without checking those figures?

Mr. MARTIN. I will check those figures.

Senator MALONE. Is it not a fact that the Federal Reserve earnings given the Treasury are not interest in any proper sense as provided for in section 16, paragraph 4, or is it?

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Mr. MARTIN. No, I think that is right. That is why we are glad that in the present Financial Institutions Act that the law is being changed to provide specifically for——

Senator MALONE. Does that mean if we do not pass that act that you have been violating the law?

Mr. MARTIN. No, I don't think so. But we are going to review this whole thing now. But I think it is perfectly clear that Chairman Eccles on the advice of his legal staff at the time conferred with the Chairman of the House and Senate Banking and Currency Committees, and decided that this was a proper way to do it.

Senator MALONE. I don't see how you can decide the thing by conferring with the committee that wasn't in office when you passed the act, because they have no authority to say what was meant or anything else. The authority, if any, or intent of Congress can be studied, isn't that about the limit of the latitude you can use beyond what the law says or in interpreting what it means?

Mr. MARTIN. I think so.

Senator MALONE. What would this committee have you do with it now if we don't amend the law? Why would you go with what the committee advised that it would like to see you do?

Mr. MARTIN. I merely cited the fact that he conferred with the two committees that are the closest allied to the Federal Reserve activities, but he did it on his own authority after he consulted with the legal advisers.

Senator MALONE. Now what interest charge so levied would there be anyway to make it equal 90 percent of the earnings of the Federal Reserve banks each year since 1946?

Mr. MARTIN. So levied—not exactly on the notes, but I will put in the record how we figured that.

Senator MALONE. Give us the principle of how you are doing it.

Mr. MARTIN. Right.

Senator MALONE. Has such a so-called interest charge as that paid to be levied, ever acted as a restriction on the issuance of Federal Reserve notes?

Mr. MARTIN. No.

Senator MALONE. Is it not a simple fact that an interest charge on the issuance of Federal Reserve notes, as provided for in section 16, paragraph 4, has never been levied by the Board?

Mr. MARTIN. I think that is right, but I will have to check it.

Senator MALONE. Make any correction that you care to make in your testimony there. Is it not a fact that the Board decided in 1947 and since to amend section 7 to suit this purpose, and is that what you are doing now?

Mr. MARTIN. That is what is being done at the moment in the Financial Institutions Act.

Senator MALONE. If it doesn't pass, would that make any difference in what you are doing?

Mr. MARTIN. If it doesn't pass I presume we would use the old authority.

Senator MALONE. You would continue to do what you are doing regardless of whether it is amended or not?

Mr. MARTIN. We would have no alternative until we got additional authority.

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Senator MALONE. Aren't you now in a position that Mr. Eccles was in, don't you have to make the decision yourself and stand or fall on it?

Mr. MARTIN. That we are doing. We have already decided that it ought to be done.

Senator MALONE. If you don't get the authority, then you would review it and see what you should do on your own account?

Mr. MARTIN. We are reviewing it. We have reviewed it and are convinced that we have the legal authority.

Senator MALONE. Why do you want it amended?

Mr. MARTIN. There are some differences of opinion on this, and we wanted to clarify it so there would be no doubt whatever about it.

Senator MALONE. Did not this procedure on the part of Mr. Eccles in 1947 arise from the fact that nearly all the earnings of the Reserve System arose from investment by Federal Reserve banks of the United States, securities, and from the desire to avoid an airing of the fact which would have been necessary to ask Congress to amend section 7? He didn't ask for an amendment; he went ahead and did it?

Mr. MARTIN. That is right.

Senator MALONE. You have aired it. You have had a hearing before the Banking and Currency Committee; they asked you the necessary questions and then got the bill introduced; is that it?

Mr. MARTIN. That is correct.

Senator MALONE. Does not correct administration of the Reserve Act require that the Board adhere to the provisions of sections 7 and 16, as written by the Congress, until Congress should alter them? That was the purpose of my question of what you would do if you don't get it.

Mr. MARTIN. We will continue to utilize the same procedure that we have been utilizing.

Senator MALONE. Would you ask your attorney to look it over again?

Mr. MARTIN. I will be glad to, and have that commented on in the record.

Senator MALONE. I mean if you didn't get the amendment? If you do everything according to law, would you feel it necessary to go into it again legally to get the legality of it as interpreted by your own counsel if you didn't get this amendment?

Mr. MARTIN. We have already had our counsel review it, and he believes it is legal at the present time.

Senator MALONE. But he also believes that he ought to be fortified by an amendment?

Mr. MARTIN. That is right.

(The following was subsequently furnished for the record:)

INTEREST ON FEDERAL RESERVE NOTES

In connection with section 7 of title II of the proposed Financial Institutions Act (S. 1451), questions have been raised as to the purposes of the provision of section 16 of the Federal Reserve Act authorizing the Board to levy an interest charge on outstanding Federal Reserve notes and as to the legality of the action taken by the Board under this provision in 1947 and in succeeding years for the purpose of providing for payment of excess earnings of the Federal Reserve banks to the United States. Questions have also been raised as to the amounts which have been paid by the Reserve banks to the United States as a result of this action during the years 1947 to 1956, and as to the methods used in calculating the interest rate established by the Board for this purpose.

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PURPOSES OF THE PROVISION

The fourth paragraph of section 16 of the Federal Reserve Act (12 U. S. C. 414) provides that, in connection with the issuance of Federal Reserve notes to a Federal Reserve bank, "such bank * * * shall pay such rate of interest as may be established by the Board of Governors of the Federal Reserve System on only that amount of such notes which equals the total amount of its outstanding Federal Reserve notes less the amount of gold certificates held by the Federal Reserve agent as collateral security." This provision was a part of the original Federal Reserve Act, although as first enacted it provided that the interest charge should be imposed upon the total amount of Federal Reserve notes issued; by an amendment in 1917, the provision was changed to make the interest charge applicable only to the amount by which outstanding Federal Reserve notes exceeds the gold held as collateral security for such notes.

The legislative history of the provision indicates that the framers of the Federal Reserve Act regarded it as a means of preventing inflation through undue expansion of the volume of outstanding Federal Reserve notes. At the same time, however, there is evidence that they also regarded the provisions as a means of providing revenue to the Government.

The report of the Senate Committee on Banking and Currency with respect to the original Federal Reserve Act stated:

"* * * The emission of these notes is controlled by the Federal Reserve Board, which is authorized to control the volume of these notes and the terms upon which they shall be advanced to the Federal Reserve bank and the conditions of retirement.

"The Federal Reserve Board is authorized to tax the issue of the notes and also to fix the rate of interest on the discounts of the Federal Reserve banks, and in this way keep a double check on the issuance of the Federal Reserve notes" (S. Rept. 133, Nov. 22, 1913, p. 25).

When the bill was under discussion in the House of Representatives, Mr. Barkley stated that the proposed "tax" on Federal Reserve notes would "prevent an inflation of the currency" (50 Congressional Record 4788). On the floor of the Senate, Senator Swanson, after pointing out that the tax on Federal Reserve notes was modeled after a similar provision in the German banking system, declared:

"* * * The tax or interest charge upon the currency issued under this bill is regulated by the Federal Reserve Board. This Board can increase or decrease this tax or charge as the requirements of the situation demand. By being privileged to fix the tax or charge upon currency they can retard excessive inflation or in time of gloom or depression give needed encouragement and stimulation. * * *" (51 Congressional Record 431).

In response to a question as to whether the purpose of the tax on Federal Reserve notes was to provide revenue or to impose a check upon inflation, Senator Owen, the sponsor of the bill, stated that the provision was designed "to prevent the possibility of expanding those notes to excess."

Despite the above indications that the provision was regarded as an instrument for the control of the volume of Federal Reserve notes, there were also indications that the provision was considered as a means of providing revenue to the Government.

The report of the House Banking and Currency Committee on the Federal Reserve Act observed that the plan for retiring national bank notes secured by bonds bearing the circulation privilege would cost the Government approximately 1 percent per annum, since under the bill is was proposed that 2-percent bonds should be exchanged for 3-percent bonds without the circulation privilege. To meet this cost, however, the committee report stated:

"The committee has arranged to give the proposed Federal Reserve Board power to tax the new currency at such rate as it might deem best, and should it impose a tax of 1 percent the Government would be reimbursed for any excess interest payments which it might be required to make on the new bonds" (H. Rept. 69, Sept. 9, 1913, p. 25).

Although, as previously indicated, Senator Swanson referred to the provision as a means of preventing inflation, a few minutes later in the same speech he made the following statement which clearly indicates that he regarded the provision as also designed to give the Government a part of any profits resulting from the issuance of Federal Reserve notes:

"* * * Another benefit accruing to the Government on account of the method of issuing these notes is that, being Government notes, the benefits derived from

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their issuance will go to the Government and thus to all the people. All the profits of these Reserve banks which issue these currency notes, after the payment of 6 percent interest on their capital stock, will go to the Government. In addition the Federal Reserve Board is given the power to fix the tax which would be imposed upon the issue of notes, thus giving them ample authority to look after the interests of the Government in this respect" (51 Congressional Record 432).

In the circumstances, it can fairly be said that the legislative history of the provision in question indicates that, while its primary purpose was control of the volume of Federal Reserve notes, it was also regarded as a possible method of affording the Government a certain profit from the issuance of Federal Reserve notes.

Not long after the enactment of the Federal Reserve Act, counsel for the Federal Reserve Board, in a memorandum to Mr. Paul M. Warburg, then a member of the Board, stated that the intent of this provision was "to enable the Federal Reserve Board to control, as far as possible, the conditions governing the demand for credit and to enable the Board to adapt not only rediscount rates but also the volume of Federal Reserve notes to the varying needs of different sections of the country." In 1916, in a public statement, the Board stated that "one of the primary purposes of this provision was to enable the Federal Reserve Board to control the volume of notes of this character placed in circulation" (16 Federal Reserve Bulletin, p. 273).

These statements, however, are not necessarily inconsistent with the position that one of the purposes of the provision may have been to raise revenue. It is to be noted that the Board's 1916 statement referred to the control of the volume of Federal Reserve notes as one of the purposes of the provision. Actually, there would have been little reason before 1933 for invoking the provision as a means of diverting excess earnings of the Federal Reserve banks to the United States, since the payment of interest under the provision would have been an expense which would have reduced the net earnings of the Reserve banks and therefore the amount of the franchise tax which the Reserve banks were required to pay to the Treasury prior to 1933. This point was mentioned when, in February 1937, Chairman Eccles was testifying before the House Banking and Currency Committee. At that time, Representative Patman, after criticizing the Board's failure to levy an interest charge on Federal Reserve notes, stated that apparently the reason for which the Board had not levied such a charge before 1933 was that, because of the franchise tax, excess earnings of the Reserve banks went "into the Treasury anyway."

LEGALITY OF THE USE OF THE PROVISIONS FOR REVENUE PURPOSES

From the date of the original enactment of the Federal Reserve Act until passage of the Banking Act of 1933, section 7 of the act required each Federal Reserve bank to pay to the Treasury, annually, 90 percent of its net earnings after expenses and dividends. However, in setting up the Federal Deposit Insurance Corporation, the Banking Act of 1933 required each Federal Reserve bank to subscribe an amount equal to one-half of its surplus to the capital stock of that Corporation. These subscriptions reduced the surplus of the Reserve banks to considerably less than one-half of their subscribed capital; and consequently Congress deemed it desirable at that time to eliminate the franchise tax in order to permit Federal Reserve banks to build up their surplus accounts from future earnings.

During the 10 years following the Banking Act of 1933, the earnings of the Reserve banks were relatively small. After the war, however, their earnings substantially increased, largely because of their holdings of Government securities. Accordingly, in 1947, the Board concluded that it would be appropriate for the Reserve banks to pay to the Treasury the bulk of their net earnings after providing for necessary expenses and the statutory dividend on stock held by member banks. For this purpose, the Board acted under section 16 of the Federal Reserve Act to levy an interest charge on outstanding Federal Reserve notes at such a rate as to make it possible for the Reserve banks to pay to the Treasury annually approximately 90 percent of their net earnings.

Before taking that action, the proposed imposition of an interest charge on Federal Reserve notes was discussed by Chairman Eccles, of the Board, before both Banking and Currency Committees of Congress at open hearings. An announcement of the Board's action was published in the Federal Reserve Bulletin for May 1947. The Board's action was reported to Congress in the

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Board's annual report for 1947; in each annual report from that time the Board has informed Congress as to the amounts paid by the Federal Reserve banks to the Treasury as interest on Federal Reserve notes.

As heretofore indicated, the legislative history of the provision of section 16 of the Federal Reserve Act here under discussion contains evidence that one of its subsidiary purposes may have been to permit payment of a portion of the earnings of the Federal Reserve banks to the Government. In any event, however, the language of the provision is so clear and unambiguous as to make it unnecessary to resort to any extrinsic aids in its construction, including its legislative history. It explicitly gives the Board discretion in establishing a rate on Federal Reserve notes without qualifying that discretion by any indication of the purpose for which the provision may be used. The repeal of the franchise tax provisions by the Banking Act of 1933 did not affect the authority of the Board to establish rates of interest under section 16; and it may be noted that, while the franchise tax was payable by virtue of a mandatory provision, the authority to impose interest charges under section 16 is committed entirely to the discretion of the Board.

In its recommendations to the House Banking and Currency Committee with respect to the proposed Financial Institutions Act, the Board expressed the opinion that "it is clearly authorized to require the Federal Reserve banks to take the action it did in 1947 and annually since that time." However, since this authority had been questioned in some quarters and since the procedure involved is somewhat awkward and complicated, the Board recommended that the law be clarified so as to provide specific direction or authority for payment to the United States by the Federal Reserve banks of a percentage of their net earnings after expenses and dividends.

AMOUNTS PAID BY FEDERAL RESERVE BANKS TO UNITED STATES

The total amount paid by the 12 Federal Reserve banks to the Treasury of the United States from 1947 to 1956, inclusive, in the form of an interest charge on Federal Reserve notes, was $2,450,650,837.

METHOD OF COMPUTING RATE OF INTEREST

In utilizing its authority under the fourth paragraph of section 16 of the Federal Reserve Act, the Board has established the interest rate as an arithmetical device which will result in payment to the Treasury of approximately 90 percent of the net earnings (after expenses and dividends) of the Federal Reserve banks. Thus the amount that is to be paid to the Treasury is known and is used as the basis in working back to the interest rate which is necessary to accomplish the desired result. The computing procedure is outlined below:

1. Net earnings.
2. Deductions—
   (*a*) Dividends.
   (*b*) Allowances to build up surplus to 100 percent of subscribed capital.
3. Net earnings subject to interest (item 1 minus item 2).
4. Desired interest payment (90 percent of item 3).
5. Daily average of outstanding Federal Reserve notes not collateraled by gold certificates.
6. Interest rate (item 4 divided by item 5).

Senator MALONE. The question then is whether the Treasury should be required to return to the Federal Reserve bank that proportion of the earnings which the Board has diverted since 1946. But you have already reviewed that, and you would not consider that necessary even if this amendment did not pass?

Mr. MARTIN. That is right.

Senator MALONE. When Mr. McKinney was discussing how member banks get reserves, he mentioned borrowing from the Federal Reserve banks and open-market operations, but he omits the float, which could be more important than the rediscounts and advances. Why wasn't this included? Do you have any information on that matter?

Mr. MARTIN. I thought he mentioned it, Senator.

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Senator MALONE. I didn't notice it in the review of the testimony.

Mr. MARTIN. I think he mentioned it.

Senator MALONE. Now his inventory of anti-inflation prescriptions does not include the elimination of the float. We have already reviewed that and your going into it again.

Mr. MARTIN. Right.

Senator MALONE. Now you have said that the Employment Act of 1946 plus the Federal Reserve Act, considering the two together, you think they give you the necessary authority—the general rule you have adopted is correct?

Mr. MARTIN. That is correct.

Senator MALONE. That you can take into account the amount of money in circulation necessary for "sustained economic growth."

You can consider the economic system and carrying the continued advance of the investments and economic system, you can take all that into consideration? On March 13, 1939, the banks issued the statement in respect to proposals to maintain prices at fixed levels through the monetary action in which it was stated that experience has shown that prices cannot be controlled by changes in the amount and cost of money. The Board's control of the amount of money is not complete, and cannot be made complete, that steady average of prices does not necessarily result in lasting prosperity—what do you have to say there that the prices cannot be controlled by changes in the cost of money?

Mr. MARTIN. I will have to review that statement, Senator. I am not familiar with it. That is March 13, 1939?

Senator MALONE. Yes, March 13, 1939. Now, a steady level of average prices is not nearly as important to the people as a fair relationship between the prices of commodities which they produce and those they must buy. The relationship you know is what counts. Will you discuss that?

Mr. MARTIN. I will.

(The following was subsequently furnished for the record:)

I was not a member of the Board in 1939 and the present Board has not had occasion to review the statement of March 13, 1939. It is quite clear, however, that the conditions which confront us today are quite different from those of 18 years ago, to which that statement was addressed. At that time a major concern was a decline in wholesale commodity prices, primarily in the prices of farm products, which had continued for about 18 months and which appeared to threaten recovery from the secondary depression of the late thirties. The ease in credit conditions then was unprecedented, yields on United States Government securities were at new record low levels, the excess reserve position of member banks exceeded $4 billion, and consumer prices were relatively stable.

My statement with respect to the Employment Act of 1946 is addressed to a situation where there has been such a persistent rise in the cost of living at a time of high prosperity that business and individual decisions begin to be made in the expectation that the cost of living will continue to rise. This, we believe, can only lead to ultimate economic chaos and incalculable human suffering.

Senator MALONE. Now, the Board then at that time was opposed to the steady average of prices as a criterion of economic health. They did not wish Congress to make a prerequisite of Federal Reserve policy. You seem to disagree with items 3 and 4 of that Board statement. What lessons have we learned since 1939 in that regard which would indicate that your opinion as to desirability of stable prices is correct and their judgment erroneous in 1939? Have you thought of it in that light?

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Mr. MARTIN. I have, and I will be glad to get that statement of 1939 and——

Senator MALONE. All right. Now may I ask you a question that is bothering a good many people. You are in a position to know. Did the Treasury furnish oil companies, that is through the banks, the members of the Reserve System, like the Chase National, the National City banks and others, to pay oil royalties in the Middle East or Indonesia in the past 5 years?

Mr. MARTIN. I don't know.

Senator MALONE. Is there any way of finding out?

Mr. MARGET. I think I know, Senator, the problem referred to. I will try to provide the information.

(The following was subsequently furnished for the record:)

I know of no such transactions during the past 5 years. In 1948, a foreign government released gold sovereigns, held under earmark at the Federal Reserve Bank of New York, to enable an oil company to make royalty payments in the Middle East. This was an agency transaction and did not involve the account of either the United States Treasury or the Federal Reserve System.

Senator MALONE. Fine. You can provide it.

Mr. MARTIN. Yes.

Senator MALONE. How much gold has been provided in foreign trade? It is my impression that we have a table in volume I of the printed testimony.

Mr. MARTIN. I think we have it, but we will get it for you.

(The following was subsequently furnished for the record:)

A table showing United States gold transactions with foreign governments, central banks, and international institutions, 1934–57, has been submitted by the Secretary of the Treasury and published on page 457, part 1, of these hearings.

Senator MALONE. That is a matter of judgment. You are familiar with the fact that a good many Treasury bonds are bonds issued by the Treasury and are being cashed in pretty fast, as a matter of fact; isn't that a fact?

Mr. MARTIN. Yes.

Senator MALONE. Why do you think that has taken place? Does it have anything to do with lack of confidence in the money system, the bonds, as to what their value is likely to be, market value?

Mr. MARTIN. Well, in the case of E bonds, it is not market value, but I think it is an opportunity to get a better return on some other investment.

Senator MALONE. In other words, they think their money is safer in stocks than it is in bonds?

Mr. MARTIN. I don't think it is a case of safer. I think they think they can get a better return.

Senator MALONE. In other words, they can realize on the inflation.

Mr. MARTIN. That is right.

Senator MALONE. That the price of the bonds, if they are sound bonds to start with, in sound companies, will advance with inflation.

Mr. MARTIN. That is right.

Senator MALONE. And the Government's security will not?

Mr. MARTIN. That is right.

Senator MALONE. So you think that is more the reason than lack of confidence?

Mr. MARTIN. I think so.

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Senator MALONE. What is the price of these bonds on the market right now? What are the various rates of interest that are being paid on the bonds that are on the market at the present time?

Mr. MARTIN. The E and H bonds that are being sold now pay 3¼ percent interest. They are not marketable. They can be cashed at any time for the same amount of money that was put into them.

Senator MALONE. Plus the interest up to date?

Mr. MARTIN. Yes. There is a table on the back of each bond that shows how much you can get if you hold it for a specified period of time.

Senator MALONE. And that approximates the amount of interest up to that date?

Mr. MARTIN. That is right.

Senator MALONE. What is that bond worth on the open market?

Mr. MARTIN. They are not marketable, you see. The E and H bonds are—if you buy the bond, a $1,000 bond for $750, you can, after holding it 2 months, always get your $750 back. If you hold it for 6 months you will get $756. If you hold it for another 6 months, you get——

Senator MALONE. So if you hold it over a 10-year period, you get the $1,000 regardless of what it will buy, less or more at that time?

Mr. MARTIN. That is right.

Senator MALONE. What bonds are there that are marketable?

Mr. MARTIN. There is quite a list of them here.

Senator MALONE. Would you make that just a part of the record.

Mr. MARTIN. Yes; we will be glad to.

Senator MALONE. What are those bonds quoted on the market, a $100 bond, what is it quoted on the market—there are different rates of interests on these bonds, are there not.

Mr. MARTIN. I will get you recent market prices on all of them and put them in.

(The following was subsequently furnished for the record:)

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Prices and yields, U. S. Government marketable securities, Aug. 19, 1957

[In millions of dollars]

Issue	Amount outstanding	Yield (percent)	Price in points and 32ds
Treasury bills:			
Aug. 22, 1957	$1,800	3.05	
Aug. 29, 1957	1,801	3.00	
Sept. 5, 1957	1,800	3.00	
Sept. 12, 1957	1,800	3.00	
Sept. 19, 1957	1,600	3.05	
Sept. 23, 1957 [1]	1,501	3.07	
Sept. 26, 1957	1,602	3.02	
Oct. 3, 1957	1,599	3.10	
Oct. 10, 1957	1,600	3.12	
Oct. 17, 1957	1,601	3.15	
Oct. 24, 1957	1,601	3.20	
Oct. 31, 1957	1,700	3.24	
Nov. 7, 1957	1,700	3.28	
Nov. 14, 1957	1,700	3.28	
Mar. 24, 1958 [1]	3,002	4.00	
Apr. 15, 1958	[2] 1,750	[2] 4.25	(2)
Total Treasury bills	28,157		
Certificates:			
3⅝, Dec. 1, 1957	9,971	3.56	100.00+
3⅜, Dec. 14, 1958	10,851	4.03	99.22
3½, Apr. 15, 1958	2,351	3.98	99.22
4, Aug. 1, 1958	10,599	3.96	100.01
Total certificates	33,772		
Treasury notes:			
1½, Apr. 1, 1958	383	3.58	98.24
2⅞, June 15, 1958	4,392	4.05	99.02
1½, Oct. 1, 1958	121	3.64	97.22
1⅞, Feb. 15, 1959	5,102	3.98	97.00
1½, Apr. 1, 1959	119	3.80	96.14
1½, Oct. 1, 1959	99	3.83	95.10
1½, Apr. 1, 1960	198	3.93	94.00
3½, May 15, 1960	2,406	3.98	98.24
1½, Oct. 1960	278	3.91	93.00
1½, Apr. 1, 1961	144	4.03	91.18
4, Aug. 1, 1961	2,589	3.90	100.12
1½, Oct. 1, 1961	332	4.10	90.08
3⅝, Feb. 15, 1962	647	3.75	99.16
1½, Apr. 1, 1962	176	4.22	88.22
Total Treasury notes	16,986		
Treasury bonds:			
2½, March 1956–58	1,449	3.85	99.08
2¼, September 1956–59	3,819	4.01	96.17
2⅝, March 1957–59	927	3.99	97.18
2⅜, June 1958	4,245	3.94	98.24
2½, December 1958	2,368	3.97	98.04
2¾, June 1958–63 [3]	919	2.85	99.14
2¼, June 1959–62	5,270	4.04	92.08
2¼, December 1959–62	3,459	3.97	91.26
2⅛, November 1960	3,806	3.95	94.16
2¾, December 1960–65 [3]	1,485	2.88	99.02
2¾, September 1961	2,239	4.00	95.12
2½, November 1961	11,177	4.06	94.00
2½, June 1962–67	2,114	3.79	89.16
2½, August 1963	6,755	4.01	92.02
2½, December 1963–68	2,822	3.86	87.18
2½, June 1964–69	3,749	3.88	87.00
2½, December 1964–69	3,824	3.85	86.28
2½, March 1965–70	4,708	3.83	86.26
2½, March 1966–71	2,954	3.75	86.26
2½, June 1967–72	1,860	3.67	86.26
2½, September 1967–72	2,718	3.69	86.12
2½, December 1967–72	3,770	3.63	86.26
3¼, June 1978–83	1,605	3.70	92.16
3, February 1995	2,744	3.61	87.16
Total bonds	80,783		
Panama Canal bond: 3, June 1961	50	2.12	102.08
Total marketable direct debt	159,748		

[1] Tax anticipation issue.
[2] "When-issued."
[3] Partially tax-exempt.

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Senator MALONE. All right.

Do you of your own knowledge know that they are under 100 percent?

Mr. MARTIN. Oh, yes. There are a number of them that are under.

Senator MALONE. How low are they quoted, some of them?

Mr. MARTIN. I would say about 83, 84 is about as low as it is.

Senator MALONE. What is the reason for that?

Mr. MARTIN. The reason for it is the increase in interest rates and the—that is the method by which the increase in interest rates is reflected in the bonds of current holders.

Senator MALONE. I just wanted the record to show it. You can elaborate in this list, if you will.

Mr. MARTIN. Yes.

Senator MALONE. For a long time—your memory wasn't very good before—for a long time when this debt was going up by leaps and bounds, the propaganda from Washington was that it does not make any difference because the interest is so much lower, so the cost of the additional amount is really lower than the original amount. Do you remember the propaganda that used to go out, that lowering the interest rate would result in a lower cost of carrying the increased debt even though the debt was greater? Do you remember that argument?

Mr. MARTIN. Yes.

Senator MALONE. You do remember it?

Mr. MARTIN. I remember that.

Senator MALONE. Since we got ourselves in this fix, many of us knew and stated that it would happen, when we reached around a $280 billion debt, Mr. Chairman, that the interest would be raised. What is the debt today?

Mr. MARTIN. About two hundred and seventy-three.

Senator MALONE. $273 billion. It varies from day to day, doesn't it?

Mr. MARTIN. Right.

Senator MALONE. Whatever it is, if we are successful in selling all of the bonds, Mr. Chairman—what is the last issue offered at, what rate of interest?

Mr. MARTIN. That last issue was a 237-day bill in the amount of a billion and three-quarters, and it sold at 4.17 percent.

Senator MALONE. Haven't some been put out at about five?

Mr. MARTIN. No. That is the highest.

Senator MALONE. Not yet. So that is the highest. If you are able to float everything as you go along during the next year, there are quite a few maturities as you go along, aren't there?

Mr. MARTIN. Yes.

Senator MALONE. Suppose we come to the end of all of them? We refinance, and it is 4 or 5 percent, 4½ percent average, times $273 billion. What would be the interest charged to the Government?

Mr. MARTIN. That is an almost impossible computation.

Senator MALONE. After it all happened, if there was an average of 4½ percent, it would be easy; wouldn't it?

Mr. MARTIN. Yes.

Senator MALONE. What would it amount to?

Mr. MARTIN. I have to compute it.

Senator MALONE. Just make it a part of the record. It would be around 13 to 14 billion; wouldn't it?

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Mr. MARTIN. It would be very high.

(The following was subsequently furnished for the record:)

Four and one-half percent of $273 billion is about $12.3 billion. Of the $273 billion of public debt about $160 billion is marketable debt, of which less than one-half matures within a year while $2.7 billion does not mature until 1995.

Senator MALONE. What was the cost of running the Government in 1933 or 1934, the total cost of everything?

Mr. MARTIN. It was relatively way down. We can check.

(The following was subsequently furnished for the record:)

Budget expenditures in 1933 were $4.7 billion and in 1934, $6.7 billion.

Senator MALONE. For your information, it was about $3½ billion a year. Times have really changed, haven't they? The interest on the debt is four times that now, or coming up to it.

What was this about the German Government loaning a hundred million dollars to the World Bank? Are you familiar with that? Mr. Chairman, do you know about that?

Mr. MARTIN. Mr. Marget can answer that.

Mr. MARGET. Yes, it was simply this. The German Government has a large reserve. It has been the custom for many of the European, indeed foreign central banks all over the world, to keep some of their reserves invested in short-term securities in the New York market. They invest, for example, in Treasury bills on a considerable scale. What they have done here, since the German reserves are very comfortable, is simply this. They thought they could invest this sum in securities of a slightly longer maturity, with a higher yield.

Senator MALONE. They did loan them the money?

Mr. MARGET. Yes.

Senator MALONE. Where did they get the money to loan $100 million back to an outfit that we largely financed?

Mr. MARGET. We financed Germany—let me put it this way—we financed it at a time when its level of economic activity was very low indeed, when there was hunger in the country, when the whole economic apparatus was smashed. Since that time, Germany has staged a very remarkable recovery and one of the aspects of this recovery was that she was not only able to import considerable commodities, so to speak, to pay her way, but also to do some saving in the form of building up reserves.

That is the answer, I think. She has built up a very sizable reserve.

Senator MALONE. Germany has 1,777 million in dollar balances; is that right?

Mr. MARGET. That is the dollar balance part of it. If you include her gold holdings, it is much more. She has not far from $4 billion in gold and foreign exchange holdings.

Senator MALONE. What are her gold holdings?

Mr. MARGET. I will look that up.

Senator MALONE. I think we have asked for a table of gold holdings for each nation. If you have it handy, you can supplement the record here.

Mr. MARTIN. That is right.

Mr. MARGET. I can give you that German figure.

Senator MALONE. Just give round figures, and then correct it in the record. You don't have to find it.

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Mr. MARGET. We do have it separately broken down. Gold and short-term dollars together are over 3 billion, 3.5. The rest of it, the rest of the 4 billion, is made up of convertible currency.

Senator MALONE. What would that make the gold holdings?

Mr. MARGET. Something under the 3.5 billion figure I just gave you, because that includes also the dollar balances.

Mr. MARTIN. I would think they would be, roughly, a billion and three-quarters.

Senator MALONE. Where did they get this gold?

Mr. MARGET. They accumulated it out of trade basically. It came basically from excess of exports over imports, and some capital movement. There has been some recent strong speculative movement of funds to Germany. Money has gone to Germany because the speculators think they will appreciate their currency.

Senator MALONE. That means raise the value in terms of the dollar?

Mr. MARGET. That is right. The figure for reported gold reserves of Germany is $1.8 billion.

Senator MALONE. Let me ask you: Do they still use the mark?

Mr. MARGET. It is the mark reestablished after the war.

Senator MALONE. They just cut loose from anything they issued before. Haven't they done that twice now over the span of years—two wars?

Mr. MARGET. They call this the deutschemark as opposed to what they called the reichsmark. The reichsmark was the currency that depreciated so considerably during the war, and then they had a conversion.

Senator MALONE. How much money have we given Germany since the war?

Mr. MARGET. Something about $3 billion in relief of various kinds.

Senator MALONE. It corresponds roughly to the dollar balance and the gold they have?

Mr. MARGET. It happens to work out that way.

Senator MALONE. I don't see how it could do otherwise.

Mr. MARGET. Some other countries haven't come out with such an equal balance.

Senator MALONE. I don't suppose Congress and the Secretary of the Treasury and the Federal Reserve think of it, but I have. I thought of it in 1947. German people will work and they will fight. That is different from most of the European nations.

Now, what I would like to leave roughly with you, Mr. Secretary—we have covered most of it, I think—is that the plan—and I believe there was a plan—in 1933 and 1934, and from there on for a number of years to depreciate our currency through inflation, price ourselves out of all world markets, which we did, all this poppycock about our methods and know-how, being able to compete with cheap foreign labor, of course, doesn't stand up. If you would look it over, you would know better in 5 minutes.

The United States investors—and I do not blame them, they are smart, and if I were handling one of their companies, I would do exactly the same—I blame a silly Congress and a policy of an administration that makes it profitable—under this free trade where there is no duty or tariff to equal the difference in the wage standard of living and the cost of doing business here and in the chief competing

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nation on each product. Through the 1934 Trade Agreements Act the responsibility of Congress to regulate foreign trade was transferred to 34 competing nations in Geneva; with 4 organizations which we have reviewed—you named them for me at the beginning. Can you name them again?

Mr. MARTIN. The Export-Import Bank, the International Bank, the International Monetary Fund, and the International Finance Corporation.

Senator MALONE. Those are the four.

Mr. MARTIN. Yes.

Senator MALONE. And coupled with the Department of Commerce, all with one idea; that is, to get American capital invested abroad in the so-called underdeveloped countries by cheap-labor countries.

I promised one of your compatriots in another department, if he wanted to see some real underdeveloped areas, I will show him some after the session in this country, not only underdeveloped, but going back to the undeveloped state under our free-trade policies, after millions and millions of dollars had been expended to develop them.

This is what they do. I want you to understand it and I want it in the record. Not only are American investments going abroad to use the low-cost labor and import goods into this country, but the 70 billion, whatever it is, including the 4 billion to Germany, has been used to build the factories and to manufacture the products, the very goods they are importing, that we were manufacturing here with American labor. Now our industries are being kept alive to the extent of the armed services buying.

So, they take advantage of those billions of dollars of taxpayer's money invested in foreign countries and with their own capital compete with American labor and investors. The last factory built is the best in the world, because it is the last one—would you understand that?

Mr. MARTIN. Yes.

Senator MALONE. Whom do they send—engineers and enconomists go first—the best in the world—the best they can get. Then they take the best trained men, 3 to 5 percent of American workingmen, maybe 7 to 8 percent, to train the low-cost labor. He does one thing and does it well, and, in a week or a month, he can learn to do it under the instruction of the American workingman who is the teacher while he is working.

I have been through these factories. I am not talking from hearsay or from reading about it. The difference of the cost of labor is the difference in cost of the product plus transportation.

So, these men are trained by American workingmen. They have the best plant in the world. Where do you think the best copper plant is? I am about to tell you. I am sure you don't know. It is in northern Chile, because it is the last one built, a smelter. It is the best plant in the world.

The latest textile plants have been built in Japan, and are the best in the world, because they are the last ones. They don't hire any of these point 4 individuals, you notice. Most of them could not hold a job with private industry.

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So this poppycock of being able to compete with cheap foreign labor on account of our machinery and know-how is out, since our machinery and know-how is available to every nation.

The last, wherever it is, in Borneo, Chile, or in Idaho is the best plant. The only difference is in the cost of labor and transportation.

So from what you have said, you are just two decades behind, and it is the time for some of you to catch up with the world's methods.

In Japan and Germany they work longer hours and harder than we do.

So, the only difference, besides the difference in wages, is the cheap water transportation.

Under the conditions laid down by the General Agreement on Tariffs and Trade—GATT—the foreign nations don't have to live up to the conditions of the multilateral trade agreements while they are having money exchange difficulties. They will see to it that they have those troubles until we have averaged our wealth with theirs, and we are all living alike.

So, you are to judge how much money ought to be in circulation in the United States of America for sustained economic growth, with the mining, machine tools, textiles, crockery, chemicals, and 5,000 other products on the way out through foreign sweatshop labor competition.

You say that doesn't affect you, my friend; I think it does.

Then the 4 organizations you mentioned promoted American investments abroad—in 1946—through the $3¾ billion loans to Britain and the Marshall plan in 1948. We started the real distribution of America's wealth with the nations of the world. It is now the ICA—International Cooperation Administration—and through these gifts of cash these nations have built up dollar balances that endanger our whole economic structure.

The Prime Minister of England took General Marshall's statement in 1947 on the first bounce, and within 30 days told us just what it would cost us for 5 years—$17 billion. That was the real kickoff.

The cheapening of the dollar through inflation didn't start yesterday under you. You are not responsible for starting it, only for carrying it on. The inflation started when we left the gold standard in 1936. Do you agree with that?

Mr. MARTIN. I agree that inflation started then.

Senator MALONE. Then, in 1934, when they passed the 1934 Trade Agreements Act (so-called Reciprocal) that started the rush of imported cheap-labor goods into this Nation. Then, in 1955, Mr. Dulles testified, sitting right where you are now, that under the 1934 Trade Agreements Act the President had full authority to organize GATT and locate it in Geneva, which he did in 1947.

So, with 34 foreign competitive nations, sitting in Geneva, dividing the American markets among them through multilateral trade agreements, and the Federal Reserve Board continuing the inflation started in 1933, through their belief that they must judge the amount of money they put into circulation for "sustained economic growth," the American workingmen and investors are going down the drain.

So, what we inflated was our currency, and deliberately priced ourselves out of a world market. We have virtually free trade, so that American-produced products can be displaced by foreign cheap-labor materials in American markets.

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Thank God, the 1934 Trade Agreements Act, upon which GATT in Geneva is based, expires next year, in June.

It all adds up to a preconceived plan to destroy the economic and social independence of the United States.

I am going to read you what Mr. Lincoln said about such a plan. He gave us a way of recognizing it. He said, referring to things that were happening to him, referring to what he considered a preconceived plan—you will find this on page 537 of part 1 of these hearings—in a summary of the testimony of the Secretary of the Treasury, whom I admire, as you know; but Mr. Lincoln said:

> We cannot absolutely know that all these exact adaptations are the result of preconcert. But, when we see a lot of framed timbers, different portions of which we know have been gotten out at different times and places and by different workmen, and when we see these timbers joined together, and see they exactly make the frame of a house or a mill, all the tenons and mortises exactly adapted to their respective places, and not a piece too many or too few—in such a case, we find it impossible not to believe that all worked upon a common plan or draft drawn up before the first blow was struck.

Does that ring a bell, that all these happenings beginning in 1933 dovetail, Mr. Chairman?

Mr. MARTIN. I think that is a very interesting quotation.

Senator MALONE. It is beyond an interesting quotation. It shows perception. We need a little horsesense such as displayed by Lincoln in those days, and I don't think we are past redemption. I think that Congress in 24 years has transferred practically all of its responsibility under the Constitution of the United States to the Executive—and he has given as much of that power to foreign nations through international organizations as he can under the law.

Congress is not exercising its constitutional responsibilities. Why? I cannot tell you. I believe that Congress will start taking back its constitutional responsibility. That is my opinion.

Do you know why I believe that? The people have known for a long time that something is wrong. They worship the President. They like to believe in the Congress. Their confidence is very hard to shake. But we have shaken it. And they are beginning to think now, and you are going to hear from them; and when you do, this Congress will change overnight.

I believe—I actually believe this—that if the people of this Nation suddenly fully understand what the Congress has done to them over 24 years, they would move on Washington, they would not wait for an election.

It is the fault of Congress. It is not your fault that all these things make a pattern, and they do, Mr. Chairman. You are just one little tadpole in the puddle, but you may have authority you should not have, just as the Director of the Office of Defense Mobilization with an office in the White House who can write off taxes on a short amortization plan for a construction that he himself judges necessary in the national-defense picture. No one man should have that power.

I will place a summation of what you have said today in the record, just as I did with the Secretary of the Treasury, and I know you will have no objection.

Mr. MARTIN. Not a bit, Senator.

I have enjoyed very much having this opportunity to get an insight into your thinking.

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Senator MALONE. I don't say that I have decided anything. I came here 11 years ago. I am going to try desperately, as I have in the foreign-trade field, to understand the workings of this financial setup, so when we have to vote here, I will have made up my mind.

I hope I am guided enough in it that I won't make a mistake. I can't tell you I won't. I don't know. No man knows all these things. We only set them up in the last 24 years to give one man the authority to say, "You shall sink or swim in a certain industry. You shall have a certain percent interest that will come about by the amount of money in circulation. You shall have one man who is a judge here whether the economic system needs more money or less."

Congress passed the legislation; you didn't do that.

We are adjourning the meeting, to the call of the Chair.

Mr. MARTIN. Thank you very much, sir.

(Senator Malone subsequently submitted the following:)

SUMMARY

The 1957 annual report of the International Monetary Fund contains some very pertinent information under the heading "Relations With Other International Organizations."

INTERNATIONAL ORGANIZATIONS

The following paragraph under that heading is found on page 142 of the 1957 annual report:

"In addition to its special relationship with the International Bank for Reconstruction and Development, the fund has maintained close contacts with the contracting parties to the General Agreement on Tariffs and Trade (GATT), the Organization for European Economic Cooperation (OEEC), and the Bank for International Settlements. Arrangements were agreed for an increase in the interchange of information of mutual interest between the fund and the contracting parties, and liaison has been maintained between the secretariats of the two organizations. As in the past, fund missions attended meetings of the contracting parties in Geneva, and the contracting parties were represented at the annual meeting of the governors of the fund in Washington.

"The fund was consulted in 1956 by the contracting parties in connection with their consultations with five governments on the discriminatory application of import restrictions being imposed in order to safeguard balances of payments and monetary reserves. In addition, similar consultations with the fund are being held through 1957 in connection with the contracting parties' consultations with some 20 governments on import restrictions maintained for balance of payments reasons. The fund transmits to the contracting parties the results of its own article XIV consultations with the various governments concerned, together with background material relating to such countries, and fund missions cooperate with the GATT working parties conducting the consultations."

INTERNATIONAL SOCIALISM

The summary of my cross-examination of former Secretary of the Treasury, George Humphrey, found on page 537, part 1 of the hearings of the Senate Finance Committee, contains an outline of the relationship between our currency managed by the Federal Reserve Board and the Secretary of the Treasury, the four organizations to promote American investment abroad, the 1934 Trade Agreements Act, resulting in the regulation of our foreign trade by 34 foreign competitive nations under the General Agreement on Tariffs and Trade located at Geneva, and the distribution of American taxpayers' money throughout the world spearheaded by the Marshall plan in 1948, and currently under the International Cooperation Administration.

MANAGED CURRENCY

The testimony of the Chairman of the Federal Reserve Board, Mr. William McChesney Martin, is very closely related to the testimony of the Secretary of the Treasury, Mr. Humphrey. Mr. Martin emphasized that the managed cur-

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rency should continue until the relations between the nations of the world had become stabilized. Since such conditions have not existed for several hundred years the estimate of time which must elapse before we could return to a sound money basis, such as the gold standard that would prevent inflation, is rather remote.

A MANAGED CURRENCY EQUALS A MANAGED ECONOMY

A managed currency leads to a managed economy, and since Congress no longer has any direct control over the money system and has divested itself of control of foreign trade and is willing to appropriate billions of dollars each year of the taxpayers' money to be distributed throughout the nations of the world, to say that you have a managed economy is probably a mild assertion.

The Chairman of the Federal Reserve Board, Mr. Martin, claims the authority under the Federal Reserve Act and other legislation to regulate the amount of money in circulation in accordance with the judgment of the Board for a "sustained economic growth," whatever this phrase may mean.

Much of my cross-examination of both Mr. George Humphrey, former Secretary of the Treasury, and Mr. William McChesney Martin, Chairman of the Federal Reserve Board, hinged around the advisability of abandoning the managed currency idea which has led to a managed economy and returning to the gold standard where the citizens of this Nation could present a gold certificate at the window and secure gold in payment, and likewise with the silver certificates. Therefore, I am submitting a complete study and outline of the history of the gold standard and the use of the metal for stabilization of the currency which, coupled with the summary of my cross-examination of the Secretary of the Treasury found in part I of the hearings, on page 537, completes the résumé to date.

GOLD, DOLLARS, AND THE INTERNATIONAL MONETARY FUND

1. "The Congress shall have Power * * *To coin Money, regulate the Value thereof, and of foreign Coin, and fix the Standard of Weights and Measures."—Constitution of the United States, article I, section 8, paragraph 5.

2. Congress on April 2, 1792, created the gold eagle, in the value of $10, designating its weight as 270 grains 0.9162/3 fine. The net gold content of the eagle was 247.5 grains or 24.75 grains per dollar.

3. On June 28, 1834, Congress reduced the net gold content of the dollar to 23.2 grains by lowering the required fineness to 0.899225, and on January 18, 1837, the net gold content of the dollar was increased to 23.22 by increasing the fineness to 0.900. No change in fineness has been made since and if gold coinage was resumed gold coins, in the absence of a statutory change, would contain 9 parts gold and 1 part copper.

4. On January 31, 1934, the President of the United States, Franklin D. Roosevelt, set the weight of the official but fictitious gold dollar at $15\frac{5}{21}$ grains 0.900 fine, thus reducing the net gold content of the dollar to 13.7142 grains. The gold content of the dollar was thus reduced to 59 percent of what it had been for 97 years.

5. The late Garet Garrett, an authority on finance and who handled financial news on leading New York newspapers for many years, states in his work, The People's Pottage, what the purpose was and how the administration profited from this devaluation of the dollar. "The difference, which was 41 cents in every dollar of gold that had been confiscated, was counted as Government profit and took the form of a free fund in the Treasury, called a stabilization fund, with which the President could do almost anything he liked. Actually it was used to take control of the foreign exchange market out of the hands of international finance." Subsequently, however, foreign exchange control was again internationalized, and by action of the same administration, as will be shown.

6. Devaluation of the dollar to 59 percent of its former worth was accomplished by a series of steps, including:

(*a*) An Executive decree signed by the President on April 5, 1933, requiring all individuals and corporations to turn over their gold to the Government subject to penalties of double the value of any amounts of gold withheld plus imprisonment for noncompliance.

(*b*) Congress in the Federal Emergency Relief Act of May 12, 1933, gave the President authority to devalue the dollar at his discretion in any amount down to 50 percent of its previous value. Although gold had been confiscated and the President now had power to diminish its value, many corporations and indi-

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viduals still held gold certificates which on their face were redeemable in gold. They had been sold and purchased in good faith and the Government had a solemn obligation if not a statutory or contractural duty to so redeem them at the termination of the emergency.

(*c*) On June 5, 1933, Congress by an act requested by the administration, repudiated the gold redemption clause in all Government obligations, in effect divorcing all citizens from any semblance of the gold standard.

(*d*) The President, under the presumed authority granted him in the Federal Emergency Relief Act, issued an Executive pronouncement authorizing the Reconstruction Finance Corporation to "buy newly mined gold in the United States at prices to be determined from time to time after consultation with the Secretary of the Treasury and the President." The President also announced it a policy to buy and sell gold in the world market.

(*e*) In accordance with this plan the President and the Secretary of State then until January 30, 1934, determined on a day-to-day basis the price that would be paid for minted gold, making such determinations arbitrarily and following no known criteria. Prices fluctuated generally between $30 and $34.

(*f*) Congress on January 30, 1934, ratified the previous confiscation of gold coinage, and vested in the Government absolute title to the gold it had compelled the people to surrender in the months preceding.

(*g*) One day later, on January 31, 1934, the President formally reduced the amount of gold in the dollar to the amount described in paragraph 4.

7. On May 25, 1942, a so-called Cabinet Committee was set up at the request of the President to consider a plan proposed by the Treasury Department to set up a United Nations Stabilization Fund, later to become the International Monetary Fund, and a bank for "reconstruction and development." The Committee functioned until completion of preparations for the Bretton Woods Conference of July 1–22, 1944, at which the International Monetary Fund was born. Secretary Morgenthau, Harry Dexter White, and V. Frank Coe were among those attending the initial Committee meeting. Harry Dexter White was generally conceded to be the spearhead for this plan.

8. According to State Department publications "it being agreed that it was desirable for this Government to proceed with its plans for the creation of an international monetary fund and bank, it was decided at this meeting to establish an interdepartmental subcommittee, which would report to the 'Cabinet Committee.' This subcommittee, known as the American Technical Committee, held its first meeting on May 28, 1942, under the chairmanship of Harry D. White, who was primarily responsible for the Treasury's work in this field."

9. On April 7, 1943, the Treasury Department made public a letter from Secretary Morgenthau to Finance Ministers of 37 "United and Associated Nations," again quoting the Treasury Department, "enclosing the proposal for an International Stabilization Fund developed by the Treasury under the guidance of Harry D. White in collaboration with the interdepartmental American Technical Committee and inviting them to send their technical experts to Washington to discuss the proposal. The following day, the British Government released the plan drawn up by its experts headed by Lord Keynes."

10. "The discussions were conducted for the United States by the American Technical Committee and continued throughout the rest of 1943 and into 1944. They include an exchange of views with Soviet experts, who came to Washington early in 1944, and continuing exchanges with the British * * *"

11. A "Joint Statement by Experts on the Establishment of an International Monetary Fund" was released on April 21, 1944. The statement set forth "principal features" of the proposed international fund on which, to quote the State Department, "agreement had been reached among the United States, the United Kingdom, China, the Soviet Union, and other countries."

12. President Roosevelt on May 26, 1944, announced he had called a conference of 44 nations to meet at Breton Woods, N. H., in July of that year "to discuss the proposal for an International Monetary Fund and 'possibly' the proposal for a Bank for Reconstruction and Development."

13. At the conference, held July 1–22, 1944, in a remote mountain resort hotel at Bretton Woods, agreement was reached to create both the International Monetary Fund and International Bank for Reconstruction and Development. Secretary of the Treasury Morgenthau was chairman of the United States delegation, which included Harry Dexter White, Assistant to the Secretary, and from December 15, 1941, in direct charge of all Treasury matters "having a bearing on foreign relations."

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14. Articles of agreement were signed by delegates to the Conference, subject to ratification by their governments.

15. The International Monetary Fund Agreement, conceived by Harry Dexter White and his associates, professes a number of generalized objectives, including the promotion of exchange stability, establishment of a multilateral system of payments, and the advancement of funds to member countries "to correct maladjustments in their balance of payments." Actually it embraces a scheme for a perpetual international RFC, international control of the currencies of the world, and acquisition by officers and manipulators of the Fund of complete knoweldge of gold production, gold transactions, and the national economy of nations throughout the world.

16. Economic policy was to be given equal weight with monetary policy in a provision that funds of the new international organization were to be used "to the development of the productive resources of all members as primary objectives of economic policy," and for the elimination of restrictions "which hamper the growth of world trade." Thus the fund was a forerunner of the $3,700 million loan to Great Britain, in which Harry Dexter White participated, the General Agreement on Tariffs and Trade, commonly known as GATT, in the conception of which Mr. White also participated, and in the subsequent foreign aid program which have cost the taxpayers of the Nation $69,136 million or only slightly under $70 billion.

17. The agreement specified that members of the fund should be those countries represented at the Bretton Woods conference whose governments accepted membership, and to all other governments which subsequently sought membership in accordance with "such terms as may be prescribed by the fund."

18. Each signatory country to the agreement was assigned a quota as its contribution to the fund, which initially was to total $8,800 million. The United States was assigned the largest quota, $2,750 million, which was paid in full, most of it in 1946 and the remainder in 1947. The United Kingdom was assigned a quota of $1,300 million, Russia a quota of $1,200,000, China a quota of $500 million, and the other 41 signatory nations amounts ranging downward to $500,000. Russia, however, did not become a member or contribute.

19. Each member, under the agreement, was to pay his contribution partly in its own currency and partly in gold or United States dollars. The remainder had the option of paying in gold 25 percent of its quota, or in gold and United States dollars 10 percent of its net official holdings in gold or dollars. Whichever basis of payment the nation chose, it was required to furnish to the fund the amount of its holdings in gold and dollars. Officers of the fund would therefore obtain full knowledge of the financial stability of each member nation.

20. The signatory countries were all nations which had been "united" or "associated" in World War II, and had therefore participated to a major or minor degree in the $49,224, million expended by the United States in wartime assistance. Britain, not long after the monetary fund agreement, was extended a loan of $3,750 million, or nearly 3 times her quota to the monetary fund, a loan in which Harry Dexter White was active in procuring for her. White also proposed a $10 billion credit to Soviet Russia in addition to the $11 billion she has received in so-called lend-lease, but the latter was not granted and Russia did not become a participant in the fund. In other words, the United States, directly or indirectly, could be said to have financed the gold or dollar contributions to the fund made by other countries.

21. Seventy-five to ninety percent of the contributions by foreign countries were made in their own currencies, which with the exception of several commonwealths were of fluctuating or little value. As stated before, these foreign nations were required to contribute only 10 to 25 percent in gold or dollars; the United States was required to contribute 100 percent in gold or dollars.

22. The fund agreement stipulated that each member country furnish the fund such information as the officers of the fund deem necessary, including data pertinent to virtually every phase of the nation's economy.

23. Specifically, data are required on the following:

(*a*) Price indexes, i. e., indexes of commodity prices in wholesale and retail markets and of export and import prices.

(*b*) National income.

(*c*) Gold production.

(*d*) Gold exports and imports, according to both countries of destination and origin.

(*e*) Official holdings of gold at home and abroad.

(*f*) Official holdings of foreign exchange.

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(*g*) Holdings of gold by banking and financial agencies, other than official agencies.

(*h*) Holdings of foreign exchange by banking and financial agencies other than official agencies.

(*i*) Total exports and imports of merchandise, in terms of local currency values, according to countries of destination and origin.

(*j*) International balance of payments, including gold transactions, trade in goods and services, and known capital transactions.

(*k*) International investment position, i. e., investments within the territories of the member owned abroad and investments owned abroad by persons in its territories.

(*l*) Buying and selling rates for foreign currencies.

(*m*) Exchange controls.

(*n*) Details of amounts awaiting clearance in respect to commercial and financial transactions.

24. Assuming the authority and supernational powers of a one-world government, the agreement provided that the International Monetary Fund might obtain "further information" facilitating the preparation of studies "designed to assist members in developing policies which further the purposes of the fund."

25. Each participant was required by the agreement to express in terms of gold or terms of the United States dollar the par value of its currency as of July 1, 1944.

26. Changes in the par value of a member's currency, the agreement stipulates, "may be made only on the proposal of the member and only after consultation with the fund," and no member shall propose a change "except to correct a fundamental disequilibrium." This provision is of particular importance to the United States. As stated in paragraph 4 the par value of the United States dollar was reduced by President Roosevelt on January 31, 1934, to a net gold content of 13.7142 grains, although the Constitution, article 1, section 8, paragraph 5, states that it is to be set by the Congress, which did set the par value prior to President Roosevent's action, and at a much higher gold content. Under the fund agreement, however, officers of the fund presume the right to pass on any change in the par value of the dollar the Congress might choose to make.

27. The 79th Congress enacted the Bretton Woods Agreement Act, approved by the President on July 31, 1945. Section 5 of that act states in part: "Unless Congress by law authorizes such action, neither the President nor any person or agency shall on behalf of the United States * * * propose or agree to any change in the par value of the United States dollar under article IV, section 5, or article XX, section 4, of the articles of agreement of the fund, or approve any general change in par values under article IV, section 7." Thus Congress, in effect, reserves the constitutional right which it possesses to revalue the dollar, but precludes another President from changing it as did President Roosevelt. Reserving only this authority, the 79th Congress otherwise affirmed the articles of agreement of the International Monetary Fund in their entirety.

28. The 79th Congress, in this same act, gave blanket endorsement to other international movements, declaring that "additional measures of international cooperation are necessary," that it is the "policy of the United States" to seek to bring about further agreement and cooperation among nations and international bodies, and that in pursuance of that policy ways and means should be sought "as soon as possible" to "reduce obstacles to and restrictions upon international trade, eliminate unfair trade practices, promote mutually advantageous commercial relations, and promote the stability of international economic relations."

Duties to equalize wages here and abroad are often referred to as trade barriers or obstacles to trade.

29. The inaugural meeting of the Board of Governors of the fund was held in Savannah, Ga., in March 1946, Executive Directors were selected, and Washington, D. C., established as headquarters of the fund. The first Washington meeting was held May 6, 1946.

30. Harry Dexter White was appointed Executive Director of the International Monetary Fund by President Harry Truman and entered on his official duties in that capacity on May 1, 1946, or 6 days prior to the first regular meeting. At that time White, the "father" of the International Monetary Fund who had nursed the plans for its formation since May 1942, was known to the Federal Bureau of Investigation, and to the White House, as a Soviet spy.

31. White was Executive Director of the International Monetary Fund, "the center for the collection and exchange" of international monetary, financial, and

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economic information, until December 3, 1952, when he was dismissed after invoking the fifth amendment before the Senate Internal Security Committee.

32. Par values on the currencies of 32 countries were announced on December 18, 1946, and by March 1957 there were 48 countries with par values agreed to by the fund. Many countries, however, maintain multiple exchange rates, with a wide disparity between the so-called official rate and the free rate; 38 of the present 60 member countries of the fund now employ multiple-exchange rates and discriminatory exchange practices.

The currencies of most of the 60 countries where par values were agreed to by the fund are valued at a much reduced rate on the exchange markets or free-market rate.

33. The par value of the currency of the following countries has not yet been established by the fund: Afghanistan, Nationalist China, Greece, Italy, Korea, Thailand, Uruguay, and Vietnam.

34. On January 7, 1957, the fund established the par value of the Argentina peso at 18 to the United States dollar or the equivalent of 0.0556. Argentina, however, under her multiple-exchange system, also has a free rate of 40 to the dollar or 0.0246.

35. Australia: Initial par value of the Australian pound, established on November 17, 1947, was 2.86507 grams of fine gold per pound or 322.400 United States cents per pound. On the proposal of the Australian Government, in which the fund concurred, the par value of the pound was changed on September 18, 1949, to 1.99062 grams of fine gold per pound or 224 United States cents per pound.

36. Austria: The schilling is 26 to the dollar or 3.84615 cents. It is unchanged since May 1953.

37. Belgium: The initial par value of the Belgian franc, established on December 18, 1946, was 0.0202765 gram of fine gold per franc or 2.28167 United States cents. On the proposal of the Belgian Government, in which the fund concurred, the par value of the franc was changed on September 22, 1949, to 0.0177734 gram of fine gold per franc or 2 cents.

38. Bolivia: The initial par value of the boliviano, established on December 18, 1946., was 0.0211588 gram of fine gold per boliviano or 2.38095 cents. On the proposal of the Government of Bolivia, in which the fund concurred, the par value of the boliviano was changed by decree on April 8, 1950, to 0.0148112 gram of fine gold per boliviano or 1.66667 United States cents. On May 14, 1953, on the proposal of the Government of Bolivia, in which the fund concurred, the par value of the boliviano was changed to 0.00467722 gram of fine gold per boliviano or 0.526316 of a United States cent. Bolivia, however, has a free rate, according to latest advices from the Department of Commerce, of 7,650 bolivianos to the United States dollar, a boliviano being the equivalent in value of only 0.00012 of a United States cent.

39. Brazil: The par value of the Brazilian cruzeiro, according to the International Monetary Fund, is 18.5 per United States dollar or 5.40541 United States cents. The official rate, according to the Department of Commerce is approximately the same, 18.82 to the dollar or the equivalent of 0.0531 dollar or slightly more than 5 cents. Brazil, however, also has a free rate of 77 to the dollar with an equivalent value of 1 3/10 cents.

40. Burma: The kyat contains 0.186621 gram of fine gold, or valued at 4.761 to the United States dollar or 21 cents.

41. Canada: Initial par value of the Canadian dollar, established December 18, 1946, was 0.888671 gram of fine gold per dollar or 100 United States cents. On September 19, 1949, "following consultations with the fund," the par value was changed to 0.807883 gram of fine gold per dollar, and on September 30, 1950, Canada introduced a new exchange system under which the exchange value would be allowed to fluctuate, "so that for the time being Canada will not insure that exchange transactions within its territories will be based on the par value established on September 19, 1949. Information given here in regard to par values of foreign currencies, and statements within quotations, are unless otherwise noted, from the International Monetary Fund publication "Schedule of Par Values," 23d issue dated March 15, 1957. With reference to Canada the publication also states: "No new par value has been proposed to the fund."

The Canadian dollar has consistently been worth more on the open market than the United States dollar. It is now quoted at $1.06 in United States money.

42. Ceylon: Par value of the rupee in terms of United States dollars, established January 16, 1952, is 4.76190 or 21 cents.

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43. Chile: Initial par value of the Chilean peso, established on December 18, 1946, was 0.028668 gram of fine gold per peso or 3.22581 United States cents. On the proposal of the Chilean Government, in which the fund concurred October 2, 1953, the par value was changed to 0.00807883 gram of fine gold per peso or 0.909091 of a United States cent. Chile, however, has a multiple-exchange system including a "bankers' free rate" and a "brokers' free rate." The Department of Commerce on June 10, 1957, noted the former as 592 to the United States dollar or a peso equivalent to 0.0017 cent, and the latter as 701 to the dollar with a peso equivalent to 0.0014 cent.

44. China: The par value has not yet been established.

45. Colombia: Par value of the Colombia peso, established on December 18, 1946, was 0.507816 gram of fine gold per peso or 57.1433 United States cents. On the proposal of the Colombian Government, in which the fund concurred on December 17, 1948, the par value of the peso was changed to 0.455733 gram of fine gold per peso or 51.2825 United States cents. Colombia has two rates, basic and free. The basic rate, according to the Department of Commerce is 2.51 pesos per United States dollar with a peso equivalent to 39.84 cents. The free rate, however is 7.05 pesos per dollar with the value of the peso equivalent to a fraction over 14 cents.

46. Costa Rica: The Costa Rican colon has a par value of 0.158267 gram of fine gold, with 5.615 to the dollar of each colon worth 17.809 cents, according to the fund. The Department of Commerce lists two exchange rates, one "official" and one free. The "official" rate is 5.67 to the dollar, and the free rate 6.65 or the equivalent of 15 and a fraction cents.

47. Cuba: The Cuban peso is the equivalent of the United States dollar.

48. Denmark: The initial par value of the Danish krone, established on December 18, 1946, was 0.185178 gram of fine gold per krone or 20,8376 United States cents. On the proposal of the Danish Government, in which the fund concurred, the par value of the krone was changed on September 18, 1949, to 0.128660 gram of fine gold per krone or 14.4778 United States cents.

49. Dominican Republic: The Dominican peso equals the United States dollar.

50. Ecuador: The initial par value of the sucre, established on December 18, 1946, was 0.0658275 gram of fine gold per sucre or 7.40741 cents. On the proposal of the Government of Ecuador, in which the fund concurred, the par value of the sucre was changed on December 1, 1950, to 0.0592447 gram of fine gold or 6.66667 United States cents. Ecuador has a "central bank" or "official" exchange rate, and a free rate. The official rate is given by the Department of Commerce, as 15.15 to the dollar or 6 6/10 cents, and the free rate as 18.30 to the dollar or 5½ cents.

51. Egypt: Par value of the Egyptian pound was established on December 18, 1946, as 3.67288 grams of fine gold per pound or 413.300 United States cents. On the proposal of the Egyptian Government, in which the fund concurred, the par value of the pound was changed on September 18, 1949, to 2.55187 grams of fine gold per pound or 287.146 United States cents.

52. El Salvador: Par value of the colon, set December 18, 1946, has remained at the equivalent of 2½ to the dollar or 40 cents.

53. Ethiopia: The Ethiopian dollar has remained stable, containing 0.357690 gram of fine gold and valued at 40¼ cents.

54. Finland: The Finnish markka contains 0.00386379 gram of fine gold, or 230 to a dollar and each markka worth 0.43 of a United States cent.

55. France: France presents an unusual situation. According to the fund: "The initial par value of the French franc, established on December 18, 1946, was 0.00746113 gram of fine gold per franc or 0.8399583 United States cent per franc. Since January 26, 1948, there has been no agreed par value with the fund for the franc.

Computations by the fund are made on the basis of the rate of 349.60 francs per United States dollar." Recently the French Government affected a devaluation of the franc by imposing what the Wall Street Journal terms "a new 20 percent tax on all imports except fuel and raw materials and a 20-percent subsidy on all exports except steel, iron, and certain grades of coal." It stated further: "The French Government's weekend tinkering with the franc is but a prelude to further devaluation moves."

In a dispatch from Paris by its correspondents there, it was reported that in the view of Paris financial experts "the selective devaluation will be extended within the next 6 months to take in most trade transactions not yet covered. And there's speculation that France may later be forced into an even deeper, across the board devaluation. * * * The weekend's partial devaluation was

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intended mainly to curb imports and bolster French exports, and thus reduce the nation's excess of foreign spending over earnings." Further in the report the writers state:

"A sizable deterioration in the free market value of the franc undoubtedly would move the International Monetary Fund to start reapplying pressures on the French to devalue further. France has a potential $262 million to draw on in the IMF, but that body is strongly of the view that France should not be allowed to withdraw its funds without further evidence that it is taking effective steps to combat inflation. French finances are certain to be a top topic at the September annual meeting of the Monetary Fund. The partial devaluation this weekend was in part designed to appease fund officials and head off a nasty showdown at next month's session, officials here reckon." Editorializing on France's move the Wall Street Journal states in part: "For years the French franc has been greatly and plainly overvalued. So it is simply a recognition of reality for the French Government now to cut the currency's value by 20 percent on most trade transactions. The French prefer not to call this devaluation but that is what it is. For one thing, various devices have already been in use to make French exports cheaper; the new 20-percent cut is intended to replace a system the French Finance Minister describes as 'complicated, uncertain, and precarious.' Thus the devaluation is not as drastic as it looks. *More importantly, the whole notion that nations can in fact peg their currencies at whatever rate they choose is illusory. They can't do it. If the pegged rate does not reflect real value—it usually doesn't—then free markets or black markets will provide the realistic exchange facilities. That has been the experience of France.*

"Not even the Russians, with their supposedly total control of the economy, can do it. The ruble is fantastically overvalued at four to the dollar, so for some time the Soviet Government has been making concessions to reality through discounts to tourists and other gimmicks. More recently the Soviets established a 'premium' rate of 10 to the dollar while still hanging on to the fiction of the old official rate. *Sooner or later, then, the governments which try to play this monetary game have to come down to earth.*" A New York dispatch, printed in the same August 13, 1957, issue, reported that "some New York dealers quoted the franc at 450 to the dollar, compared with around 435 Friday." [Emphasis in the above paragraph supplied.]

56. German Federal Republic: The initial par value of the deutschemark, established January 30, 1953, at 0.211588 gram of fine gold per unit or 4.2 to the United States dollar, the equivalent of 23.8095 cents, has not been changed since.

57. Greece: The par value of the Greek drachma has not been established by the fund.

58. Guatemala: Par value of the quetzal is identical to the United States dollar.

59. Haiti: Par value of the gourde is the equivalent of one-fifth of the United States dollar or 20 United States cents.

60. Honduras: The par value of the lempira is the equivalent of 50 cents, according to the International Monetary Fund, to 49½ cents in the Department of Commerce table.

61. Iceland: The initial par value of the Icelandic krona was established on December 18, 1946, as 0.136954 gram of fine gold per krona of 15.4111 United States cents. On the proposal of the Government of Iceland, in which the fund concurred, the par value of the krona was changed on September 21, 1949, to 0.0951359 gram of fine gold or 10,7054 United States cents. On March 20, 1950, on the proposal of the Government of Iceland, in which the fund concurred, the par value of the krona was changed to 0.0545676 gram of fine gold or 6.14036 United States cents.

62. India: The initial par value of the Indian rupee, established on December 18, 1946, was 0.268601 gram of fine gold per rupee or 30.2250 United States cents. On the proposal of the Indian Government, in which the fund concurred, the par value of the rupee was changed on September 22, 1949, to 0.186621 gram of fine gold or 21 cents.

63. Indonesia: No par value has yet been established but the fund makes its computations "on the basis of 11.40 Indonesian rupiahs per United States dollar."

64. Iran: The par value of the Iranial rial has remained unchanged from 0.0275557 gram of fine gold per unit or the equivalent of 3.1 United States cents.

65. Iraq: The initial par value of the Iraqi dinar, established on December 18, 1946, was 3.58134 grams of fine gold per dinar or 403 United States cents. On

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the proposal of the Iraqi Government, in which the fund concurred, the par value of the dinar was changed on September 20, 1949, to 2.48828 grams of fine gold per dinar or 280 United States cents.

66. Israel: Par value of the Israel pound was first established on March 13, 1957, as 0.493706 gram of fine gold, the equivalent of 55,555 United States cents.

67. Italy: Par value of the Italian lira has never been established.

68. Japan: The initial par value of the yen, established on May 11, was 0.00246853, the equivalent of 360 units to the dollar or 0.277778 of a United States cent, and has since been unchanged.

69. Jordan: Initial par value of the Jordanian dinar was established on October 2, 1953, as 2.48828 grams of fine gold per dinar, the equivalent of 280 United States cents.

70. Korea: Par value not yet established.

71. Luxembourg: The initial par value of the Luxembourg franc, established December 18, 1946, was 0.0202765 gram of fine gold per franc or 2.28167 United States cents. On the proposal of the Government of Luxembourg, in which the fund concurred, the par value of the franc was changed on September 22, 1949, to 0.0177734 gram of fine gold per franc or 2 United States cents.

72. Mexico: The initial par value of the peso, established by the fund on December 18, 1946, was 0.183042 gram of fine gold per peso or 20.5973 United States cents. On the proposal of the Mexican Government, in which the fund concurred on June 17, 1949, the par value of the peso was changed to 0.102737 grams of fine gold per peso or 11.5607 United States. On the proposal of the Mexican Government, in which the fund concurred on April 19, 1954, the par value of the peso was again changed, this time to 0.0710937 gram of fine gold or 8 cents.

73. Netherlands: The initial par value of the Netherlands guilder, established on December 18, 1946, was 0.334987 gram of fine gold for guilder or 37.6953 United States cents. On the proposal of the Netherlands Government, in which the fund concurred, the par value of the guilder was changed on September 21, 1949, to 0.233861 gram of fine gold per guilder or 26.3158 United States cents.

74. Nicaragua: The initial par value of the cordoba, as established by the fund on December 18, 1946, was 0.177734 gram of fine gold per cordoba or 20 United States cents. On the proposal of the Government of Nicaragua, in which the fund concurred, the par value of the cordoba was changed on July 1, 1955, to 0.126953 gram of fine gold per cordoba or 14.2857 United States cents. Nicaragua has both an "official" and a "curb" exchange. On the basis of the official rate, according to the Department of Commerce, the cordoba is $14\frac{18}{100}$ cents, while on the basis of the free rate it is worth $12\frac{9}{10}$ cents.

75. Norway: The initial par value of the Norwegian krone, set by the fund on December 18, 1946, as 0.179067 gram of fine gold per krone placed it as worth 20.15 United States cents. On the proposal of the Norwegian Government, in which the fund concurred, the par value of the krone was changed on September 18, 1949, to 0.124414 grams of fine gold per krone or 14 United States cents.

76. Pakistan: The initial par value of the Pakistan rupee, established on March 19, 1951, was 0.268601 gram of fine gold per rupee or 30.2250 United States cents. On the proposal of the Government of Pakistan, in which the fund concurred, the par value of the rupee was changed on July 31, 1955, to 0.186621 gram of fine gold per rupee or 21 United States cents.

77. Panama: The Panamanian balboa is the equivalent of the United States dollar.

78. Paraguay: Par value of the guarani was established by the fund on December 18, 1946, as 0.287595 gram of fine gold or the equivalent of 32.3625 United States cents. On the proposal of the Paraguayan Government, in which the fund concurred, the par value was changed on March 5, 1951, to 0.148112 gram of fine gold per guarani or 16.6667 United States cents. On the proposal of Government of Paraguay, in which the fund concurred, the par value of the guarani was changed on January 1, 1954, to 0.0592447 gram of fine gold or 6.6667 United States cents. On the proposal of the Paraguayan Government, in which the fund concurred, the par value on August 18, 1954, was changed to 0.0423177 gram of fine gold or 4.76190 United States cents. On the proposal of the Government of Paraguay, in which the fund concurred, the par value of the guarani was changed on March 1, 1956, to 0.0148112 gram of fine gold per guarani or 1.66667 United States cents. Paraguay has an official rate at this last value, and also a free rate. On the basis of the free rate it requires 120 guaranis to be the equivalent of a dollar, and a guarani is worth a microscopic fraction over 0.8 of 1 United States cent.

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79. Peru: Initial par value of the Peruvian sol, established by the fund on December 18, 1946, was 0.136719 gram of fine gold or 15.3846 United States cents. In November 1949, Peru introduced a new exchange system, on which no agreement as to par value has been reached. Selling rate of the Peruvian sol, as quoted by the Department of Commerce, is 19 or 19.05 to the United States dollar or the equivalent of approximately 5¼ United States cents.

80. Philippines: Par value of the peso has long remained at the equivalent of 50 United States cents.

81. Sweden: Par value of the Swedish krona has remained unchanged at the equivalent of approximately 19⅓ cents.

82. Syria: Par value of the Syrian pound was established as 0.405512 gram of fine gold on July 29, 1947, or the equivalent of 45.6313 United States cents, and has remained unchanged since.

83. Thailand: Par value not yet established.

84. Turkey: Par value of the Turkish lira was established by the fund on June 19, 1947, as 0.317382 gram of fine gold, or the equivalent of 35.7143 United States cents, and has not been changed.

85. Union of South Africa: The initial par value of the South African pound was established on December 18, 1946, as 3.58134 grams of fine gold per pound, or $4.03. On the proposal of the South African Government, in which the fund concurred, the par value of the pound was changed on September 18, 1949, to 2.48828 grams of fine gold per pound, or $2.80.

86. United Kingdom: The initial par value of the pound sterling, established on December 18, 1946, was 3.58134 grams of fine gold per pound, or $4.03. On the proposal of the Government of the United Kingdom, in which the fund concurred, the par value of the pound sterling was changed on September 18, 1949, to 2.48828 grams of fine gold per pound sterling, or $2.80.

87. The par value of the United States dollar, expressed by the fund in grams is 0.888671 gram per dollar, or $35 to a troy ounce of gold, as established by President Roosevelt in 1934. It has not been changed.

88. Uruguay: The par value of the peso has never been established by the fund. Uruguay has three types of exchange, basic, free certificates, and free. The peso at the basic rate is worth 47 and about two-third cents, at the other rates 24 and a fraction cents.

89. Venezuela: The International Monetary Fund gives the par value of the bolivar as 0.265275 gram of fine gold or the equivalent of 29.8507 United States cents.

90. Vietnam: The par value has not yet been established.

91. Yugoslavia: Initial par value of the Yugoslav dinar, established by the fund on May 24, 2949, was 0.0177734 gram of fine gold per dinar, or 2 United States cents. On the proposal of the Yugoslav Government, in which the fund concurred, the par value of the dinar was changed on January 1, 1952, to 0.00296224 gram of fine gold per dinar, or one-third of a United States cent.

92. Actually not one of the currency units given above contains gold. The gold content is fictitious. There is no gold pound or gold dollar any more than there is a gold boliviano or a gold franc or a gold yen, each of which, if a gold coin, would be scarcely larger than a flyspeck. The gold fiction is maintained only for the purposes of actual gold exchanges between governments.

93. The International Monetary Fund record cited above shows that it has concurred in the devaluation of the currencies of 21 countries, including the United Kingdom, Belgium, Mexico, The Netherlands, India, Norway, Pakistan, and Yugoslavia; has taken no position on devaluation by France or Peru; has been ignored by Canada, and has set no par value on the currencies of 8 countries, including Italy, Uruguay, Thailand, or Greece.

94. The International Monetary Fund, on December 18, 1946, established par values on a varying basis for the separate currencies Britain's colonies and possessions, including Gambia, Nigeria, Sierra Leone, Federation of Rhodesia and Nyasaland, Bahamas, Bermuda, Cyprus, Falkland Islands, Gibraltar, Jamaica, Malta, Aden, British Somaliland, Kenya, Tanganyika, Uganda, Zanzibar, Barbados, British Guiana, Leeward Islands, Trinidad, Windward Islands, British North Borneo, Brunei, Malaya, Sarawak and British Honduras. On the proposal of the United Kingdom, in which the fund concurred, the par values of all of these separate currencies, except that of British Honduras, were reduced substantially on September 18, 1949, and that of British Honduras was reduced on December 31 of that year. The British West African pound, Southern Rhodesian pound, Bahamas pound, Bermuda pound, Cyprus pound, Falkland

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Islands pound, Gibraltar pound, Jamaica pound and Maltese pound, all of which have a parity with sterling, were reduced from the equivalent of $4.03 to $2.80 United States. The British East African shilling was reduced from 20 to 14 United States cents, the British West Indian dollars from 84 to 58 United States cents, the Malayan dollar from 47 to 33 United States cents, and the British Honduras dollar from the equivalent of the United States dollar to 70 cents. Belgium and France were granted similar devaluations of their colonial currencies.

95. At the same time that the International Monetary Fund, 26.60 percent financed by the taxpayers of the United States, has concurred in or condoned devaluations in currency of the major trading nations of the world, these nations have erected barriers against the importation of products from the United States, or barriers against payment for such goods or both. A complete table of these restrictions, listed by countries, appears in my floor speech of August 13, 1957, reported in the Congressional Record. These tables are published on pages 13292, 13293, and 13294 of the Record of that date, and demonstrate the hypocrisy of Harry Dexter White and his associates in establishment of this fund in expressing as a major purpose of the fund, the "elimination of foreign exchange restrictions." Thirty-eight of the member countries of the International Monetary Fund require import licenses or exchange permits, 18 of them both.

96. From the evidence given above it can be seen that the International Monetary Fund has been wholly ineffective in either stabilizing exchange or discouraging multiple exchange rates which negate any sound determination of currency values. The facts are that the currencies of the world are no longer based on gold or silver, but on printed paper, the value of which is whatever the issuing government may choose to say it is.

97. It is also obvious that in our international financial transactions the United States has been continually shortchanged in the trade markets of the world.

(Whereupon, at 8:35 p. m., the hearing in the above entitled matter was adjourned.)

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