INVESTIGATION OF THE FINANCIAL CONDITION OF THE UNITED STATES

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INVESTIGATION OF THE FINANCIAL CONDITION OF THE UNITED STATES

WEDNESDAY, APRIL 16, 1958

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 (chairman), Kerr, Frear, Gore, Douglas, Martin, Williams, Flanders, Malone, Carlson, Bennett, and Jenner.

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

The CHAIRMAN. The committee will come to order.

We have a very distinguished witness before the committee today and I will ask the Senator from Utah, Mr. Bennett, to present him to the committee.

Senator BENNETT. Mr. Chairman, it is a great privilege today for this committee to have before it the Hon. Marriner Eccles and it is a privilege for me, representing the State of Utah, to present him to the committee.

I am sure he needs no introduction to this committee. He has appeared before many congressional committees, always with credit to himself. His views have always been of great help.

Mr. Eccles was born in Utah, and except for the interruption of his Washington service, has always been deeply connected with the financial and industrial community of my State. He and his family have made tremendous contributions to the sound foundation upon which our State's economy has been built.

He has tremendous experience both in banking and in industry, and then added to it, the experience in Government service which gives him a well-rounded point of view from which to talk on this subject which is before the committee now. I am very happy to have the opportunity of presenting him to the members of the committee for his statement.

Senator DOUGLAS. Mr. Chairman, I would like to have the privilege of supplementing the comments of the Senator from Utah.

I consider Mr. Eccles one of the finest public servants that this country has ever had, who, as chairman of the Federal Reserve Board, carried out his responsibilities with great integrity, intelligence, and courage, and who, interestingly enought, testified before this committee in February 1933, just before the bank holiday, and gave words of advice to the Nation which, at the time, were scorned, but which later became the basis for the financial policies of the year that followed.

If there was ever a prophet who has been vindicated by time it was the unknown young banker from Utah who came out of the West in February 1933 to be more or less scorned by the financial pundits of the period, but whose advice furnished the mainstay for the financial policies of the years which followed.

The CHAIRMAN. Thank you, Senator Douglas.

STATEMENT OF MARRINER S. ECCLES, FORMER CHAIRMAN OF THE BOARD OF GOVERNORS OF FEDERAL RESERVE SYSTEM

Mr. ECCLES. May I say a word, Mr. Chairman?

Senator Bennett and Senator Douglas, I want to express my thanks for your very kind words.

I am grateful to you for the complimentary things which you have said. I only wish that I merited all of the nice things you have both said about me. I hope that I can continue to live up to the reputation that I seem to have among at least two Senators.

Thank you.

Senator KERR. Mr. Chairman, if I might be permitted an observation, without either taking issue with or affirming the sentiments of our two distinguished members on this committee, I want to say, Mr. Eccles, that you are somewhat of a mythical phenomenon.

You are the first identity or element or thing or principle that I have ever known who seemed to be the catalytic agent to bring such harmonious expression and approval from the two gentlemen who have just spoken. [Laughter].

Senator DOUGLAS. It is proof of the multiplicity of truth.

Senator KERR. I can neither accept nor reject that. I would have to analyze the significance of the word "multiplicity of truth." There is multiplicity all right, Mr. Eccles. [Laughter.]

Senator MARTIN. Mr. Chairman, to clear the record, I think if we are going to get into discussions of this kind, we more humble members of the committee will have to bring our dictionaries with us.

Senator KERR. To whom are you referring, Senator?

Senator MARTIN. All of us. [Laughter].

The CHAIRMAN. Mr. Eccles, it must be very evident to you we are honored to have you with us.

You may proceed, sir, in your own way to give us the best advice you can, on the matter before the Committee.

Mr. ECCLES. Chairman Byrd and members of the committee, I consider it a privilege and an opportunity to be invited to testify before this most important committee of the United States Senate. It is many years since I last had this honor; in fact, it was on February 24, 1933, just before the bank holiday.

I did appear a good many times before many other committees, especially the Banking and Currency Committee, but I do not think that I was ever before this committee while I was in the Federal Reserve.

A complete study of the financial condition of the United States, which this committee is undertaking, is of the greatest importance to the present and future welfare of our country. Simply stated, I believe the purpose is to ascertain what has been done, what is being done, and what can be done to maintain maximum production and employment on the basis of a stable currency, without sacrifice of the principles of our democratic capitalistic society.

In the words of your chairman:

> A stable currency involves not only the value of the money with which the Government redeems its own bonds, but also the savings, pensions, life insurance and so forth of the people of the Nation, which can be protected only by a stable dollar.

The recognition of this fact is of the most vital importance to the people of this country. I am also glad to note that Senator Byrd recognizes that—

> * * * responsibility for sound currency is a prime responsibility of the Central Government.

Throughout a continuous period of service with the Government, commencing February 1, 1934, the recurrent and general theme of my economic philosophy has been this: That in time of recession or depression, the Government must spend more than it collects so as to stimulate consumer demand and purchasing power, to increase production and employment. On the other hand, in times of boom conditions, except in cases of war, it must at least balance its cash budget or create a budgetary surplus, depending on the degree of existing inflationary pressures.

In this conception, the Government is the compensatory agent for an economy based on principles of free enterprise and private property. It does not compete with private business, but it consciously uses its system of taxation and expenditures, supplemented by monetary and credit policy, with the objective of maintaining maximum production and employment, so far as that is possible within the framework of a stable currency.

I realize that this committee has heard lengthy testimony, supported by impressive statistics by Mr. Humphrey, Mr. Burgess, Mr. Martin and others. There is little that I can add to the extensive factual information which they have given. However, I have a statement expressing some of my views relative to the study this committee has undertaken.

I am fully aware of the difficulties of maintaining production and employment on the basis of a stable economy. It will always be a subject of the greatest economic and political controversy how the national product will be divided.

Government and other public bodies want increasing amounts to spend. Workers want more pay and fringe benefits for fewer hours of work. Business wants greater profits, and the increasing ranks of oldsters call for higher pensions. However, everyone wants these benefits on the basis of a stable dollar. Unfortunately, the unalterable economic facts of life are that all the economy has to divide is the goods and services which it is willing and able to produce—and not the amount of money which it could create which is, of course, without limit.

In our type of society this situation poses a dilemma, especially for our congressional Representatives whose constituencies demand easy money, lower prices, higher wages, greater profits and fewer taxes.

In order to understand more fully what to do in our present situation, it would be well to briefly consider the economic developments since 1953. From that time up to the present, there has been a further increase in the cost of living of about 7 percent. Nearly all of this inflation has taken place during the past 2 years. This has happened even though there has been no deficit financing during this period. As a matter of fact, the amount of Government securities held by the public has decreased approximately $7 billion, and that held by the Government agencies and trust funds has increased by a like amount.

In other words, the Government has collected $7 billion more in cash from the public than it has spent. This demonstrates that there can be inflationary developments even though there is a budgetary cash surplus. The question arises here: Why, then, did inflationary developments occur?

I believe this was largely due to four principal factors, all interrelated: The excessive growth of consumer credit, mostly automobiles, housing mortgages, capital expenditures for new plant and equipment, and the rapidly rising cost of labor.

Stimulated by the easy credit policy adopted by the Federal Reserve in 1954, consumer credit grew $6½ billion in the following year—nearly $4 billion of this amount was automobile credit. In that year, nearly 8 million automobiles were sold. This was borrowing heavily against future production and employment.

The easy credit of the Federal Reserve, coupled with the Government's excessively liberal mortgage terms (including no downpayment on veterans' loans) brought about the construction of 1,400,000 new housing units in that year, resulting in a $13 billion growth in mortgage credit. This likewise was borrowing heavily on future production and employment. I feel that the housing and automobile boom sparked the huge capital expenditure program for new plant and equipment which has increased from $26.8 billion per year in 1954 to $37 billion per year in 1957.

The capital expenditure growth was also given impetus by the Government's continuing to issue certificates of necessity allowing rapid amortization, as well as favorable tax legislation of 1954 permitting accelerated depreciation.

Large expenditures for mechanization were also made in an effort to offset soaring labor costs.

Organized labor has had a field day, with demand in many categories exceeding supply. This has put labor in the driver's seat. It has forced up wages and fringe benefits that in many instances have far exceeded increases in productivity. Business, in turn, has added these increased costs on to prices wherever possible.

The Federal Reserve has been the only agency that has made a real effort to curb inflationary developments. It has courageously made effective use of its powers in spite of unreasoned opposition from powerful groups—in and outside of Government. These groups have been as critical of the inflation as anyone, and as lacking in constructive proposals to deal with it.

The action of the Federal Reserve curbed the growth in the supply of money causing the demand to exceed the available supply. Hence, the cost of money was bid up. This tightness had the effect of increasing the velocity, or use, of money about 15 percent, a record. This tended to compensate temporarily for the curbing of its growth.

The Federal Reserve was confronted with an unhappy choice—to permit the supply of bank credit to increase to satisfy demands would continue the wage-price spiral. To do otherwise would curb the growth of production and employment, and risk bringing about an economic recession.

We are now witnessing the result of the courageous action which they have taken. Failure to have taken this action would have continued the inflationary spiral and ultimately wrecked the currency.

Such inflation—

in the words of Senator Douglas—

is a destroyer as evil as war itself. In the eyes of those who want to destroy democracy and capitalistic institutions, it is a cheap way of achieving their collapse.

It is unfortunate that the Government did not supplement Federal Reserve policy by pursuing a program of larger budgetary surpluses, thereby reducing the public debt while the private debt was rapidly increasing. The only time the Government debt held by the public can be reduced without deflationary effects is when the growth of the private debt is exerting inflationary pressures.

Conversely, the only time that such debt can be increased without inflationary effect is when the contraction of the private debt is exerting deflationary pressures.

Our business leadership has some responsibility for the situation which has developed, but I think the record will show that the major responsibility rests squarely on the shoulders of the leaders of organized labor.

Business generally has been willing to grant excessive demands of labor rather than face a strike, so long as it was able to pass on to the public the increased costs. Business did not hesitate to use every means of high-pressure advertising and salesmanship and absurdly easy credit terms to induce millions of the public to buy beyond their means.

As a result, the consumer debt has grown from $27.4 billion at the beginning of 1953 to nearly $44.8 billion at the end of 1957.

Likewise, housing mortgage debt has increased from $58.5 billion at the beginning of 1953 to $107.6 billion at the end of 1957. I believe that consumer credit and liberal housing mortgage terms serve a useful purpose in our economy so long as they do not grow faster during periods of high prosperity than the growth in the national product.

Otherwise, the time must come when the continuing growth cannot be maintained, and this will create deflationary pressures. The gross national product has grown from $353.2 billion in 1953 to $434.4 billion in 1957, a percentage increase of but 19.6 percent, whereas the increase in consumer credit in the same period was 63.5 percent and the mortgage debt increase 83.9 percent, that is, the housing mortgage department.

Now, let us consider the role of organized labor in this situation. I believe the main cause of rising prices has been the use which labor union monopolies are making of their power to force up wages and numerous costly fringe benefits far in excess of increased productivity.

For some time now organized labor has demanded, and is getting, an increasingly larger share of the national income. This has been reflected in increased prices and decreasing profit margins.

According to a recent study by the Twentieth Century Fund, total wages and salary disbursements were 50 percent of the national income in 1929 and 73 percent in 1955, whereas dividends decreased from 5.8 percent to 3.9 percent of that income.

Labor's share of the national income since 1950 increased by 10 percent up to the end of 1956, whereas the business share, represented by profits of all corporations, decreased by 33 percent. It should be apparent from these figures that business cannot absorb out of profits, as labor contends, increased wages and fringe benefits, without increasing prices. With the combination of labor's demands added to prices, organized labor has already jeopardized its real interest by pricing many of its goods and services out of the market. I mean by that that about two-thirds of your population or unorganized labor, have not received the same increases and the same fringe benefits.

Take the pensioner, take the farmers, take the fixed income groups, and the disequillibrium between those groups and the organized labor groups, has in effect priced many of the goods produced by organized labor out of the market.

I think that is one of the reasons for our present downturn.

We therefore have the paradoxical situation of millions of unemployed, idle facilities, surplus goods of all kinds, and, at the same time, further increases in the cost of living. In the face of this situation, the only contributions of organized labor are demands for increased pay and further fringe benefits.

We all recognize that a recession has been developing for more than 6 months. It is becoming increasingly severe, with small likelihood of an improvement this year without prompt and appropriate action on the part of the Government. If the recession is permitted to become cumulative, it will be increasingly costly to bring about recovery.

We should accept the present price, wage, and debt structure. We cannot liquidate them without a severe depression. The present large private debt can be validated only by a rapid and substantial expansion of the public debt. The longer the recession is allowed to run, the more it will cost the economy as a whole—in idle men, in idle facilities.

The American consumer is curtailing his purchases because he has never been better supplied with goods of all kinds; he is already heavily in debt and worried about the unemployment picture. There will be little increase in home building because of the overbuilding in the past; the huge mortgage debt now being carried, and the excessive cost of land and construction.

Likewise, there is already a large excess capacity of new plant and equipment and the downturn in capital expenditures in this category is estimated to reach more than 5 billion for 1958; more in 1959.

The Federal Reserve, to counteract the recession, reversed its restrictive monetary and credit policy last November and since that time has reduced the discount rate from 3½ to 2¼ percent by successive steps. In addition to this, it has created substantial excess reserves in the member banks by its open market operations and reducing the reserve requirements on demand deposits.

The result has been a general easing in the money market and a reduction in interest rates, especially the rates on short-term Government obligations, bankers' acceptances, and commercial paper.

The rate on bills has gone down from an average of 3.59 in October to 1.14 at the end of March; at the present time it is down below that, whereas the average rate on long-term Government bonds has only gone down from 3.78 in October to 3.21 at the end of March.

This shows that an extremely wide sp ad has taken place between the interest rates on short-term and long-term Government securities in a very short time, and that is of course true on other paper relatively.

Concurrently, the Treasury's financing has been through the issuance of intermediate and long-term securities which have largely competed with the private bond and mortgage markets, thereby tending to hold up long-term rates.

I believe it would have been more effective antirecession policy had the Treasury's financing been through the issuance of bills and other short-term securities, which would have been largely purchased by the commercial banks.

This would have increased the money supply accordingly and reduced the competitive pressure in the long-term market. Higher short-term and lower long-term rates would then have resulted.

It would appear that no matter what the economic situation is, the Treasury feels that it should lengthen maturities of the public debt. It is my view that during periods of inflationary pressure, Government financing, whether refunding or new issues, should be lengthened and sold in the investment market so far as possible.

Conversely, during a recession, an effort should be made to increase the holdings of Government securities by the commercial banks by issuing short-term securities and thereby increasing the money supply.

In the light of the Treasury's recent debt management policy, I believe it would have been more effective credit policy had the Federal Reserve—I am saying in light of what the Treasury did. If the Treasury issued short-term security what the spread did would have been O. K. But in the light of their issuing long-term investment securities I think it would have been more effective credit policy had the Federal Reserve reduced reserve requirements on time deposits in the commercial banks from 5 to 3 percent, instead of the reduction of 1 percent that was made in the reserve requirements on demand deposits.

This would have increased the funds available for the mortgage and long-term Government and municipal securities markets and would have narrowed the unrealistic spread between the long- and short-term rates.

Although a restrictive monetary policy—this possibly should have been another paragraph here, it is a very important point.

Although a restrictive monetary policy can ultimately prevent a serious inflation, an easy-money policy cannot reverse a recession. It can only create a favorable climate for credit expansion and relieve the pressure for credit contraction.

I am sure the Federal Reserve understands the role that it can play in the present economic situation and will do its part.

It is generally recognized that Government action is necessary to halt the recession and reestablish employment and production. The great debate on the question is whether this can best be accomplished by a large public works program or a substantial tax reduction, or both, I might say.

Either program will increase the Federal deficit. I strongly favor the tax program over the public works because that action can be taken promptly and the effect would be more immediate. If we delay we are taking a risk of having to employ more drastic measures. In that case the deficit would be greatly increased because of the loss of revenue through a prolonged recession.

The Government is, and always will be, carrying on or supporting a vast public works program but such a program does not have sufficient flexibility to be used as the principal stabilizing force in our economy. To try to speed up and enlarge such a program makes for waste and inefficiency. It would, in any case, be too slow to produce the desired results this year. Furthermore, it would create new inflationary pressures a year or two hence.

While both a tax reduction and a public works program will add to the Federal deficit, the tax reduction has the advantage of letting the people spend their own money instead of the Government's doing it for them. It will also assure a quicker and a much wider distribution of the funds. In the one case the spending starts quickly from the grassroots, whereas in the other, the money has to trickle slowly down.

Another objection to a rapidly developing public works program is that it would inevitably foster a further enlargement of Government bureaucracy.

It seems difficult, if not impossible, to bring Government expenses down once they have risen, even when the need for the increase no longer exists. Furthermore, I do not think that the recession should be used as a reason for extravagant expenditures which otherwise would not be made. I believe tax reduction would be less likely to increase inflationary pressures in the future because it would exercise restraint on future increases in Government spending.

Any consideration of tax reductions, Government deficits, or the public debt, must be related to a realization that—using our manpower and full productive facilities—this is a $450 billion economy, measured by our gross national product.

If recovery can be hastened by a tax reduction, and I believe it can, it is reasonable to expect that even lower tax rates will soon be offset by the growth in the national income.

Therefore, a balanced budget could be achieved through such recovery, whereas with higher tax rates and a depressed economy, the Government revenue would be diminished and a balanced budget impossible.

I believe the Government deficit over the next 2 years, and hence the public debt, will be less if an adequate tax-reduction program is promptly adopted than would be the case if the country had to wait for the stimulating effect of increased Government spending.

A tax reduction, in order to accomplish its purpose, should be from 6 to 7 billion dollars. The character of the tax reduction should largely benefit the lower income group. I do not feel that I have sufficient information to be able to present a detailed tax-reduction program; however, I would recommend that the following excise taxes, on what should be considered essentials, be repealed: Communication, transportation, freight and consumer durable goods; you might exclude certain things in that consumer durable goods item that might not be considered essential, certainly not as essential as other things, together with a tax exemption on the first $2,000 of the cost of automobiles.

I believe that the reduction of these excise taxes would be immediately reflected in prices to the benefit of all.

The corporation tax of 52 percent, I understand, is higher than that of any other country in the world. It should be reduced to no more than 50 percent with a limit of 25 percent on the first $25,000 in order to help small business.

That would be reducing from 30 to 25. I am sure that prices are influenced by the higher corporation taxes.

A reduction would encourage business and would be passed on to the consumer in lower prices, certainly under a competitive market.

Any other tax reduction, to have the most beneficial effect on the economy, should apply to the first $2,000 of individual taxable income. I roughly estimate that the—about three and a half billion would be the amount of loss of tax revenue on the excise taxes and the corporate taxes and if a $7 billion bill were passed it would leave three and a half billion to apply directly against the first $2,000 of the individual's taxable income; besides, the benefits that I have mentioned in the excise taxes would, I think, go to all of the people.

I feel very strongly that a 50-percent extension is essential in the number of weeks unemployed workers can draw benefits. This is not only an urgent and necessary human action, but is desirable from an economic standpoint. It would be most effective in helping to sustain consumer buying power and thereby reducing deflationary pressures.

There is a popular feeling that Government deficits and the growth in the public debt are always bad because they are inflationary. Such is not the case. Government deficits and the growth in the public debt are necessary when production and employment are declining, in order to reverse the trend. In a period of inflationary pressure the reverse is true. There must be a growth in the total debt, public or private or both, in order to sustain a growth of employment and production. A recession is the result of debt contraction.

The public debt is large or small in relationship to the gross national product. I am not concerned about its present size. It has grown very little in the last 10 years.

The growth was largely, I think as we will recall, the result of the war, and I think some additional was substantially paid off between the end of the war and the Korean war and it went back again at the end of the Korean War so the Government total debt is about the same as it was 10 years ago.

Thanks to Senator Byrd, I think it may have been substantially higher than what it is if there had not been some pressures in that direction during periods of inflationary pressures.

The growth has been approximately 7 percent, whereas the growth in the national product has increased 87 percent.

With the reduction of taxes and the temporary loss of income as a result of the recession, there could be a deficit of $12 to $15 billion in the next fiscal year which would be about 3 percent of the national product and approximately one-sixth of the total annual budget. Such an amount would be a cheap price to pay for a quick economic recovery.

We should bear in mind that if the recession is allowed to continue, it could seriously affect our leadership throughout the Western world, greatly impairing our moral and political influence and further building up the prestige of the Communists.

I am not oblivious to the serious inflationary dangers that recovery will bring. These dangers will come from two principal sources.

First, if our defense and foreign aid program is not related to our manpower and productive resources so that (after recovery) it can be paid for currently, a stable dollar will be impossible. I mean by that we have got to have a balanced budget and maybe a surplus to get recovery.

Finally, we must recognize that future inflation cannot be prevented so long as the Government is willing to let the monopolistic powers of labor organizations go unchallenged. These organizations, which have grown immensely in size and power (about 25 percent of the entire labor force), must be made subject to the antimonoply laws of Government to which business has always been accountable.

Without such control, there is no limit to their demands, all of which, in the final analysis, must be paid for by the entire American public through higher prices.

If the Government evades this issue, it is shirking its responsibility for the maintenance of a stable currency—and opening the door for the ultimate destruction of the democratic capitalistic system.

The CHAIRMAN. Mr. Eccles, the committee thanks you for an extremely interesting and helpful statement.

I would like to ask just a few questions.

As I understand it, in your judgment the present recession began 6 months ago?

Mr. ECCLES. That is right.

The CHAIRMAN. The beginning of it, in October?

Mr. ECCLES. That is right.

The CHAIRMAN. In your judgment, did the policies of the Federal Reserve System contribute to that recession?

Mr. ECCLES. I think so. I think they prevented the growth of the money supply. The total demand deposits and currency increased very, very little during 1956 and 1957.

In other words, they, through their policy, stopped the growth of the money supply.

The CHAIRMAN. Do you mean the high interest rates?

Mr. ECCLES. Well, they did not establish the high interest rates. The thing that made the interest rates high was not the action of the Federal Reserve. The thing that made the interest rates high was the demand for money exceeded the supply of money.

Now they could have expanded the supply to an unlimited extent, but of course that would have been inflationary in its effect.

The action of the Federal Reserve was to control the growth of the supply. They controlled the growth of the supply by not providing reserves to the member commercial banks, and raised the discount rate. There are three ways that the banks are able to expand credit, and thus increase the supply of money.

The Federal Reserve can purchase Government securities in the market and thereby add to the reserves of the banking system, what we call through open market operations.

They can decrease the reserve requirements of the member banks, which is much more of a shotgun method than through open market operations, which is much more of a flexible and subtle method of providing reserves.

The other manner in which reserves are provided must be done by the initiation of the bank. The banks by initiating the purchase or the providing of reserves by borrowing from the Federal Reserve bank of their district.

The discount rate has little or no effect upon the willingness of banks to borrow. Banks, as a general rule, are unwilling to borrow from the reserve system. They only borrow to meet the reserve requirements and avoid the penalties for failing to have reserve requirements.

They do not borrow continuously through the discount window in order to provide funds to their customers. They will borrow temporarily but not on any continuous basis.

So that the question of the interest rate was because there was practically no growth in the money supply. Whereas there was a growth in the labor force, and there was a growth in the total production, a growth in the national product. That brought about an increased velocity or an increase in the use of existing funds, and as the demand for funds exceded the supply, rates were bid up.

The CHAIRMAN. As I understand it, it is your opinion that the actions of the Federal Reserve bank prior to October——

Mr. ECCLES. Yes.

The CHAIRMAN. Did not contribute to the high interest rates?

Mr. ECCLES. Well, their action brought about high interest rates. But there was also another factor. The amount of savings by and through the various sources, by the public, was inadequate to meet the investment demand. Savings in 1955 and 1956 were entirely inadequate to take care of the mortgage and the general, what we call the investment demand for housing and the capital account. They were inadequate.

Of course those demands could have beeen met by the commercial banks making long-term mortgage and other loans if the Federal Reserve had provided them with reserves to do that, and had they been willing to expand that type of credit.

The CHAIRMAN. Had the Federal Reserve adopted a so-called easy money policy prior to October, would that have retarded or increased the so-called recession?

Mr. ECCLES. I think if the Federal Reserve had carried the easy money policy of 1954 on into 1955 and 1956, you would have had a real inflationary situation. It would have—an inflation raises interest rates the highest in time.

The first effect of an excess supply of money is and would be a lower rate. But as the inflation grows you will find that the cost of money goes up. And you will find, too, that people are unwilling to buy insurance or unwilling to save.

In countries where you are having a rapid inflation, interest rates are very high, and there is running away from the dollar into real estate and into things rather than into money forms.

Rates are exceedingly high in countries where you have a real inflation.

The CHAIRMAN. Then you think the Federal Reserve System acted wisely?

Mr. ECCLES. I think the Federal Reserve System acted wisely. Had I been chairman of the Federal Reserve Board I would have undertaken, I think, would have supported the same type of policy that they pursued.

The CHAIRMAN. You do not think the high interest rates that existed prior to October was the main cause of this present recession?

Mr. ECCLES. Yes; I do. I think that the high interest rates that were brought about tended to bring about the recession. But I think you had the alternative of whether you bring about a recession or whether you support and feed an inflation.

The CHAIRMAN. Well, could the Federal Reserve System——

Mr. ECCLES. That is the dilemma that you had.

The CHAIRMAN. Could the Federal Reserve System have taken any action prior to October that would have prevented this recession?

Mr. ECCLES. I don't think so.

The CHAIRMAN. You generally approve then of the actions taken by the Federal Reserve System?

Mr. ECCLES. I do.

The CHAIRMAN. Up to October and after October?

Mr. ECCLES. Yes, sir. I do.

The CHAIRMAN. It would have been practically the same action had you been Chairman of the Federal Reserve System?

Mr. ECCLES. I think so.

The CHAIRMAN. During that period?

Mr. ECCLES. Yes, sir.

The CHAIRMAN. Well, now, I have been very much interested, Mr. Eccles, in your explanation of the inflation in the cost of living.

You refer here to the fact that the cost of living has increased? Do you think the cost of living is an index of inflation?

Mr. ECCLES. Yes; I do. I think that is the thing that the people of the country are concerned about. I think that——

The CHAIRMAN. I am speaking in terms of reducing the purchasing power of the dollar.

Mr. ECCLES. That is right.

The CHAIRMAN. You say that the cost of living has gone up 7 percent since 1953?

Mr. ECCLES. That is right.

The CHAIRMAN. And by the same line of reasoning the purchasing power of the dollar has gone down approximately 7 percent?

Mr. ECCLES. That is right.

The CHAIRMAN. You attribute that to the excessive growth of consumer credit, automobiles and mortgages and so forth?

In other words, one of the main factors in that increased cost of living and the inflation is the private borrowing?

Mr. ECCLES. That is right.

It is both—there are four factors that I mentioned there: the growth of consumer credit; the growth of housing mortgage credit; the increased cost of labor, and the growth in productive facilities and equipment.

The CHAIRMAN. As I recall it, in that period the total debt increased to $800 billion.

Mr. ECCLES. Yes. Well, I don't——

The CHAIRMAN. I mean including the Federal debt?

Mr. ECCLES. Yes. Well, I mean I don't have those figures.

The CHAIRMAN. If private debt was inflationary why do you think that public debt is not inflationary?

Mr. ECCLES. Well, I think that it is a question of when the public debt—I think they are. I think that it is a question of the growth of the total debt. I think that the public debt can be just as inflationary as private debt and it can be just as deflationary as private debt.

If private debt is growing rapidly, public debt should contract.

If the private debt is growing to such an extent that it is bringing about higher prices and inflationary pressures, the way to relieve those pressures would be to have budgetary surpluses and reduce the public debt.

If the private debt is contracting, which usually takes place in a deflationary period, and it can become cumulative as we remember from 1929 to 1933, how the debt began to contract. We could not contract the private debt as fast as the national income went down.

When private debt is contracting, as it always does in a recession, and as the recession goes into a depression, the private debt contracts that much more rapidly, during that period an expansion of the public debt is not inflationary, it is antideflationary. It tends to compensate for the contraction of the private debt, and as I made a point here, that I think that we would have maybe carried out a wiser policy, if we had contracted more of the public debt since the war than we did.

I think that a heavier contraction of the public debt during the past 10 years, while this private debt was expanding as it was, would have been a wise policy and would have prevented some of the inflationary situation that developed.

The CHAIRMAN. In other words, you think that the public debt should be increased in times of recession?

Mr. ECCLES. That is right.

The CHAIRMAN. And reduced in times of prosperity?

Mr. ECCLES. That is right.

The CHAIRMAN. That comes back to the old argument that you and I had nearly 20 years ago.

Mr. ECCLES. That is right.

The CHAIRMAN. You cannot turn those things off, as you can water from a spigot.

Mr. ECCLES. That is right.

The CHAIRMAN. What machinery can you set up?

Mr. ECCLES. The question is, What is the alternative?

I think the use of fiscal policy and monetary policy, and possibly in our type of system, the best policies that we know of in order to tend to create economic stability is what we should use.

Now when you go beyond that, you get into the question of direct controls which, in a democracy, are not acceptable.

To try to put on price controls and wage controls during a period of peacetime is the alternative, and I think that we have got to apply the fiscal and the monetary means first. I think the public will accept the restriction of the use of credit in inflation and the easing of credit in deflationary periods.

I think they would accept budgetary surplus in periods of inflationary pressure, budgetary deficits in periods of downturn.

The CHAIRMAN. In periods of inflation, would you favor Government controls of prices and labor?

Mr. ECCLES. I don't know—I think that would be a last resort. I think to try to administer prices and wages in a peacetime economy would be extremely difficult.

The public, we found even in a war period, it was extremely difficult when the public was willing to accept it.

In a peacetime period, without public acceptance, I think the administration of it would be impossible.

The CHAIRMAN. But you are setting up a pattern here whereby within a period of, say, 12 months, you change the levels of spending by both the Government and the people. I don't see exactly how that can be worked out.

That would require mandatory controls.

Mr. ECCLES. I am not talking about more spending on the part of the Government; I am talking of reduction in taxes.

The CHAIRMAN. You are speaking of deficits?

Mr. ECCLES. My emphasis is on the reduction of taxes. You get the deficit either by increasing public spending or by reducing taxes, and what I am saying here is that I would prefer the reduction of taxes and let the general public get the use of the spending.

The CHAIRMAN. Now the practical situation that confronts us today I want to present to you is this: The administration has overestimated the income of the next fiscal year, I think, by at least $3 billion.

Mr. ECCLES. That is in 1950?

The CHAIRMAN. Yes.

You would agree with me that estimate was very extravagant?

Mr. ECCLES. I think so, and I think that the deficit will likely exceed, if nothing is done, it would likely exceed $3 billion.

The CHAIRMAN. What I mean is the loss of revenue would be substantial.

Mr. ECCLES. Yes.

The CHAIRMAN. So by a conservative estimate there is a loss of $3 billion so far as the balancing of the budget is concerned.

Now whether we like it or not, whether we think it is good policy or not, the expenditures of the Government will be increased in the next fiscal year by $4 to $6 billion.

Now that is a practical situation that confronts us today because these enactments have either been made or will be made.

So there you have a deficit of about $9 billion before tax reduction. You propose a tax reduction of $6 billion. Well, that is $15 billion. And you recognize, as a practical man, very experienced in governmental affairs, that if you have a deficit of $15 billion it is going to last for a long time beyond the next fiscal year.

What effect do you think a deficit of $15 billion would have in the next fiscal year, and then to continue this, perhaps in a lesser degree for a good many years to come?

Mr. ECCLES. Well, I think it would depend a good deal upon the growth of the national product. I think that, and I think that some of these Government expenditures that we refer to are not going to be made next year. I think it takes longer to get these expenditures made than——

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The CHAIRMAN. When they get started, Mr. Eccles?

Mr. ECCLES. Than they appear.

The CHAIRMAN. They can be spent pretty fast and there are 8 months before the next fiscal year starts. So I think spending will rise rapidly.

Mr. ECCLES. Of course I do not like to see, as I have said in this statement, a recession used as, say, an excuse for making expenditures that otherwise would not be made.

I think that under all conditions the Government should make expenditures that are necessary and useful to be made and that should be done as efficiently as it is possible to make such expenditures.

If they should be needed, they should be useful.

The CHAIRMAN. Well, I think you will agree military expenditures are necessary to meet the challenge of Russia in the new field of space weapons.

Mr. ECCLES. Yes, I agree that we have been very far behind in some of our military development.

The CHAIRMAN. There are going to be additional expenditures made there whether any of us approve of it or not, and I think there should be.

Mr. ECCLES. But I think that there is likewise still a good deal of waste in the military.

The CHAIRMAN. I agree with you on that.

Mr. ECCLES. I believe there should be some discontinuing of expenditures that are out of date and that are unnecessary.

The CHAIRMAN. I entirely agreed with you on that.

Mr. ECCLES. And I certainly think that the competitive situation we have had in the Military Establishment has made for a good deal of waste.

The CHAIRMAN. That waste is very difficult ——

Mr. ECCLES. We could cut off in one direction or we could cut off possibly as much or more in expenditures, in wasteful expenditures or unnecessary expenditures that are being made to offset the increased expenditures which are necessary.

The CHAIRMAN. It is possible to do it but will we do it?

Mr. ECCLES. Well, I don't know.

The CHAIRMAN. It has never been done in the past.

I have been here 25 years and I served with you part of the time.

Mr. ECCLES. Yes; I know.

The CHAIRMAN. And expenditures grow and grow.

Now there are two lines of thought in the Congress as to meeting this recession: One would increase public works and so forth, and the other would reduce taxes.

I want to ask you this question: Assuming there will be a deficit of $8 or $9 billion without tax reduction, would you still favor a tax reduction that would make the deficit around $15 billion?

Mr. ECCLES. Yes; I would, because I think if the recession is not stopped, and our tax base is reduced, the deficit can become very huge if you do not have employment and production which is the basis for taxation.

I remember distinctly from 1929 to 1933, that when the budget was less than $4 billion and it was impossible to balance the budget during a deflationary period because the national income fell from $82 billion to $40 million, and the basis for taxation was wiped out.

So that in the year 1932 the corporations of America on balance were in the red. There was no net earnings. They had a net loss, the corporations of America, of about two billion dollars.

So what I am saying is that the basis for taxation is production and employment. To the extent that we have unemployment, to the extent that we have idle facilities, we lose our base for taxation, and I think that when a recession becomes cumulative, it becomes increasingly difficult to stop it.

It takes more and more in the final analysis to turn it, and it seems to me that with the huge consumer debt, with the housing mortgage debt, with what has been spent on plant and facilities and new office building, and so forth, that right at the moment, it is pretty difficult to see any sources for turnabout.

Certainly there is going to be no expansion in the building of new plants and facilities. On balance that is going down. I don't believe we are going to have any real substantial increase in housing.

The CHAIRMAN. Mr. Eccles, there are other questions I would like to ask, but I do not want to take the time of the other members of the committee.

You have given a most interesting statement which will receive the consideration of the committee and the Congress.

Just one last question and please answer as briefly as possible.

How long do you think this recession will last; will it get worse or will it get better?

Mr. ECCLES. Well, of course, it is impossible to give a definite figure but it is my feeling that if nothing is done that—more than has been done—that you are not likely to see a turnaround here this year. I mean you are taking that chance.

The CHAIRMAN. Yes. Have we reached the bottom of it in your opinion?

Mr. ECCLES. Well, I am not sure. I have some doubt that we have.

I have some doubt that the bottom has been reached if nothing more is done, and I feel that we should not take the chance of it becoming cumulative because of what it costs then to stop it.

We are taking a great risk to wait and do nothing.

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

Senator Kerr?

Senator KERR. Well, Mr. Eccles——

The CHAIRMAN. At this point, if the Senator will excuse me, may I say, I imagine Mr. Eccles will be asked a great many questions.

Is it the pleasure of the committee to continue this hearing tomorrow when we recess today?

Can that be arranged with the witness?

Mr. Eccles will contribute a great deal to consideration here, so if it is the pleasure of the committee, we shall continue tomorrow, if that is satisfactory to you——

Mr. ECCLES. Can I get finished tomorrow?

Senator KERR. Well, you reserve the right, and no man will question it, for you to leave when you get ready.

Mr. ECCLES. What is that?

Senator KERR. I say you will reserve the right and no member of the committee will question that you are in sole and exclusive possession of both it and the privilege of exercising it to leave when you got ready.

Mr. ECCLES. Well, that is being very fair. I would like to stay as long as the committee desires me to stay. I came quite a ways to be here.

The CHAIRMAN. We appreciate your contribution.

Mr. ECCLES. I have an engagement in New York tomorrow evening, and if there was any likelihood that I would have to stay over, I would like to know it. But I can leave tomorrow—I was planning to leave tomorrow afternoon at 4 o'clock. So that between now and 4 o'clock, why my time belongs to the committee.

The CHAIRMAN. What is the pleasure of the committee about an afternoon session?

(Off the record.)

The CHAIRMAN. We will meet tomorrow at 10 o'clock in time for you to take your train.

Mr. ECCLES. Thank you.

Senator MALONE. Mr. Chairman, I do have some questions to ask Mr. Eccles. He is from our part of the country.

Mr. ECCLES. How are you, Senator?

Senator MALONE. Fine, thank you, and often we run out of time before they got down to me on the totem pole, and I would like very much this time to finish. I will be very glad to do it this afternoon, if it meets with the convenience of the committee rather than just not taking a chance.

The CHAIRMAN. Unless we are called to the floor when we recess at 12:30, we will convene again at 2:30 this afternoon.

Mr. ECCLES. I will be glad to be here this afternoon.

The CHAIRMAN. And maybe they can finish this evening.

Senator Kerr?

Senator KERR. Mr. Eccles, I want to tell you that I did not get to hear all your statement, but when I left the room I stayed out until I had read it in its entirety, and I agree with much of it and disagree with some of it, but I want to say to you that in my judgment there is more meat in it than has been brought to this committee by any other witness.

Mr. ECCLES. Well, thanks, Senator.

Senator KERR. Now, if I understand you correctly, you have told us that this recession that we are now in is manmade.

Mr. ECCLES. Well, yes, I say that it is manmade.

I think that the Federal Reserve's restrictive money policy brought about the recession. But I also said that——

Senator KERR. I understood you to say that you approved the actions that they took.

Mr. ECCLES. Because the alternative——

Senator KERR. And we will talk about that in a minute.

Mr. ECCLES. Yes; I think the restrictive monetary policy had the effect of bringing a recession certainly before a recession would otherwise have developed.

Senator KERR. Well, now, we would, of course, only be expressing an opinion when we talk about whether one would otherwise have been developed or otherwise would have developed.

Mr. ECCLES. Well, I think that a psychological inflation, an increase in wages and prices that was going on would certainly bring about a condition where you would sooner or later take a downturn.

Senator KERR. I certainly recognize the basis of your opinion in that regard; and would not want to say to you that I entirely disagree with it, yet I do not believe that that is determinative of whether or not the recession that we now find ourselves in is or is not manmade.

Mr. ECCLES. Well, I am willing to admit that the recession was certainly brought on by the restrictive monetary policy. I think that it might have been brought on at a later time by——

Senator KERR. Other causes?

Mr. ECCLES. Well, I can give you what I think would be the causes. I think that a disequilibrium between the various income groups would have resulted in the high cost pricing a very substantial part of the population out of the market and I think that would have brought it about.

Senator KERR. I think the recession was brought on by three things, Mr. Eccles, and I would like to have your opinion about it:

No. 1, I think it was brought on by the impairment of the income of about 6 million farm families in the country.

No. 2, I think it was brought on by excessive imports which adversely affected the production of domestic raw materials and domestic industries, some of which are in your State, and some of which in your State have been affected the most, as they have been in my State.

Then I think the thing that really accelerated the arrival of the recession was the restrictive monetary policies of the Federal Reserve System, coming as it did on top of these other two conditions, one of which had been in effect for some 4 years, and the other gradually increasing in effectiveness during those 4 years, and in fact, having been in operation prior to those 4 years insofar as the excessive imports were concerned.

Would you care to comment on that?

Mr. ECCLES. Well, I am favorable to Mr. Benson's farm program. I think that——

Senator KERR. Let's forget Mr. Benson for the moment.

Mr. ECCLES. All right.

Senator KERR. Let's not get into an argument as to whether or not he caused it. You do recognize that farm income has been much lower in the last 5 years than it had been?

Mr. ECCLES. That is right. It went down from its wartime high, and I think that the parity-support-price program was an impossible one to continue with because of the huge surpluses that were being piled up.

Senator KERR. Do you happen to know what the commodity credit inventory was when Mr. Benson came in?

Mr. ECCLES. Well, it seems to me it was around $4 billion, was it not?

Senator KERR. Would you be surprised to know it was less than a third of that?

Mr. ECCLES. At the present time?

Senator KERR. No; when he came in.

Mr. ECCLES. And than it is now?

Senator KERR. No; then the $4 billion figure that you gave.

Mr. ECCLES. Well——

Senator KERR. I say would you be surprised to know when he came in the surplus was less than a third of the $4 billion?

Mr. ECCLES. How much, what were the funds that the Commodity Credit was borrowing at that time?

Senator KERR. Well, we were talking about the inventory; I do not suppose they borrowed money to put in other than inventory.

Mr. ECCLES. Well, of course I know we have shipped a good many of our surplus farm products abroad.

Senator KERR. Would you be surprised to know that the surplus now in the inventory is over three times what it was when he came in?

Mr. ECCLES. I would not be surprised; no.

Senator KERR. But aside from that, I am sure you and I cannot agree on——

Mr. ECCLES. Well, my only point is this: It is a question of alternatives. Certainly I have every sympathy with the position of the farmer, that is some of them. I know other farmers, large-scale farmers, that are doing exceedingly well.

I think that the small farmer and the tenant farmer are the ones who are having most of the difficulty at the present time.

Senator KERR. Now the one question I would like for you to address yourself to, because I am sure you and I will never agree on the worthiness or unworthiness of Mr. Benson's policies.

Mr. ECCLES. Yes.

Senator KERR. And I do not think this is the forum in which they should be discussed. You have the privilege of doing so if you want to. I only asked you if you thought that the reduced income of that average farmer you are talking about contributed to this recession.

Mr. ECCLES. Well, I doubt that. I don't think that the reduction was sufficient to bring about the recession.

Senator KERR. I don't say that it brought it about, Mr. Eccles. I am just asking you if you did not think that the average income of some five or six million families in any way contributed to development of this situation in which there is decreased purchasing power and increased unemployment.

Mr. ECCLES. I think naturally that any group that had a greater purchasing power would have tended to sustain your prosperity that much longer, maybe make for that much more inflation.

Senator KERR. Or any large group that had a substantial decrease in purchasing power would thereby contribute to the unemployment and recession?

Mr. ECCLES. Whether the farm income goes down or whether you have unemployed people, naturally all contributes to the recession; that is true.

Senator KERR. Well, I thank you for that. I don't want to discuss the merits of Mr. Benson nor would I want to indicate that I think your admission of that in any way constitutes criticism of Mr. Benson. I am sure we can discuss the condition that exists insofar as this hearing is concerned without attempting to either place the blame or give credit for it.

Mr. ECCLES. That suits me. I am not partisan in the matter, I can assure you.

Senator KERR. Well, I am, I can assure you.

[Laughter.]

Senator KERR. But I am not sufficiently partisan that I either want to establish assumptions as facts and I am not nonpartisan to the extent that I do not want to deprive facts of their validity by trying to make assumptions out of them.

Mr. ECCLES. Well, on the other point——

Senator KERR. And we can discuss that in a bipartisan manner because the situation started under the previous administration and has grown, has continued and increased in its intensity under this one.

Mr. ECCLES. Well, that likewise poses a dilemma.

I think that I have every sympathy for the mining interests, the oil interests, and other interests that are affected by imports. But I think from an economic point of view, what is lost domestically by the curtailment of production is possibly made up by exports.

After all, it is a problem of foreign trade to the extent that we import goods from foreign countries just to that extent they do get dollars, and to the extent that we import goods from foreign countries to that extent we get dollars and are able to export them.

Senator KERR. No; they get dollars.

Mr. ECCLES. They get dollars and we are able to export that much more in goods.

Senator KERR. You do not think there is an absolute relationship between imports and exports, do you?

Mr. ECCLES. Well, I think dollarwise, yes.

Senator KERR. You think when we buy a barrel of oil from Saudi Arabia that we automatically create a market for a dollar's worth of our products?

Mr. ECCLES. I think we do somewhere in the world; that dollar is going to be spent and only one place it can be spent, and that is in the United States.

Senator KERR. To the extent that it is spent in England or Germany or France?

Mr. ECCLES. It makes no difference. They spend it here. It is in a multilateral trade basis, that the imports that we buy provide funds to pay for our exports, and, as a matter of fact, our exports have far exceeded our imports and the balance of payments has been pretty largely made up by our foreign aid, economic and military.

Senator KERR. Do you think when we buy a dollar's worth of lead or zinc in Mexico, where it is produced and where the labor in producing it is performed and paid for and where the profit on it is taxed locally, is as productive in our economy as if it were spent in Oklahoma and Utah?

Mr. ECCLES. I think so. I think the money that Mexico gets—as is true of all Latin American countries, and countries in the world, they spend all that money here either directly or indirectly, that our economy, as a whole, without looking at the particular industry that is affected, is not hurt by imports, because I think our exports have substantially exceeded our imports.

Now I understand the serious effect of imports on certain industries. I understand the favorable effect of exports on certain industries.

Senator KERR. Would you have any difficulty convincing the miners in Utah and Oklahoma of the validity of that equal benefit?

Mr. ECCLES. I doubt it. I think if they were openminded they would recognize the benefit.

Senator KERR. I am not talking about what you and I could do if—I was asking if you thought that under all the actualities you could persuade them of the validity of that situation?

Mr. ECCLES. Well, I do not know. I am glad that I don't have to. [Laughter.]

Senator KERR. I want to tell you if you were able to do that I would like for you to spend some time in Oklahoma and give them that explanation, not that the convincing of their minds would relieve the pangs of hunger in their bodies, but it might help some if they could have that mental conviction that their sufferings were offset by blessings received by other Americans.

As it is, they think their sufferings are offset by blessings of those in foreign countries.

Mr. ECCLES. I will say this, Senator: That if my interest was one of having a mine that was closed down because of a foreign import, I would be doing everything I could, I think, to try to get it open in one way or another.

It is rather difficult to be objective where your immediate livelihood or your investment is concerned.

I realize that fully.

Senator KERR. Mr. Eccles, I find more and more evidence to appreciate your ability and beliefs.

Mr. ECCLES. It is a dilemma.

Senator KERR. Let's go back to the recession now, aside from the contribution these others may have made.

We have agreed that it was manmade, that it was deliberately produced.

Mr. ECCLES. Well, I do not think it was deliberately produced. I think that the Federal Reserve knew they were taking a risk, but I think they were hopeful that by restricting the growth of the money supply for the purpose of curbing the inflationary development that was taking place, that the economy could be leveled out.

Senator KERR. That means that the degree of activity reduced——

Mr. ECCLES. That is right. But I am not sure that they expected or thought that it would lead to the recession that it has led to. I think they took the risk all right. They took the risk but I do not believe——

Senator KERR. They deliberately took the risk?

Mr. ECCLES. Oh, yes, they took the risk because I am sure they felt that was their obligation to do it.

It was their responsibility.

Senator KERR. I understand it. But aside from why they did it, there is no question so far as that is concerned, based on the testimony of Humphrey, Burgess and Martin there is no question but that they did and but what they deliberately took the risk and took the actions that they knew involved the risk.

Mr. ECCLES. Well, I think that is true. I think that is true. I think I would have done the same.

Senator KERR. I say you tell us that you approve it?

Mr. ECCLES. I would have done the same rather than face the alternative of feeding the inflation.

Senator KERR. Now these actions were taken to achieve certain results, weren't they?

Mr. ECCLES. That is right.

Senator KERR. And those results that they sought to achieve, some referred to them as an adjustment.

The President refers to it as a breathing spell. But in terms that you and I can understand, the results they sought to achieve were a slowing down of the tempo of the economy.

Mr. ECCLES. Slowing down of the growth of credit, is what it was. That is the effect of it and that does slow down the economy.

Senator KERR. And creates unemployment?

Mr. ECCLES. That is right.

Senator KERR. Well, now, they told us, and you have indicated that is what you approve of, that the purpose was to achieve the result of reduction of prices or stopping of what they called inflation and what you have called inflation?

Mr. ECCLES. Well, I would not expect it would reduce prices. I would have expected that it would stop the increase of prices. I do not see how it is possible to reduce prices with the rigidity that you have in your situation, with your wage structure frozen as it is—well it is not even frozen—that there are contracts that have been made that call for further increases in wages and fringe benefits, some of it going into 1960.

Now the great element of cost: 75 percent of the cost of everything is wages, and the idea of thinking that you can stop the growth of inflation without curbing the growth in wages and fringe benefits. I think it is all right to have the growth of wages and fringe benefits to the extent we have gotten an increased productivity that can support those increases. But the idea of getting a reduction in prices when you have increases in freight rates and increases in gas rates and utility rates and increases in your telephone rates, increases in practically every manufactured good that is produced by union labor is unrealistic. I am advocating we stop this recession by the reduction of taxes quickly, and not wait to liquidate the present wage and credit structure.

Senator KERR. Well, that is the thing about your testimony, frankly, that leaves me a little confused, because you have told us that you approved of the actions that were taken.

Mr. ECCLES. That is right.

Senator KERR. And the purpose that they had in mind——

Mr. ECCLES. That is right.

Senator KERR. Now the objectives they had in mind have not yet been achieved?

Mr. ECCLES. Well, if they had in mind a bringing down of wages and prices, then I think they are going to be disillusioned because I do not think that it is possible to bring down wages and prices and the debt structure substantially without a deep depression.

Senator KERR. Mr. Eccles, you are entirely right, yet they are still devoted to that objective.

Mr. ECCLES. Well, they will get defeated if they are.

Senator KERR. They will. That is very true, but in the meantime a lot of people are going to get hurt in addition to those already hurt.

Mr. ECCLES. And it finally will cost them more in the final analysis to go through a depression, bring down prices through a reduction of wages, which means mass unemployment——

Senator KERR. It means liquidation.

Mr. ECCLES. It means liquidation of the debts through receivership, through the foreclosing on cars and houses and so forth.

Senator KERR. Everything else?

Mr. ECCLES. In order to support the present debt structure, which is too big, you see; but in order to support the position we are in, you have got to get the national income——

Senator KERR. Up?

Mr. ECCLES. Back up. That is the only basis upon which it can be supported.

Senator KERR. You are entirely right about that.

Now, Mr. Mellon was the modern father of the liquidation theory, wasn't he?

Mr. ECCLES. Well, I do not know. I don't know who was responsible for it; all I know is that I went through a couple of them.

Senator KERR. You know, Mr. Hoover, in his Memoirs, says that Mr. Mellon was the leader of the liquidationist group in his administration; don't you?

Mr. ECCLES. No; I do not know that. I know the results of the depression, both after the First World War, from 1920, especially in the agricultural area through most of the twenties.

Senator KERR. Well, Mr. Hoover quotes Mr. Mellon in which he says Mr. Mellon told him, as I remember, and I will put into the record exactly what he did say, liquidate labor, liquidate farms, liquidate business, and liquidate everything and there will be people around alert and capable that will pick up the pieces and start to rebuild:

> First was the "leave it alone liquidationists," headed by Secretary of the Treasury Mellon, who felt that government must keep its hands off and let the slump liquidate itself. Mr. Mellon had one only formula: "Liquidate labor, liquidate stocks, liquidate the farmers, liquidate real estate." He insisted that, when the people get an inflation brainstorm, the only way to get it out of their blood is to let it collapse. He held that even a panic was not altogether a bad thing. He said: "It will purge the rottenness out of the system. High costs of living and high living will come down. People will work harder, live a more moral life. Values will be adjusted, and enterprising people will pick up the wrecks from less competent people."

But whether he was the father of that principle or not, that is the ultimate of restrictive monetary policies put into effect until they achieve the result of reducing prices, is it not?

Mr. ECCLES. Well, I do not think the Federal Reserve have any idea, and I do not think the present administration have any idea of carrying out such a policy.

If they did, some of the action that they have already taken would not have been taken.

Senator KERR. I understand that. But I say that is an ultimate of that policy.

Mr. ECCLES. Oh, that is the ultimate of it. The ultimate of a policy of——

Senator KERR. Of restrictive monetary control?

Mr. ECCLES (continuing). Of balanced budgets and restrictive monetary policy, is the process of liquidation.

Senator KERR. In depression?

Mr. ECCLES. That is right. That is what happens.

Senator KERR. I want to read you what Mr. Brundage told this committee—you know who Mr. Brundage is, or was.

Mr. ECCLES. You mean the Director of the Budget, is that the Brundage?

The CHAIRMAN. Yes, he was the Director of the Budget.

Senator KERR. He was the Director of the Budget, he was here talking to us about the increasing of the debt ceiling. He was here between—around February 4, 5, or 6.

Mr. ECCLES. Yes.

Senator KERR. And he was talking about their estimate of the need for an increase of $5 billion in the debt ceiling. To quote:

> Senator MARTIN. Was it taken into consideration that we would open some of the valves which would mean inflation?
>
> Mr. BRUNDAGE. Well, I think that the President has the danger of inflation very much in mind as I do, and I think that the Treasury does, too. So that is why they are going a little slow, not quite as fast as has been demanded in certain quarters. I also feel that if we are going to control inflation that we cannot have a continued steady rise in our business.

Mr. ECCLES. Well, I don't agree with that, if he means by business growth in the national product, that is not true. I think where you have a growth in the labor force of at least three-quarters of a million of new workers coming into the market, and I think where you have the research work that is being done, the technological development that is taking place throughout private industry, that in order to maintain a maximum employment and production, even at an even price level, your national product is going to have to grow at least 3 percent a year.

Now, that would mean that the money supply under normal conditions would grow about 3 percent a year, in order to——

Senator KERR. Have to?

Mr. ECCLES. Yes, that is right. Otherwise you stop the growth.

Senator KERR. Otherwise you open one end of the alimentary canal for the intake of additional enlargement and close up the other end with the result of certain explosion.

Mr. ECCLES. That is right. You stop the growth.

Senator KERR. I did not think you would agree with this.

Mr. ECCLES. Oh, yes.

Senator KERR. And I want to say there to you, if we have got to have monetary controls imposed to bring about certain results, I would rather have you doing it rather than the fellows who are doing it. I am just reading to you here what one representative of the administration said in February of this year.

Mr. ECCLES. That was in February?

Senator KERR. Yes.

Mr. ECCLES. Yes.

Senator KERR. And that was nearly a month after we had received their estimate that they were going to have a $400 million deficit this fiscal year and a $500 million surplus the next one?

Mr. ECCLES. I would like to say this: I think that Senator Byrd in the stand he has taken in order to stop the increase in the debt ceiling during the past few years has helped considerably to prevent inflation.

I think that during the time, the Government should not only have had a balanced budget, but they should have had surpluses, and during a period of nearly full employment and production is the time when they should have had surpluses and reduced the debt.

Now, at the present time, with a recession on, I think you have got to increase the debt limit.

Senator KERR. I think so, too.

Mr. ECCLES. And I am in favor of increasing the limit substantially.

Senator KERR. I am, too.

Mr. ECCLES. I was very much opposed to increasing it during a period of full employment and production.

Senator KERR. We are talking about 1958?

Mr. ECCLES. I think you have got to increase it now. I think if you do not increase it you are going into a deeper depression.

Senator KERR. There is not any doubt about it, not the slightest doubt in my mind. This was in early February he said—

> I also feel if we are going to control inflation that we cannot have a continued steady rise in business because I think if everybody expects that the prices of everything will go up, we will say, even 3 percent a year then they discount it, then it is almost inevitable that it begins to go up faster than 3 percent.

Here is the significant statement I want to read to you as indicating my belief, which I expressed a moment ago, that they do not think the job is done yet, although there are other actions that have been taken that indicate they are fleeing from the positions they have previously taken rather precipitously, if not in terror, certainly in panic.

I don't mean as to the economic welfare of the country, I mean as to the validity of the positions they have taken.

Here is what Mr. Brundage said:

> That is why I do not think that the present situation is economically unsound or dangerous.

In other words, he told us here in February, just 2 months ago, that he did not think the condition of the country, whether it was recession or what it was, was either economically unsound or dangerous; and I know you do not agree with that.

Mr. ECCLES. Well, I do not think the situation has reached a position of danger. I think that we—I think the country is basically sound.

Senator KERR. I do too.

Mr. ECCLES. It is sound in the sense it has got great productive facilities.

It has good agricultural production, it has got a strong labor force.

Senator KERR. Even the strongest man can get sick a day or two.

Mr. ECCLES. That is right. It is being able to utilize the wealth we have, and get production but try to get that production on the basis of stable prices because without stable prices, you do not have a stable currency.

Senator KERR. I am going to talk about that in a minute.

Mr. ECCLES. But that is where the trouble is.

Senator KERR. I want you to tell me this now: If you think that a failure to do certain things is going to bring on deepening recession, how can you tell me that you are of the opinion that there is nothing dangerous in the present situation?

Mr. ECCLES. Well, I do not think that it has reached a point of danger and I want action taken quickly so that it won't reach that point.

Senator KERR. I see.

Then you think it ought to be taken now, don't you?

Mr. ECCLES. Yes; I do; definitely. The sooner it is taken, the less it will cost.

Senator KERR. Certainly you and I are in agreement with that, although you may think the danger is tomorrow and I think it exists today.

Don't you imagine that with nearly 6 million unemployed today, they feel that the present situation is dangerous?

Mr. ECCLES. Well, I am sure that the unemployed people are in a desperate position.

Senator KERR. You don't think there is any danger in it?

Mr. ECCLES. Sure there is a danger. There is a danger.

Let me put it this way: I don't think you can always have in a free democratic society full employment. I think you will always have some unemployed.

I think it is unavoidable in our type of society, and you can only have complete, possibly full employment, in a dictatorial society, a communistic society where they are directing people where they are going to work.

I do not think you can always have full employment. But I do think that when you have the number of idle people that you have now, and the part-time workers and the idle facilities, and the surplus goods, you have a recession that can develop into a depression. It should be stopped as soon as possible.

I do feel that there is a great failure to recognize the basic reason for this inflation, and that is the cost of labor. Now, when you consider that the cost of everything is from the raw material to the delivered product, about 75 percent of it is labor, you cannot have an increase in wages and fringe benefits, at the speed at which they have gone, without having some inflation.

Senator KERR. What is inflation, Mr. Eccles?

Mr. ECCLES. Well, inflation is where the dollar continues to buy less.

Senator KERR. I thought inflation was where there were too many dollars trying to be spent for products which were in limited supply and in less supply than the available dollars trying to buy them.

Mr. ECCLES. Well, I think inflation, to the average person or even to the investor, we will say, is where your money is decreasing in its purchasing power.

Senator KERR. Well, isn't that a result of inflation, rather than inflation?

Mr. ECCLES. Well, yes; that is the result of inflation.

Senator KERR. And it is also the result of other causes than inflation, is it not, Mr. Eccles?

Mr. ECCLES. Well, I think it is the result of an amount of money in the hands of those who will spend it, which exceeds the amount of goods and services in the market.

That will give you inflation in a free economy but where you have the rigidities that you have today, you have what we call administered prices, administered wages, you are finding today that a shortage in the supply of money that did exist, we will say, last fall, the shortage in the supply of money and credit, did not tend to bring down prices and even today, with a lot of unemployed people, you are not bringing down the wages of union labor.

You have Mr. Reuther demanding further wages and benefits.

Senator KERR. Well, the thing I cannot understand about your position and so much of what you have said here is so accurate and so sound, that I have a good deal of difficulty understanding your present attitude, that in view of the fact that the policies which they have implemented, and which you approve, have not yet achieved the objective that they stated that they had in mind for them, you now advocate a more vigorous reversal of them than they themselves have put into effect.

Mr. ECCLES. Well, I think that is true. I think that is definitely true.

I think that, I suppose it is a matter of judgment, it is a matter of analyzing the situation as you see it, and I am sure that the Treasury and the administration, the Federal Reserve possibly feel that in letting the recession continue beyond what it has, that it will reach a bottom and reversal will come about as a result of easy money, cheaper credit. I doubt that.

Senator KERR. Has the prime interest rate gone down in your bank?

Mr. ECCLES. Well, we have very little prime rate paper out there.

Senator KERR. You have a prime rate, don't you?

Mr. ECCLES. Yes. We follow the market——

Senator KERR. What is that?

Mr. ECCLES. We follow the market on the question of rates. The prime rate has not gone down.

Senator KERR. The prime rate has not gone down a penny in New York, has it?

Mr. ECCLES. That is right.

Senator KERR. Yes.

Mr. ECCLES. But I don't think the prime rate would make very much difference. It would make very little difference. The people who get the prime rate if the rate was 1 percent or 1½, instead of 4, would not borrow any more, and I am sure if the prime rate was 6 and they would be just as likely to borrow as 4. I don't think the rate is the thing that is determinative—that is 90-day paper.

That is the paper used to carry accounts and inventories and the people who have the prime rate, your big companies today are reducing their debts because their inventories are going down, their outstanding accounts are going down.

Senator KERR. Is American Telephone & Telegraph reducing its debt?

Mr. ECCLES. That is the long-term debt. The telephone and the utilities go to the investment market. They do not go and borrow from the banks on a prime rate.

Senator KERR. But the interest rate they pay is pretty largely influenced by the prime rate?

Mr. ECCLES. No; the interest rates they pay are really not influenced by the prime rate.

Senator KERR. Who is affected by the prime rate, the little fellows?

Mr. ECCLES. No——

Senator KERR. If the little fellows are not affected, and the big fellows are not affected, and the Government is not, who are affected?

Mr. ECCLES. The Government today is paying the prime rate.

Senator KERR. I just thought you said they were not.

Mr. ECCLES. They are paying the prime rate. But the volume of credit is going down.

Senator KERR. You just said that the utilities volume of credit is going up.

Mr. ECCLES. Well, the utilities are very different. They do not have big inventories. They do not carry accounts.

Senator KERR. Well, they are part of our economy.

Mr. ECCLES. That is right; yes.

Senator KERR. They are the second largest business in this country.

Mr. ECCLES. They do not use the prime rate.

Senator KERR. But the interest rate they pay is certainly affected by the prime rate?

Mr. ECCLES. No; I do not think so, very little.

Senator KERR. Well, whose rate is affected by the prime rate?

Mr. ECCLES. Only the concerns like General Motors, Westinghouse, United States Steel.

Senator KERR. Don't you think the fellow who runs a grocery store or that operates the farm, is his interest rate affected by the prime rate?

Mr. ECCLES. He does not get a prime rate.

Senator KERR. I understand he does not, but isn't the rate he does get affected by the prime rate?

Mr. ECCLES. His rate is affected by the competitive market.

Senator KERR. Is the prime rate any indication of the rate he has to pay?

Mr. ECCLES. No, I think the Treasury bill rate is related to it.

Senator KERR. To what?

Mr. ECCLES. I think that the Treasury bill rate, commercial paper rate is the thing that influences the rate the farmer pays——

Senator KERR. What is the Treasury bill rate?

Mr. ECCLES. Well, it is a little over 1 percent.

Senator KERR. What was it 5 months ago?

Mr. ECCLES. It was 3.6.

Senator KERR. And what was the prime rate 5 months ago?

Mr. ECCLES. Well, I think the prime rate was about 4 percent.

Senator KERR. What is it today?

Mr. ECCLES. It went up to 4½, it is still 4.

Senator KERR. All right. Then if the prime rate is the same as it was 5 or 6 months ago, and the Treasury bill rate is less than a third of what it was at the same time, evidently the Treasury bill rate is not affected by the prime rate?

Mr. ECCLES. Well, I think if it had not been for the change in the discount rates you would have—the prime rate could have gone up again to 5 percent.

Senator KERR. The banks would have put it at 5 percent if they could have gotten away with it?

Mr. ECCLES. You had a prime rate of 4½ percent but there was very little money. The banks had no money to lend. The banks were loaned up completely over the country, and have been loaned up——

Senator KERR. Then what you are saying amounts to telling this committee that the net result of the prime rate was just to get a higher interest income to those that loaned money?

Mr. ECCLES. Well, I would think certainly that the demand for money is going to affect the rate.

Senator KERR. But I say, the prime rate reflected the fact that they did not lend either more or less from what you said?

Mr. ECCLES. Yes.

Senator KERR. Because they loaned all they had, practically.

Mr. ECCLES. Practically.

Senator KERR. Then it is just a manifestation that tells us they were just getting more for what they had been lending than what they had been getting before.

Mr. ECCLES. That is right.

Senator KERR. Now the Treasury bills are selling at 1.10, they are still getting that prime rate on all the money they are lending.

Mr. ECCLES. The prime rate has come down one-half of 1 percent.

Senator KERR. Well, it was not up above 4 very long.

Mr. ECCLES. That is right. I think the prime rate is going to come down again, it is a question of timing.

Senator KERR. They won't make any rebate on the loans they have collected on the prime rate in the interim?

Mr. ECCLES. I don't think they should, I don't see any reason for it.

Senator KERR. I am not asking you whether they should.

Mr. ECCLES. You, of course, know they will not.

Senator KERR. I know they won't, I am just trying to get it into this record. I knew you knew it, and just wanted to get it in the record. You are a man highly respected around here and a statement by you would be regarded as having more significance than if I had made it.

Mr. ECCLES. I would not say that.

Senator KERR. I don't expect you to say that.

Mr. ECCLES. I don't have the forum you do, Senator.

Senator KERR. Well, that gets back to what I said a while ago, I don't want us to get into a situation here—certainly I am not going to and I know you are not, of transforming assumptions into facts. I am just trying to limit myself to facts.

Mr. ECCLES. That is what I want to do.

Senator KERR. And I appreciate that you are giving us facts.

Mr. ECCLES. I would like to make this point: There is a great difference between the commercial bank loans, the demand deposits in commercial banks, the commercial banks, than what we call the investment market.

Now, the telephone company and the utilities and the railroads and the long-term government market is not in the commercial banks. Those markets are influenced by the investment market, and that is influenced by the savings, influenced by the amount of money that the American public saves; it is influenced by the amount of money that is retained by the corporations. The big investors are the insurance companies which have their source through the American public.

Senator KERR. You are not trying to tell this committee that interest rates as brought about by conditions in the money market, are unaffected by actions taken either by the Treasury or the Federal Reserve. You are not trying to tell us that, are you?

Mr. ECCLES. What I am saying is this: That when the demand for investment funds, mortgage funds, and long-term securities or bonds, when that demand exceeds the supply of funds, rates go up. Even though the short-term rate is down the investment rate can be up.

Senator KERR. Does actions and policies of the Federal Reserve and Treasury affect interest rates to all borrowers?

Mr. ECCLES. No.

Senator KERR. They do not?

Mr. ECCLES. Let me put it this way: The action of the Federal Reserve affects the short-term commercial rate, much more than they affect the long-term rate, and that is the point I just made in my statement that the Treasury should have done short-term financing instead of long-term financing.

Senator KERR. How is it that in 1941, when the United States entered the war, you issued this statement:

> The financial and banking mechanism of the country is today in a stronger position to meet any emergency than ever before. The existing supply of funds and of bank reserves is fully adequate to meet all present and prospective needs of the Government and of private activity. The Federal Reserve System has powers to add to these resources to whatever extent may be required in the future. The System is prepared to use its powers to assure that an ample supply of funds is available at all times for financing the war effort and to exert its influence toward maintaining conditions in the United States Government security market that are satisfactory from the standpoint of the Government's requirements.
>
> Continuing the policy which was announced following the outbreak of war in Europe, Federal Reserve banks stand ready to advance funds on United States securities at par to all banks.

Mr. ECCLES. That is correct. We were in a war.

Senator KERR. We are in a cold war now, aren't we?

Mr. ECCLES. I know. But the result of that financing is a good part of the present inflation that you have got.

Senator KERR. Well, you told me though that the Federal Reserve's actions did not affect interest rates.

Mr. ECCLES. Well, I am saying here that the Federal Reserve at that time was buying long-term Government securities.

Senator KERR. At par?

Mr. ECCLES. Yes.

Senator KERR. All right.

Do you mean to tell me that that does not affect interest rates?

Mr. ECCLES. Yes,——

Senator KERR. Does that not affect interest rates?

Mr. ECCLES. That is right, but the Federal Reserve is not buying securities, it reduced the requirements of the banks.

Senator KERR. I understand. Then the Federal Reserve policies do affect interest rates?

Mr. ECCLES. It depends on what policies they adopt. The Federal Reserve war policies affect all rates, the Federal Reserve's policy today is primarily affecting the short-term rate and it is affecting indirectly the long-term rate but nothing like to the same extent.

Senator KERR. Mr. Eccles, if they have a power and do not use it, isn't that a policy?

Mr. ECCLES. Well, sure it is a policy.

Senator KERR. Then if the lack or failure to use a power results in interest rates going up or down, then they go up or down in part by reason of policies of the Federal Reserve System; don't they?

Mr. ECCLES. That depends on what rate you are talking about.

The Federal Reserve today could go out and buy long-term Government bonds that are selling at a discount and force the rate down immediately, of course.

Senator KERR. Then their failure to do that affects interest rates, does it not?

Mr. ECCLES. Well, of course it does.

Senator KERR. Then policies of the Federal Reserve System do affect interest rates; don't they?

Mr. ECCLES. Yes.

Senator KERR. Well, that is all I was trying to establish.

Mr. ECCLES. Sure, they affect interest rates.

Senator KERR. That is all I was trying to establish.

Mr. ECCLES. As a matter of fact, if the Federal Reserve does not add to the money supply and the demand exceeds the supply, as was the case 2 years ago—this puts the interest rates up.

The demand exceeded the supply.

Senator KERR. Arbitrarily controlled by the Federal Reserve System?

Mr. ECCLES. I would not say arbitrarily; I would say wisely controlled.

Senator KERR. Wisely or unwisely, it was action taken?

Mr. ECCLES. It was action taken in accordance with their responsibility, and if I had been sitting in the Federal Reserve I would have felt I was utterly failing to discharge my responsibility if I had not done what they did.

Senator KERR. I am not talking about whether or not what they did was right or wrong; I am just talking about they acted one way when they could have acted another.

Mr. ECCLES. That is right.

Senator KERR. And, therefore, their action was arbitrary.

Mr. ECCLES. Well, I do not think "arbitrary" is possibly the right word; I would not want to admit that their action was arbitrary.

Senator KERR. Well, they did not take actions dictated to them by others, did they?

Did the President tell them what to do?

Mr. ECCLES. No, no; I think they took the actions they felt the situation called for.

Senator KERR. Regardless of why they took them, they deliberately took them; didn't they?

Mr. ECCLES. Yes. They did deliberately take them.

Senator KERR. Then you have all the fun you want to about whether or not it was arbitrary.

Mr. ECCLES. They took the action they took in order to maintain a stable currency.

Senator KERR. Well, did they maintain a stable currency?

Mr. ECCLES. They helped to; yes.

Senator KERR. You say here in your own statement that prices went up 7 percent.

Mr. ECCLES. I think the currency is much more stable than it otherwise would have been. The prices could have gone up 15 or 20 percent.

Senator KERR. Now you are speculating.

Mr. ECCLES. Well, that is right.

Senator KERR. Now you are speculating. You were not speculating when you said in this statement that they had gone up 7 percent.

Mr. ECCLES. I think it would have been inevitable if you had put more money into the economy that you would have had a greater inflation than you have had. You would have had a further growth of credit.

Senator KERR. That is opinion.

Mr. ECCLES. Well, when you had practically full employment and maximum production here, to go ahead and merely add more credit and more money would have inevitably resulted, I think, in further inflation.

Senator KERR. You said a while ago they need about 3 percent more to take care of the inherent growth.

Mr. ECCLES. That is right.

Senator KERR. They did not provide that additional 3 percent?

Mr. ECCLES. That is right. If they had put 3 percent more in the last 2 years into the economy, I think what you would have had is a further inflationary picture.

Senator KERR. But that is your opinion?

Mr. ECCLES. That is right.

Senator KERR. We did have a 7-percent increase in the cost of living, didn't we?

Mr. ECCLES. We had a 7-percent increase, that is right, most of it in the last 2 years.

Senator KERR. Most of it in the last 2 years?

Mr. ECCLES. That is right.

Senator KERR. Following a period of stability?

Mr. ECCLES. Well, that is right. But you had an increase in the velocity.

Senator KERR. I understand.

Mr. ECCLES. Because the increased interest rates increased the velocity.

Senator KERR. That 7-percent increase in living costs occurred simultaneously with the restricted monetary controls?

Mr. ECCLES. Well, it occurred during the 2 years——

Senator KERR. Didn't it occur during the same 2 years you were talking about?

Mr. ECCLES. Not all of it; part of it. About 5 percent occurred there and 2 percent before.

Senator KERR. Much of it occurred during that time.

Mr. ECCLES. That 2-year period, that is right.

Senator KERR. Simultaneously with the restrictive policy?

Mr. ECCLES. That is right, because that is when the velocity increased.

Senator KERR. Velocity has been going up all the time, has it not, Mr. Eccles?

Mr. ECCLES. Oh, no. The velocity of money increased during that 2 years.

Senator KERR. It increased during the 2 years, but it had not been static before that?

Mr. ECCLES. The velocity of money?

Senator KERR. Of turnover.

Mr. ECCLES. That is right.

Senator KERR. It had not been static prior to that time?

Mr. ECCLES. It had been pretty static.

Senator KERR. Well, how could it be pretty static?

You are either static, or not static. What are they? You have got them there.

Mr. ECCLES. I have not got them before 1954. It is around about——

Senator KERR. Just read what you have got.

Mr. ECCLES. All right.

It was around 19. And in September of 1955 it was 20.9.

Senator KERR. What was it in September of 1954?

Mr. ECCLES. Well, I don't have it. In September of 1954, I think it was down at least a point below that.

Senator KERR. What was it in September of 1958?

Mr. ECCLES. I don't have it. I think maybe I could find it in the bulletin here.

Senator KERR. It is in these hearings here.

Mr. ECCLES. But it went up here in January of 1958. It went down again. It hit the high point in September here of 23.7, and with the change in the money policy, the slowing up of the economy in the last quarter of last year and the first quarter of this year, it is down to 22.9 in January from 23.7 in September.

So it is going back down, the velocity.

Senator KERR. And the cost of living is still going up?

Mr. ECCLES. Well, that is the rigidity of your labor costs. You are not going to change that no matter what you do if you do not deal with that labor problem.

Senator KERR. Well, we are going to get back to that stability a minute, because you made a statement here—I hand you herewith questions and answers between Mr. Kerr and Mr. Mayo, Mr. Mayo being here with Mr. Humphrey—Mr. Burgess, and I show you a chart they put in.

On page 701: You see what is marked there as chart 5 up in the upper right-hand corner just above the chart?

Mr. ECCLES. Yes.

Senator KERR. You see down in the lower right-hand corner annual rate of deposit demand turnover?

Mr. ECCLES. Yes.

Senator KERR. Is that what you were talking about?

Mr. ECCLES. Yes.

Senator KERR. Doesn't that show there has been a steady increase since 1950. Actually in 1947 it went up, in 1948; and went down in 1949, and then went back up in 1950, went up in 1951, went up in 1952, went up in 1953, 1954, 1955, and then a rather sharp increase in 1956.

Mr. ECCLES. Yes; I don't know where this chart is from.

Senator KERR. Well, it comes from Mr. Burgess.

Mr. ECCLES. Yes, that is right.

Senator KERR. Do you regard his data as being reliable?

Mr. ECCLES. Yes; but it depends on what is included.

Senator KERR. That says annual rate of deposit turnover.

Mr. ECCLES. Yes. But the New York banks have a very much more rapid turnover in deposits.

Senator KERR. They are influential in this country but not exclusively so.

Mr. ECCLES. I know. But the turnover there is influenced very greatly by the Government financing, very greatly by the Government financing. The best figure for determining the turnover is to exclude the New York banks, taking the rest of the banks of the country, and——

Senator KERR. Well, you don't think Mr. Burgess doctored this data?

Mr. ECCLES. I do not, no.

Senator KERR. He was talking, using the same words you are using.

Mr. ECCLES. I do not know whether he was giving the turnover of the entire banking system or whether he excluded New York. The turnover in New York is much more rapid.

Senator KERR. If he excluded New York in this instance it is the only time in his career that he ever did it.

If he operated on the basis of giving no consideration to the New York banks, I am glad to know it because I did not think that it had happened.

Mr. ECCLES. The New York turnover could very well be deceptive as a measurement for the production and employment of the country because it might include a lot of heavy Treasury bills or Government financing that influences the debits and credits which have no relation to production.

Senator KERR. I asked you what the turnover rate was, prior to 1955, and you told me you did not know.

Mr. ECCLES. That is right.

Senator KERR. Now, I gave you here a chart that was given to this committee by Mr. Burgess, at that time Under Secretary of the Treasury.

Mr. ECCLES. Yes.

Senator KERR. I asked you if what you had been talking about was the annual rate of demand deposit turnover and you said it was.

Mr. ECCLES. Yes, but I think New York is excluded in the figures I gave you.

Senator KERR. Well, then, if you are going to withhold information from this committee you ought to tell us.

[Laughter.]

Mr. ECCLES. Well the only point I was trying to make was this: That the inflation that was gotten the last 2 years of 7 percent, without any growth in the supply of money. You made the point that there had been tight money policy, that there had been no growth in the supply of money, and yet there had been a 7 percent inflation.

Senator KERR. You have established that 5 of that occurred in the last 2 years and the rest of it prior to that time.

Mr. ECCLES. Yes; the point I was making was that the reason you had gotten inflation even without a growth in the supply of money, you see, was that the use of the existing supply had substituted or taken the place of a growth in the supply of money and that caused the bidding up of the cost of money.

Senator KERR. Yet here you hold in your hand a chart which shows that the rate of increase from 1949 through 1955 was practically steady.

Mr. ECCLES. That is the rate of increase in the supply.

Senator KERR. No, the annual rate of demand deposit turnover.

Mr. ECCLES. Yes.

Senator KERR. You have a document given this committee by the Under Secretary of the Treasury of the United States.

Mr. ECCLES. Yes, that it was steady during that period.

Senator KERR. No, that the increase in the annual rate of demand of deposit turnover was steady.

Mr. ECCLES. That is right; and there was no inflation.

Senator KERR. Oh, but there was.

Mr. ECCLES. No.

Senator KERR. You mean there was no inflation from 1949 to 1955?

Mr. ECCLES. Yes; I thought you said—you had Korea.

Senator KERR. You have not looked at that chart, I gave you.

Mr. ECCLES. Yes; I did. I looked at it.

Senator KERR. On page 701——

Mr. ECCLES. Yes; I have looked at it.

Senator KERR. Doesn't that show that from 1949 to 1955 the annual rate of demand deposit turnover increased at a fairly steady rate?

Mr. ECCLES. Yes; it does. But you had some inflation, too.

Senator KERR. Well, you said there were four of those years you had stability.

Mr. ECCLES. Well, you had stability from about 1951, 1952, 1953.

Senator KERR. Go ahead.

Mr. ECCLES. And I think before—through 1954.

Senator KERR. It was late in 1955 when it started.

Mr. ECCLES. There was some change in the first part of 1955.

Senator KERR. You have there the Economic Indicators, don't you?

Mr. ECCLES. No.

Senator KERR. I will give you one. Look at consumer prices on page 23—in 1952 it was 113.5; was it not?

Mr. ECCLES. Let's see. It was "All items"; is that the one you are looking at?

Senator KERR. Yes, sir; that is the one you ought to look at, isn't it?

Mr. ECCLES. Yes. In 1952 it was 113.5. In 1953 it was 114.4. In 1954 it was 114.8. In 1955 it was 114.5.

Senator KERR. All right.

Now up to that point you had a relative stability, didn't you?

Mr. ECCLES. That is right.

Senator KERR. Well, that is what I have said.

Mr. ECCLES. Yes.

Senator KERR. During those same 4 years according to this chart, you had a consistent increase in the annual rate of demand-deposit turnover according to this chart, didn't you?

Mr. ECCLES. That is right; and that is what supported the inflation.

Senator KERR. What inflation, the inflation that occurred later?

Mr. ECCLES. The inflation that occurred in 1956 and 1957.

Senator KERR. Yes, but this was in 1952, 1953, 1954, and 1955.

There was not any inflation in those 4 years according to what this chart showed and what you just said.

Mr. ECCLES. Well, I think it may be.

Senator KERR. Well, is it or not?

Mr. ECCLES. No; you had no inflation in those periods.

Senator KERR. Well, then, if you had no inflation you did not have anything supporting inflation, did you?

Mr. ECCLES. You did not during that period of time.

Senator KERR. That is what I am talking about.

Mr. ECCLES. Well, during that period of time you did not have any inflation.

Senator KERR. All right. If you did not have any inflation you cannot say something was supporting the inflation of that time, could you?

Mr. ECCLES. Well, you did not have any inflation. The reason for not having any inflation——

Senator KERR. I am not talking about the reason you did not have any. I am just saying if you did not have any, then this chart indicates the cause of why you did have it.

Mr. ECCLES. The reason that you have had it in the last 2 years——

Senator KERR. I am not talking about that right now.

I am talking about these 4 years.

Mr. ECCLES. Well, now what is your question? I don't know exactly what information you want from me, or what you want to prove.

Senator KERR. Well, no; I am hoping that out of this we both might learn something.

Mr. ECCLES. Well, I am willing to.

Senator KERR. And you said that the failure to provide an increase in the money supply in the last 2 years was made up for by the accelerated turnover of demand deposits.

Mr. ECCLES. I did not say it was made up for. I said the fact there had been no growth in the supply tended to increase the turnover because the economy——

Senator KERR. You did not say it tended to, you said it resulted in that increase.

Mr. ECCLES. Well, I think it did. I think no growth in the supply of money and the higher rates——

Senator KERR. Mr. Eccles, we know the higher interest rates were just as much manufactured as this recession.

Mr. ECCLES. No; I don't agree with that.

Senator KERR. Well, then, there is no use for us to discuss it because I know they were, and if you don't, as smart as you are, and as much experience as you have had there is no use in my trying to——

Mr. ECCLES. I know the Federal Reserve could have had a lower rate of interest temporarily at least if they had increased the supply of money.

Senator KERR. Let me read to you from what you told the Banking and Currency Committee in the House in 1947.

Mr. ECCLES. Yes.

Senator KERR (reading):

> Mr. MONRONEY. Do you mean to say that with your present Open Market Committee and the operation of the Federal Reserve as it now stands that, regardless of what the national income is or other economic factors, that you can guarantee to us that our interest rate will remain around 2.06 percent?

That was the question he asked you.

At that time you were Chairman of the Federal Reserve Board, weren't you?

Mr. Eccles. Yes.

Senator Kerr (reading):

> Mr. Eccles. We certainly can. We can guarantee that the interest rates so far as the public debt is concerned, is where the Open Market Committee of the Federal Reserve desire to put it.

Mr. Eccles. That is correct.

Senator Kerr. And further:

> Mr. Monroney. If you do that, you will probably force the monetization of the public debt and that in turn will bring inflation.
>
> Mr. Eccles. Well, that is correct. There is no question but that if we force the interest rates down so low that the investors would not buy Government securities and the rates that are now in effect were a pattern of rates which we agreed with the Treasury at the time of the war as the basis on which the Federal Reserve would assure all Government financing.

I want to say to you I think your efforts in that direction were salutary. I think they were worthy.

Mr. Eccles. Up to the end of the war.

Senator Kerr. It just might happen that the fact we disagree about what had gone after does not change nor impair our opportunity to agree on what you did during the war.

Mr. Eccles. I would like to say this: That when it came to the question of war financing—where the Government increased the debt from forty-some-odd billion to $275 billion in a short space there of about 4 years—it became necessary for the banking system to purchase the residual amount of Government securities——

Senator Kerr. So that they had the money to finance the war?

Mr. Eccles. That is right. The Government did not tax enough to pay for the war currently.

Then the next avenue of selling securities was to the nonbank investor which was noninflationary.

The residual amount which was about 23 percent of the entire cost of the war had to be financed through the banking system, and that financing increased the money supply, I do not recall exactly, but I think it increased the money supply——

Senator Kerr. Well, regardless of how much it increased it, it increased it substantially.

Mr. Eccles. About three times.

Senator Kerr. It increased it substantially. It was done by the policies of the Federal Reserve System.

You approved it at the time?

Mr. Eccles. That is right.

Senator Kerr. I am asking you now if financing the war was the sole consideration that you had in mind in favoring that policy?

Mr. Eccles. Yes, sir; the sole consideration.

Senator Gore. What is the date of this statement?

Mr. Eccles. In 1947.

Senator Kerr. This was March 3, 1947, when you made this statement?

Mr. Eccles. That is right; but I did not favor the supporting of the Government securities even at that time.

Senator KERR. I understand. But then I am not talking about what you favored.

Mr. ECCLES. Yes.

Senator KERR. I am talking about the power of the Federal Reserve bank.

Mr. ECCLES. That is right; the Federal Reserve.

Senator KERR. And you said this:

> We certainly can, we can guarantee that the interest rate, so far as the public debt is concerned, is where the Open Market Committee of the Federal Reserve desired to put it."

and if you do it, you will have inflation.

The Federal Reserve today can do the same thing.

When we were not doing it we have had inflation.

Mr. ECCLES. You have had a little, but you would have had a lot more.

Senator KERR. I say you had inflation when you did not do it.

Mr. ECCLES. That is right. But we had inflation——

Senator KERR. So the absence of their doing it does not prevent inflation?

Mr. ECCLES. That is right. You had inflation as the result of the growth in the private debt and not of a growth in the public debt and you had inflation——

Senator KERR. Regardless of whether the Federal Reserve bank was keeping the interest rate up or down or letting it go up, we had the inflation.

Mr. ECCLES. Well, you had about 7 percent.

Senator KERR. Well, now, can you give me any other peacetime period other than that immediately following World War II when the control of prices was taken over that you had that much, as you have had in the last 2½ years?

Mr. ECCLES. I do not know what you had in 1920 and 1921, but as I recall, you had considerable inflation there after World War I, in 1919 and 1920.

Senator KERR. I am not talking about immediately after the war.

I am talking about following the period of 4 years of stability.

Mr. ECCLES. Yes.

Senator KERR. During the recess, would you just look up and see if you can find another 2½-year period where you only had 5 percent?

Mr. ECCLES. If it is not right after the First World War, I don't think there is a peacetime economy when you had that much inflation in 2 years.

Senator KERR. Then we had it when the Federal Reserve was not keeping the interest costs down as well as when they did keep it down. Do you know whether that is true or not, Mr. Eccles?

Mr. ECCLES. No; I do not know whether or not it is true.

Senator KERR. If it is not true, tell me what other comparable period had that much.

Mr. ECCLES. I know what is true is that you had a 7-percent inflation and I am of the opinion, you see, if the Federal Reserve had not adopted a restricted monetary policy during that you would have had a very much greater inflation.

Senator KERR. I understand that is your opinion.

Yet we did have that inflation in a period when they were not holding the price of interest down, didn't we?

Mr. ECCLES. That is right.

Senator KERR. You said that it is right; I am not asking you to approve or disapprove, but is it correct?

Mr. ECCLES. It was not so much the cost of interest, it was the stoppage of the growth of money that stopped the supply of the growth of money.

Senator KERR. You said here that—

> We can guarantee that the interest rate, so far as public debt is concerned, is where the open market committee of the Federal Reserve desires to put it.

Mr. ECCLES. That is right.

Senator KERR. And you said that was inflationary?

Mr. ECCLES. Yes.

Senator KERR. Now is it or is it not correct that when they were not so operating we also had that inflation that you have referred to?

Mr. ECCLES. You see in 1948——

Senator KERR. I am talking about 1955, 1956, and 1957.

Mr. ECCLES. Yes; you have had the 7-percent inflation; yes.

Senator KERR. When they were not controlling the interest rate down as they had during the war.

Mr. ECCLES. That is right.

Senator KERR. All right.

Mr. ECCLES. They had inflation.

Senator BENNETT. Mr. Chairman, may I remind you of the excellent example you gave us a little while ago of alimentary difficulties, and suggest that it is 12:30 and we are coming back at 2:30?

Senator KERR (presiding). I think the Senator from Utah has a point.

We will recess until 2:30.

(Whereupon, at 12:40 p. m. the committee was recessed, to reconvene at 2:30 p. m. of the same day.)

AFTERNOON SESSION

The CHAIRMAN. The committee will come to order, and Senator Martin is recognized.

STATEMENT OF MARRINER S. ECCLES—Resumed

Senator MARTIN. Mr. Chairman, I want to compliment Mr. Eccles on giving us a lot of very valuable information. I agree with some of the things he has stated. I am in disagreement with some of the things you have stated, Mr. Eccles.

But, we are very appreciative, and I would like to ask you just a few questions.

From your statement this morning, I infer that you are very much in favor of a stable currency.

Mr. ECCLES. That is right.

Senator MARTIN. And I inferred from your testimony this morning that you consider inflation one of the most dangerous things confronting our country.

Mr. ECCLES. That is right.

Senator MARTIN. During the past several months we have witnessed a marked change from last summer in the spending mood of Congress. Can Government spending make up for the total deficiency in employment and in economic activity during a recession such as we have?

Mr. ECCLES. Well, I think Government spending could make up for it, but I do not think it is wise to undertake to make up for it through Government spending.

If the Government spends enough money, creates a big enough deficit fast enough, they certainly can make up for it, but I do not think Government could spend enough money wisely and efficiently and economically to make up for it.

Senator MARTIN. Then, Mr. Eccles, it is your belief that if it were possible to do it, that the long-run benefits obtained would be very much less than anything favorable to the economy?

Mr. ECCLES. Well, I think that public spending which creates employment, production, would be better than to permit the contraction to become cumulative and to the point where you would bring about a reduction in wages, a reduction in prices, and a reduction of the private debt structure. That would take the pressure of a deflation to accomplish that.

Senator MARTIN. Do you think the boom of 1955–57 has any direct relation to the present recession and, if so, how?

Mr. ECCLES. Well, I think I stated in the paper this morning that the boom, 1955 to 1957, brought about a very rapid growth of consumer credit, and a rapid growth of mortgage credit, particularly in the housing field.

The growth of that credit was much greater than the growth of the national income or the national product. They were borrowing against the future.

I also brought out, I think, this fact: that this rapid growth created such demand that it sparked the industrial expansion of new plant and facilities, and that labor then was able to take advantage of a situation of short supply or a huge demand for labor, and they made unreasonable demands; they made demands for increased wages and many fringe benefits that business was willing to grant to them because they could add it on to prices under those inflationary conditions.

Now I think what has happened is we, have had inflationary pressures for the past 2 years.

I think, as I said this morning, the Federal Reserve had attempted to curb those pressures by a restrictive monetary policy. That in spite of that restriction, there was still some inflation because of the philosophy and because of the bidding up of the cost of the existing supply of money.

There has not been enough saving. The public, the total economy, has not saved enough funds to take care of the expansion, so the demand exceeded the supply and the rates went up as a result of that condition.

The Federal Reserve could have continued to pump money into the stream, as they did during the war period, and that, in turn, would have merely kept on the wage-price spiral which, of course, could end in an inflationary spiral which would be disastrous to our economy.

Now that is really what I think happened.

Senator MARTIN. Mr. Chairman, some of these questions I am now asking were discussed in Mr. Eccles' paper this morning, but I think they are of sufficient importance that I would like a little further discussion.

Do you not feel that wage increases which are not equalled by productivity are one of the most dangerous things confronting our economy?

Mr. ECCLES. I think they have done more to add to the inflation than any other factor.

Senator MARTIN. And the wage earners are really among the class which are the heaviest losers by reason of inflation.

Mr. ECCLES. They have priced themselves out of the market since a great part of the population did not get the wages and the fringe benefits that they have gotten, and if everybody had gotten the same as organized labor has gotten, you would have had just that much more inflation.

Senator MARTIN. More inflation?

Mr. ECCLES. That is right. They have profited at the expense of the farmer, the pensioner, and the unorganized groups.

Senator MARTIN. And a man who is thrifty and saves money also has——

Mr. ECCLES. He has been penalized because the purchasing power of his money has declined because of inflation.

Senator MARTIN. Mr. Eccles, do you believe when a boom such as we had in 1955–57 gets started, that monetary and credit policy alone can be adequate to hold it in check?

Mr. ECCLES. I think so. I think that monetary and credit policy will stop it.

As has been discussed this morning, the monetary and credit policy did not prevent a certain amount of inflation taking place, but it certainly curbed the speed of the inflation and the extent to which it would have taken place, in my opinion.

But rates got up so high that money was used much more rapidly than is normally the case, and so we got a very rapid use of the existing supply of money which we term as the velocity of funds, which did feed the inflation a little longer than would have been the case otherwise.

Senator MARTIN. There is a theory among a great number of people, and you expressed that this morning in your testimony, that during periods of prosperity the Government should run surpluses, and then use this to either reduce taxes or the public debt.

Mr. ECCLES. I would think it is more desirable to use it to reduce the public debt. You reduce taxes in an inflationary period and you do not take the pressure off of the inflation.

The way you reduce the inflationary pressures during an inflationary period would be for the Government to collect more in taxes than they spend, using the surplus to retire the public debt, reducing the public debt as the private debt is expanding—and we had a very rapid expansion of the private debt during the last few years—and, therefore, a contraction of the public debt would have been anti-inflationary during that period and that would have been desirable.

Senator MARTIN. This morning, Mr. Eccles, you spoke of the fact that you felt the best way to get us out of a recession is by cutting taxes.

But when you cut taxes and increase deficits, does that not feed the inflation?

Mr. ECCLES. Well, it does not feed the inflation if you have got a deflation, if you have got a recession. What that does is to increase the public debt to offset the contraction of the private debt.

A contraction of debt is deflationary; and in a dynamic or growing economy such as we have, there must be a growth in the total debt. There has never been a period of employment and production without a growth in the debt structure. There has never been a contraction or a deflation without a contraction in the debt structure, either public or private, or both.

And what I am saying now, during a period when these private debts are heavy, the consumer credit, mortgage debt credit, I do not approve of the Government's action in encouraging construction of housing with no downpayment. I think it was that action which was taken in 1934 which tended to create too much private debt and increased the cost of housing very substantially.

I do not believe the way to get out of it is to encourage an expansion of private debt with no downpayment system today. I doubt very much if it is going to do much, anyway, but I do not like the principle of stimulating private debt when the private debt today is already as large as it is, and has been growing so much faster than the national product, and is the principal factor in creating the deflationary period.

Senator MARTIN. Mr. Eccles, you have been very familiar with governmental activity since 1933, and you have also been a very careful student of private industry. Is it not true that the combined public and private debt has gradually increased since the early thirties?

Mr. ECCLES. That is right, it has, and there is no objection to it.

I think the debt has got to grow, the total public and private debt has got to grow in relation to the growth of the national product. If we have a growth in total production and a growth in the labor force, that the debt structure must likewise grow in relationship to it.

A capitalistic economy is a debtor-creditor system, and the offset of savings is debt. And when the mass public save, somebody has got to borrow, you see. It is either public or private, or both.

So that the only bad thing about debt, either public or private, is when it grows faster than the growth of the national product. Then it becomes inflationary. And when it contracts, the opposite is true.

Senator MARTIN. Mr. Eccles, is it not much easier to create debt than it is savings?

Mr. ECCLES. Well, I believe it is. I think that inflation is much more, certainly, popular than stability. I think the effort to maintain stability has its real difficulties because there is a great tendency to want higher pay, there is a tendency to want higher prices, bigger profits. There is a tendency for the Government to want to spend more money.

Senator MARTIN. Well, Col. Theodore Roosevelt once expressed that one of the greatest dangers of our country was the desire for an easy way of life; and when you have inflation and when you have heavy debt, that is an easy way of life.

But when we get into trouble, is it not the individual who has some savings and a very small debt who is the one who is in an enviable position?

Mr. ECCLES. That is true if the recession does not go into inflation. But it is not true if the deflation becomes cyclical.

For instance, the best example I can think of is the situation from 1929 to 1933 that in 1929 we had a total national income of about $82 billion, and it appeared that the debt structure at that time was too heavy, and there was a deflation which developed.

The Federal budget at that time was less than $4 billion. The Government felt that nothing should be done, that there should be an effort made to balance the budget, even though it was less than $4 billion.

There was an effort made. But there was great opposition during that period to the Government running a heavy deficit and dealing with the inflationary problem thereby. What happened was the national income finally fell until about the time of the bank holiday, when it was $40 billion instead of $82 billion.

Now it did not liquidate the debt. The debt was liquidated about 20 percent in that period of time. But the national income fell over 100 percent. So that the weight of the debt in 1933 was much heavier in relationship to the national income, the means of supporting it, you see, than it was in 1929. And we found practically every bank, every insurance company, that all of the credit institutions were bankrupt, that they could not collect the debts. They could not collect what was owed to them, and, therefore, the savers were unable to get the benefit of their savings.

Banks closed, insurance companies suspended making their payments for a period.

What you say is true, that to have savings at a time of a recession is desirable up to the point that you can always collect on them, to the time that you can collect upon the mortgage. But if a recession goes deep enough, you begin to get into defaults of your mortgages and your bonds, and your banking structures get into difficulty.

Senator MARTIN. Is that not, Mr. Eccles, because the debt was too heavy, that we had what we call in banks frozen assets, and that is because of excessive debt?

Mr. ECCLES. Well, I do not think that is necessarily true.

I think the bank indebtedness is only a small part of total indebtedness. I think the principal trouble of the deflation after 1929 was that there was the distribution of income which was bad, there were too few getting too much of it. At that particular time the tax situation was very different from what it is today, in that about 5 percent of the population was getting something like 36 percent of the income.

I think there happened to be a period then of an oversavings situation; that we had a huge volume of idle money which was being loaned into the stock market. Brokers' loans got up to $11 billion at that time, and that was a case of corporations with surplus money, of individuals with surplus money, were loaning into the stock market, and the mass public was buying securities on a 10 percent margin. That is really one of the things that happened there.

Senator MARTIN. Was not the danger at that time likely due to the fact, in the United States, that everyone started to buy stocks; that there had been a gradual rise in the prices on the stock market, not values? And I think a lot of people realized the value was not there, but we all do the same thing.

When the President gets a stomachache, then we sell stock; and if the general public is buying stock, as we all do, that that was one of the reasons; it was really an inflation?

Mr. ECCLES. We had no real inflation in 1929. The cost of living went down from 1926 to 1929, the actual cost of living went down during that period. So there was no inflation either in wages or in prices in 1929.

As a matter of fact, one of the problems was that the mass public were getting not enough of the national product. They were getting too small a portion of the national product to be able to buy what was being produced. It was a very different thing.

The deflation was a very different situation than that which you have now. Now I think you have entirely different causes and, I think, as I say, one of the principal reasons today is the high cost due to the high wages and fringe benefits which have gone to the organized labor groups.

Senator MARTIN. You are talking about labor, and we will get into that in just a little while.

Some years ago you used the phrase, "engine of inflation," in referring to the support of Government bonds by the Federal Reserve.

Mr. ECCLES. That is correct. I certainly did.

Senator MARTIN. Do you think that annual wage increases in industry, as well as escalator clauses, is another and more powerful engine of inflation?

Mr. ECCLES. I think it is. I think it is a real engine of inflation to the extent that business is willing to grant those wages, which they are willing to grant if they think they can add the increased costs on to prices.

Senator MARTIN. At the present time, as a result of those increased prices and costs, there is a buyer's strike. People are not buying.

Mr. ECCLES. Yes, sir. I think they cannot. I think there is this dis-equilibrium between the income groups which is such that a large part of the public who have not had the inflationary income that the labor groups have had are unable today to purchase at these prices.

Senator MARTIN. But, Mr. Eccles, in February we had the highest savings of any February in the history of the United States. Yet people are not buying.

Mr. ECCLES. Well, one of the reasons you have got the high savings is that people are afraid. I think when they see the downturn and they see the unemployment that they are confronted with, people are very hesitant, certainly, to spend money if they do not absolutely need to, and I think that the public generally are possibly better supplied with the necessities, the things they need, than they have ever been and, therefore, they are not willing, they are not ready to spend readily, I think, when they feel that unemployment might increase and they might need their funds.

I think the savings today, the increase in savings, is due to higher interest rate. They are getting a greater reward for their savings; they have been all last year. Last year they were getting a better return on their savings, and that is an inducement to save.

Senator MARTIN. But, Mr. Eccles, we are getting—the saver is getting— a less return on his savings than he did in the recession or depression of the late twenties and early thirties.

Mr. Eccles. Of course in purchasing power he is, but his income is substantially more, so that he has got more to save.

Senator Martin. Now I would like to go a little further. This morning you discussed the problem of the increase in wages among the organized workers as compared to the wages of the so-called nonorganized or white-collar workers and farmers, and so forth.

I wish you would discuss that just a little further.

Mr. Eccles. I think you have perhaps 25 percent of the working force known as your organized workers—members of the CIO and AFL and Railroad Brotherhoods. And aside from that you have a great many workers that, of course, are unorganized—the small-shop owner and the small operator, the farm workers, the pensioners. And now there are a good many of the unorganized workers who have received increased pay which has been comparable to that of the organized workers. Many companies where part of their force is the organized workers and part of them is the unorganized or white-collar workers, have usually increased the pay of the white-collar workers, of the unorganized groups, in relation to the increase of the pay in the organized groups. That has taken place.

But it is the pressure from the organized groups that has tended to increase pay generally.

I am not opposed; I do not want you to get the impression I am opposed to the workers of the country, in which there is close to—what do we list?—70 million of them, receiving wages and salaries and fringe benefits in relationship to the ability of our economy to pay those wages and salaries to the extent that they can be paid out of production without increasing prices, and at the same time leave a sufficient income to industry to enable it to pay a dividend, a return on capital that can attract capital, which will enable industry to hold enough in its reserve in order to expand its plant and facilities to meet the needs of a growing population.

I think, aside from that, that the workers should get increases, but the objection I have is where the increases have so far exceeded the increased productivity that for industry to have to pay the wages and the fringe benefits without increasing prices would have bankrupted many of them. It was impossible for them to do so.

Senator Martin. Mr. Eccles, we all agree that because you make the statement you do not want to see wages increase more rapidly than the productivity of wages, we all know that you desire to see better working conditions.

Mr. Eccles. Certainly I am all for it.

Senator Martin. And better salaries, because that is all a part of the American way of life.

Mr. Eccles. That is the source, and that is the only way business can succeed, is to have a market for its product, and if it does not pay enough it is going to lose its market.

Senator Martin. But, on the other hand, it is absolutely necessary for productivity to keep up with these rises in wages. If we do not, eventually these producers, both large and small, will go bankrupt, if we keep on increasing that rate in the future.

Mr. Eccles. Well, certainly they will go bankrupt unless they can add it onto prices, and the public will pay the prices. That is inflation.

Senator MARTIN. That is inflation. That is what I am getting at.

Mr. ECCLES. That is right.

Senator MARTIN. And I think you and I agree, and most members of this committee agree, and I have been very much impressed with my talks to men and women on the street, how they appreciate what inflation means and how dangerous it is to the individual, both rich and poor, because the eroding of the dollar just simply destroys the purchasing power of all of us. And it is probably what destroyed Germany, no finer people in the world than the German folks. And it was inflation which has destroyed France economically.

And I am fearful it can do the same here in the United States. That is why I am kind of repeating some of these questions, Mr. Eccles, because I was very much impressed with what you said this morning.

Mr. ECCLES. I am violently opposed to inflation, but I am likewise opposed to deflation. We speak of a sound dollar—a sound dollar means a dollar that is not only fair and sound to the creditor, the saver, but it also means a dollar that is sound to the debtor.

When you have a debtor and you have a deflation so that the purchasing power of the dollar is increasing substantially, it becomes unfair to the debtor, and it can bankrupt the debtor.

We saw how the farmers and the homeowners during the depression of the thirties lost their farms and their homes because the dollar was so sound, its purchasing power was so great in relation to its value when they borrowed the money that they could not pay the debt.

Now I think that we have got to look at both sides of this coin; that we have got to protect the insurance, we have got to protect he saver, but likewise we need to protect the debtor. We do not want to have the debtor go bankrupt.

Senator MARTIN. Of course, Mr. Eccles, in a free economy like ours, we want it fair to all concerned. But is there any way in a free economy, where much of it depends upon the emotionalism of the individual, to prevent recessions and then also periods of boom prosperity?

Mr. ECCLES. Well, I think if we do not do it, I think we are going to lose a lot of our freedom. I think you tend to help make a case for the Communists and the Socialists. I think when you have millions of idle men and idle facilities in a capitalistic system, you are making a case for State ownership and the use of your men and facilities.

Senator MARTIN. Mr. Eccles, during the history of this country we have had ups and downs starting from just a few years after the Government was established.

I realize that an unemployed group is fine soil for the planting of the seeds of communism. But on the other hand, a freeman is the man who has the freedom to choose his job, to earn his own living. Is that not true?

Mr. ECCLES. Well, I think that is right. But the difficulty is that we must not only give the man the right to work, which he has, but there is some obligation to give him the opportunity to work, and I think if you take a look at the Employment Act, the objectives of the Employment Act of 1946 are to maintain employment and production.

There is one thing I would like to have seen added to that act: Maintain employment and production within the framework of a stable economy. I would like to have seen stability added to the question of employment and production.

But certainly I do think when the Government passed that legislation, they recognized that they had some responsibility for the maintenance of employment and production, and what you have said about the early history of the country I think is true. But I think we also recognize we are living in a very different world today than we lived in 30, 40, or 50 years ago. It is not the same world.

There are, as you know, a great many changes. There is much greater interdependence in our economy today. There is much greater interdependence in the world economy. And I think what is required today is a responsibility on the part of the Government, a very much greater responsibility than the Government had a good number of years ago, and I think that any party that evades or avoids or sidesteps that responsibility is not going to stay in power.

On the other hand, I think that an inflation which destroys the value of the savings and the dollar and the pensions of people, I think the public of this country have great objection to high costs, to an increase in the cost of living, to a cheaper dollar. I think there is a great objection to that.

It is a dilemma and it is a very difficult problem, but certainly I think the objectives have got to be the maintenance of stable money, which means the prevention of inflation and also the prevention of deflation.

You have the duel responsibility. And what I was trying to present here today was what I conceived to be the problem, the things that created the problem, and what I think, under the present circumstances, needs to be done about it.

I do not believe that because there is a later danger, which I recognize, of inflation, that we should do nothing about deflation. I think we have got to deal with the problem we have now, recognizing that there is a later danger of inflation and doing something about it, being prepared to deal with the inflationary situation when you get recovery from your present recession.

Senator MARTIN. Mr. Eccles, on page 3 of your statement this morning you stated that the easy credit policy adopted by the Federal Reserve in 1954, coupled with the Government's excessively liberal mortgage terms, sparked the huge capital expenditure program and the ensuing boom and inflation of 1956 and 1957.

You said that on top of this, year-by-year increases in spending took place from $64.8 billion in fiscal 1954 to $71.8 billion in fiscal 1957.

In other words, does this mean by Government efforts in 1954 to end the then recession, we laid the groundwork for the later boom and inflation which ended in the current recession?

Mr. ECCLES. I think we had something to do with it.

I think that at that time the housing legislation that was passed, which permitted the no-downpayment, was not justified. I think it was an unsound thing to do, and it stimulated an amount of housing construction that tended to inflate the costs of housing and the cost of land, and they borrowed against the future.

Whenever you get 1,400,000 houses in a year during a boom period, you are getting too many, and you cannot maintain that. When you cannot, you are in trouble.

Senator MARTIN. Mr. Eccles——

Mr. ECCLES. I just want to say this other point here so I will not be misunderstood on it.

Senator MARTIN. I am sorry to have interrupted.

Mr. ECCLES. And that is we likewise had an extremely vigorous stimulation to the consumer buying.

Now, I am one who has always felt that the Federal Reserve should not only have the authority that they have over the over-all price of money and the supply of money, but they should have selective credit powers, such as the one they use in connection with the security markets.

There has been no inflation in credit going into the security markets because they have maintained a very high margin. It never got below 50, and it is back, they put it up to 70. I think it is back down now.

But the amount of credit that was expanded to buy securities in the market has been very limited due to that selective credit control, and I have felt that the powers the Federal Reserve once had over the use of consumer credit and mortgage credit, they should still have them, and they should use them as a selective credit control without moving in to tighten, as they did, the entire market.

I know they make a case against that. They do not like the power. It is difficult to administer, and the question of the housing credit, there is great opposition within the Government to give that power to the Federal Reserve.

The home-loan bank peo[...]—Mr. Cole.

Senator BENNETT. Housing and Home Finance Agency.

Mr. ECCLES. Yes, that is right.

There is a lot of opposition there, of course, to giving the Federal Reserve, I think, the powers over the housing mortgage credit.

But if the Federal Reserve had had these powers, I am sure that the amount of home building that was done in 1955, and the amount of consumer credit that was developed, where it was—both of those fields of credit expansion were so great and so rapid, that they could not help but have an inflationary effect, and they certainly put labor in a position where they were able to make demands, and got those demands that they asked for; put business in a position where they had to expand their productive facilities to meet these huge demands that were sparked by these credits, and the Federal Reserve did not have the powers to do anything about the selective credit, and they only moved in on the overall credit—tightening when it appeared that the cost of living was increasing, and when it appeared that overall inflationary developments were taking place.

But inflation had already taken place in the cost of housing, and also in the cost of consumer durable goods, particularly automobiles.

Senator MARTIN. Mr. Eccles, the next question is somewhat a repetition, but I think a discussion of it will be very helpful to us in our work in this committee.

Are we not now likely—by renewing easy housing terms, easy monetary and credit policies and a large deficit in 1959, and probably for later years—is it not likely that we are setting the stage for another inflationary boom to be followed by recession?

Mr. ECCLES. Well, as I said a moment ago, because of a later danger of inflation, I do not think that that justifies doing nothing about a recession.

I think that we should deal with the inflationary situation, but I likewise think that we should deal with the recession, and we should not permit that to become cumulative, and we should not lose what we are losing, billions and billions and billions of dollars of wealth production through idle men and idle facilities in order to prevent an inflation that might develop later.

I think, as I said this morning, I am not favorable to try to encourage people to go into debt because of no downpayments on housing or because of excessively easy payments, with an effort to borrow against the future again on housing production.

I think that that is making a mistake to encourage that kind of credit.

I do not think that a Government deficit necessarily is going to create inflation.

Assume that you have a public deficit in the fiscal year 1959 of, say, $10 billion or $15 billion, and you have a contraction of a private credit of $20 billion or $25 billion. You would not have inflation.

Senator MARTIN. Mr. Eccles, right at that point, that is true, but how are you going to arrange to contract this private debt so that it will offset the increase in the public debt?

Mr. ECCLES. Well, I think that private debt will continue to expand to the extent that you begin to get reemployment, with the growth of your population and the growth of your labor force, and with that employment of people, debt has to grow.

Debt inevitably will grow, because savings will grow.

The only offset of savings is debt; when you get money in a building and loan or in a savings bank or insurance compnany, that money is loaned to either municipalities or it is loaned to individuals on mortgages or it is loaned to industry for factories or to build buildings. The money has to be loaned.

Now, that money is not going to go out and be loaned unless there is a profitable use for it and, therefore, you have to have employment, and the employer has to have purchasing power in order to get a use for the facilities, and that does not happen unless you get a growth in debt.

As debt contracts, there has never been a period when debt contracts but what you get unemployment and deflation, and the only time that you get use of your facilities and the employment of your people is when debt expands.

It does seem strange, but it just happens to be true that in a debtor-creditor economy—and that is what capitalism is—that is what happened.

Senator MARTIN. This was not touched on by Mr. Eccles, and he need not attempt to answer this question unless he so desires, because there was not any reference to it in your statement this morning.

During the day I had a labor group discussing with me imports of foreign-produced goods.

I have had during the day a group of businessmen discussing imports.

What do you think should be the attitude of our country relative to the importation of products, particularly from countries where the standard of wages is much under that that we have here in the United States?

Mr. ECCLES. Well, of course, that is an old problem, and it is one that has haunted the country for a good many years, and I guess will continue to do so. It is dilemma.

If you protect the domestic industry that is forced to pay high wages, fringe benefits against the importation of goods from Japan or Germany or England or other countries abroad, then, of course, you stop the imports.

The effect of that is to curb or to stop the imports and develop the local market for the American product at the higher price.

Now, that means, on the other hand, we have a great many industries in this country that rely upon an export market.

There are two sides to this coin; that our exports have exceeded our imports.

If you stop your imports, you are going to stop your exports.

The only source of funds that foreign countries have to buy American products is the sale of the goods that they export to this country, and the invisible funds that they get through our American travel, and, of course, through lend-lease; foreign loans provide them with funds as well as imports.

Now, we are in great need in this country of many raw materials.

There was a time when we were much more self-contained than we are today, and as our population grows, and as our supply of raw materials diminishes, we are going to be increasingly a have-not country. It is an element of danger.

Our oil resources are getting less in relation to our growth and population, and nearly all our minerals are getting less in relation to our population.

Certainly our iron ore supply has created a situation where we are a big importer of iron ore.

Senator MARTIN. Mr. Eccles, you have spoken about oil. Is it not true that the increase of scientific research being what it is, it is not going to be long before we will be making oil and gas and commercial alcohol from coal?

Mr. ECCLES. Well, the Germans did it during the war.

Senator MARTIN. Oil shale, and things like that?

Mr. ECCLES. We can do it. However, it has been more economic to produce oil otherwise, but I am sure the time will come.

Senator MARTIN. But won't the time soon come?

Mr. ECCLES. Well, I do not know how soon. There is quite an expansion taking place now in the development of shale.

The Union Oil Co., and other oil companies, are doing quite a bit of work in the development of oil shale in an effort to be able to produce oil competitively with the other oil.

Senator MARTIN. Then, you spoke this morning about national defense and that is, of course, probably the No. 1 job of the Federal Government, which is to provide for the national defense.

But won't it be sound from a defense standpoint to have a critical war item like oil produced here in the United States rather than taking the chance if an enemy might have the submarine strength to prevent us from importing oil?

That is getting, Mr. Chairman, a little bit probably out of what this discussion ought to be, but still it is a problem confronting the United States, and you have expressed yourself relative to some things like that, and I would be glad to have your further comment.

Mr. ECCLES. Well, of course, there is a great division of opinion as to the extent we ought to be involved in world trade.

Some feel that, of course, we should be much more isolated than we are.

I am not one of those who believes that it would be in our long-run interest.

I think that we cannot very well prepare with the idea that we are going to be isolated or shut off from the world.

I think certainly if we should get into a war, it would likely be the atomic or hydrogen type of war, and it would pretty much destroy us; and we in turn would retaliate, and we would destroy a substantial part of the Communist world. That is what it would come to.

I do not think that we can think of war in the sense that we have thought of wars in the past, and I think we must think in terms of world trade.

I think that if we will take the Latin American countries, they are great raw-material countries. They have an abundance of raw materials, and they are in great need of food products.

They are in great need of our manufactured goods, the manufactured goods from Western Europe; and Western Europe, in turn, is in great need of the raw materials of the Latin American countries and of Africa; and I think, as time goes on, both we and Western Europe and Japan are going to be increasingly dependent upon the raw materials of these backward countries.

The only way that those countries can do business with us is for us to buy what they have to sell and we, in turn, sell to them what they do not produce and what they can get from us and other areas.

Those are the basic problems.

It may well be that in our domestic picture, in our mining area, that we may be justified in paying subsidies to support certain industries, where our costs are great because of the high labor costs. I think that is so.

But I do not believe that we can put ourselves in a position where we do not take the imports from the Western World, largely from the free world, and in turn ship them the products that they buy from us.

I think that we have got to have this multilateral trade. Without it we isolate ourselves.

As you isolate yourself, you destroy the cohesion of what I term the western or the free world, and I think you play pretty much into the hands of the Communist world.

Yet I recognize the problem it does create for certain industries that cannot compete—I think it is a dilemma, and I realize what it is.

Senator MARTIN. Thank you, Mr. Eccles. Mr. Chairman, I apologize for taking so much time.

The CHAIRMAN. Senator Flanders?

Senator FLANDERS. Thank you, Mr. Chairman.

Marriner Eccles, your statement and your answers have been of very great interest to me.

Also they have worried me somewhat, because I see a possibility of having to reorient myself slightly, and that is always an unpleasant and unsettling process.

I take it, sir, in listening to you that you are not frightened of debt as debt?

You are frightened lest it get out of proportion.

Mr. ECCLES. That is right. I am not frightened at debt. Debt is an essential.

Senator FLANDERS. All right.

Now, you have spoken of a proper relationship between debt and national product.

Mr. ECCLES. That is right.

Senator FLANDERS. That is in a way your measure.

Turning over to page 13, I get a little bit disturbed because you say that the growth in the public debt in the last 10 years is approximately 7 percent, whereas the growth in the national product has increased 87 percent.

Now, just reading that, I would wonder whether you felt we could go all the way up to that 87 percent safely?

Mr. ECCLES. No. I think what happened was, the debt and the national product have gone up rapidly because the private debt pretty much took care of it.

You see, you had a huge growth in the private debt, along with the growth in the national product.

What I am saying is that with this rapid growth in the national product, that has not been stimulated by a great expansion in the public debt.

Senator FLANDERS. Yes.

Mr. ECCLES. The private debt has pretty much been responsible for the financing and the growth of the national product.

Senator FLANDERS. Would you then want to add the 7 percent or the dollars represented by it to whatever the increase is in the private debt, and compare that with the dollars of increase in the national product?

Mr. ECCLES. Add the two together?

Senator FLANDERS. Yes.

Mr. ECCLES. Well, I think you could do that. We have had some inflation. I think the private debt has possibly grown too fast.

Senator FLANDERS. Now, does the inflation wipe itself out in the comparison or do you have to discount the national product? Would you not have to discount the national product by the inflation to get it into comparable dollars?

Mr. ECCLES. I think that what has happened is you have had a growth in the private debt. You have had some growth in the public debt, but not large. You have had a growth in the national product.

During the entire development, going back 10 years, you have had considerable inflation.

We had the Korean war, as you will recall, 1950 and 1951, and the inflation, the cost of living, went up substantially from the 1947–49 figure which, I think, was figured at a hundred. It went up nearly 15—13 or 14 points as a result of the Korean war.

The Korean war brought about a substantial growth in the national debt.

The national debt was contracted during the 10 years, and then it was again increased. It was contracted in 1946 and 1947. There was a substantial contraction.

Senator FLANDERS. You see what I am trying to do, Mr. Eccles, is to get some formula as to what would be a proper relationship between to total of public and private debt and the——

Mr. ECCLES. And the national product.

Senator FLANDERS. And the national product.

Mr. ECCLES. Well, I do not know whether that would be possible or not.

Senator FLANDERS. You seem to have been leading up to something of that sort.

Mr. ECCLES. Well, I think they are related, of course. But I do think that you get, as I said this morning to Senator Kerr—I said the velocity of funds is an important factor that enters into it, as well as the size of the debt.

Senator FLANDERS. Yes.

Mr. ECCLES. You see, you have two kinds of money. You have what you call commercial bank deposits and currency.

Now, that is what we call and is known as our supply of money. That does not represent what we call savings. That is the money that provides the current means of payment.

Then we have what is known as savings, which are created in part, by the velocity or the use of that money.

People get money; they may put it in a checking account and draw it out, and it goes to somebody else, or send it to pay for the insurance policy.

The insurance company then uses those funds to make investments. A substantial part of the insurance money is a saving.

Senator FLANDERS. Well now, shall I judge that in my trying to keep up with you, you say that the debt, private and public, should be in some way proportional, to the national product. You have now led the discussion into the next field I was going to inquire about, where money came from.

The CHAIRMAN. Senator Flanders, will you yield there for an insertion in the record?

I made a statement earlier in the day, Mr. Eccles, relative to total debt in the United States. I should like to amplify it at this time.

The total debt has increased in 4 years from—the total debt in December, last December, corporate indebtedness was $253 billion, private $213 billion, Federal $277 billion, State and local $50 billion; that is a total of $793 billion, which is an increase of $200 billion, or about 33 percent in 4 years.

I wanted to get that clear on the record, because what I said today did not refer to private debt.

As a matter of fact, private debt last December was $466 billion. But the total indebtedness, public and private, has increased in 4 years by $200 billion or 33 percent.

Senator FLANDERS. If I understood, Mr. Eccles, what you were saying about bank credit, are you not assigning the source of much of the funds with which business does its work to the extension of bank credit, which means to the generation of debt or to the willingness to go into debt?

Mr. ECCLES. Well, there could be no growth in the money supply without an expansion of commercial bank credit.

Senator FLANDERS. Does that mean without an expansion of debt?

Mr. ECCLES. Without an expansion of debt, that is right; that is exactly right.

Senator FLANDERS. "Debt" is the rough way to say it.

Mr. ECCLES. That is right.

Senator FLANDERS. "Credit" is the nice way to say it.

Mr. ECCLES. There would be no money if you had no debt.

Our system of money comes from the expansion of commercial bank credit, whether public or private.

Senator FLANDERS. I once asked George Humphrey, who was sitting where you are now, "What would happen if all the debts of the country were paid up?; and his reply was, and it is in the record, "We would be in a hell of a mess." In other words, we would not have much money to do business with.

Well then, I just want to follow through one other remark that you just made awhile back there.

You spoke about the difference between bank credit money and savings, but you gave the instance, as I understood it, of bank credit money generated from a bank credit by the incurring of debt being paid on a life insurance policy, and then entering the savings type. But was it not originally bank credit?

Mr. ECCLES. Yes; it would have to be originally bank credit; and money that goes into a mutual savings or a building and loan or into an insurance company or into the purchase of Government bonds or any other form of debt, in the first instance, has to come out of bank money, and the fact that it goes into an insurance company does not mean that it stays there.

Senator FLANDERS. No.

Mr. ECCLES. It goes into the insurance company.

Senator FLANDERS. Back into circulation.

Mr. ECCLES. And the payer of the premium gets the credit for it, and the insurance company then spends the money, spends it on investments or it pays claims, but the money immediately goes back into circulation.

You put money into a savings bank, the savings bank carries its deposit account in a commercial bank.

The savings bank gives your account credit, but the savings bank immediately uses that savings account of yours to make a mortgage or to buy a bond or to take care of a withdrawal. The money is constantly in use.

Senator FLANDERS. Well now, Mr. Eccles, I have arrived in the short discussion at the point where it would appear that debt in itself is not a curse, and a calamity, but it is, in fact, a necessity because it is the basis of our means of doing business.

What is bad is when it gets out of hand.

Mr. ECCLES. What is bad is when the debt structure is excessive in relation to the national product.

Senator FLANDERS. Yes. All right. I think I follow through there.

I want to now move sidewise to another point which is related, but I got the impression from your statement this morning that you felt in the months ahead that a Government deficit was inescapable.

Mr. ECCLES. That is right.

Senator FLANDERS. We could have it either by overspending or we could have it by expanding our public works, as they are doing over there on the floor of the Senate right this minute.

Senator MALONE. Do you think we could help it?

Senator FLANDERS. We could not do anything about it, but I did provide a majority of one at a certain stage of the proceedings.

Senator BENNETT. I am sure I was in the majority of one.

Senator FLANDERS. I am sure I was, because I had questioned whether I should go home that night.

(Discussion off the record.)

Senator FLANDERS. But now, the deficit, from your standpoint, is going to be unavoidable, as I understand it, because unless we can do something the business is going to slow down, get less and less; taxable profits and the taxable incomes are going to diminish, and if we do nothing we cannot escape that deficit; is that your statement?

Mr. ECCLES. That is correct. You can do nothing to escape the deficit. You cannot cut expenses fast enough to get a balanced budget.

Senator FLANDERS. All right. So if we do nothing we do not avoid the deficit.

Now, there are two things we can do, either separately or simultaneously: One of them is to try to get the economy into better condition. One of them is to increase Government expenditures and make more work and employ more people. That itself immediately increases the deficit——

Mr. ECCLES. That is right.

Senator FLANDERS. By the amount of those expenditures, unless and until it has some favorable action on employment and profit.

Now, I think we have to put in that proviso.

Mr. ECCLES. That is right.

Senator FLANDERS. The other possibility is that of reducing taxes and that, after a turn of the wheel, conceivably does the same thing in that if it works, employment and production will begin to expand, and we will have a better base for taxes.

Mr. ECCLES. The first thing you do is you stop the downturn.

Senator FLANDERS. Yes.

Mr. ECCLES. You cannot get an upturn; you stop the downturn.

Senator FLANDERS. You stop the downturn.

Mr. ECCLES. The easy money tends to create a favorable climate for the other.

Senator FLANDERS. Now, we have those two procedures which can be used alternatively or together.

Would you explain, as simply as possible, why you think that the use of tax reduction in place of increased expenditures will have a better effect on employment and production?

Mr. ECCLES. Well, for this reason: In the first place, the effect of tax reduction could be much quicker. An expansion in Government expenditures is slow. It takes time, and a planned large additional public expenditure would be stretched out over a period of 2 or 3 years.

Senator FLANDERS. Yes.

Mr. ECCLES. The largest part of a public expenditure might come just at a time when you have got recovery, and it would add to the inflationary pressure. It lacks the flexibility that the tax—that the tax structure has.

It is a case of the Government spending the money rather than to let the people spend their own money.

I think you get a much wider diffusion of the expenditure that would come, be injected into the economy by a tax reduction.

Senator FLANDERS. Now, you have made a case for tax reduction on account of its immediate effect.

Mr. ECCLES. And its wider diffusion and greater flexibility.

Senator FLANDERS. Its immediate effect and greater flexibility.

Mr. ECCLES. That is right.

Senator FLANDERS. Do you want to make any case as between the income tax and the excise taxes?

Mr. ECCLES. Well, I am proposing both.

There are certain excise taxes that are added on to costs that are on very essential portions of the economy.

An excise tax on freight is in the cost of everything, and a reduction of that tax would be immediately reflected.

Senator FLANDERS. Are you sure it would be immediately reflected?

Mr. ECCLES. Yes, I am.

Senator FLANDERS. Perhaps a business concern is on so thin a margin that they would want to absorb it.

Mr. ECCLES. I think the the competition today among the business concerns is going to put the business in a position of passing on to the public every cost saving they can.

While you have got the excess production you have, I think the competition—it is difficult for business today to hold on to their profits that many of them, in order to meet competition, are cutting cost to a point where their profits are being reduced; and I think that if a reduction of the freight excise tax did occur it certainly would go into the reduction of costs.

I think that the transportation and communication business are all essential. Excises are a type of tax and were put on as a war emergency. They are not luxury taxes, and I think that this is a good time to eliminate them.

I think further that automobiles today are a necessity, up to the point of where you need them for transportation.

Senator FLANDERS. I have seen some I thought were not. [Laughter.]

Mr. ECCLES. What I proposed here was a credit, a tax credit, only up to $2,000.

Senator FLANDERS. You can buy a lot of lights, unnecessary lights, and chrome for $2,000.

Mr. ECCLES. Well, the cheapest automobile today is—there are very few that are—under $2,000, delivered.

Senator FLANDERS. Yes; that is right, Mr. Eccles. What I am proposing is that when you get beyond that, you are in the luxury class and not in the essential class.

Mr. ECCLES. That is why I put the item at $2,000, because automobiles are, as we know, a necessary means of transportation in a great portion of our country.

People could not possibly get to and from work without them. But they do not buy a three or four or five or six thousand dollar car to do that. That was the reason why I proposed that.

Then you have the consumer durable goods. You could argue certain aspects of that field.

Both that and the automobile field are terribly depressed today, and in the consumer durables, I think that is a field where you might want to put a limit of $100 or $200 on certain items.

Certainly there are color television sets and there are expensive Frigidaires and other things that get above the necessity. It may be that you would want to put a limit on that, but at least those were the fields.

When you go beyond that, there is still in the tax proposal I am talking about, there would still be about $3½ billion out of a $7 billion tax reduction, there would still be about $3½ billion available, which would go to the credit of the first $2,000 table income, with the exception that I do make the point on the business tax which is 52 percent.

Senator FLANDERS. You suggested dropping that to 50 percent.

Mr. ECCLES. Yes. It went up from 47 percent some years ago to 52 percent.

Senator FLANDERS. Fifty-two percent is not a neat figure.

Mr. ECCLES. Well, I think a 50 percent—I think with the competition that would be passed back in prices.

I think a 52 percent tax is very exorbitant compared with Canada, England, and most countries, and it is a much higher tax than they have, and you do not get a credit today for dividends on our American tax.

I think a 50-percent tax would be plenty high. That would cost about $700 million—maybe less than that. That is on the basis of last year's income. On the basis of this year's income it could be substantially less.

I think regarding small business—certainly a 30-percent tax, I think, has been too high for a long while.

I think that a 25-percent tax is certainly justified in that field.

Senator FLANDERS. Well you have got down the income tax. You are suggesting 2 percent off on the business tax.

Having some business interests, I am right with you there. You are a wise man and you are a farseeing statesman.

Now do you think that any reduction in the personal income tax that we can make without a very serious drop in income, which would come from its application to the great, broad base of the income-tax structure, would be felt enough by the individuals concerned to encourage them to buy?

Mr. ECCLES. I think that the great bulk of them are still spending their income.

Senator FLANDERS. And they would automatically spend that much more?

Mr. ECCLES. The actual dropoff of the consumer, the food and consumer-sought goods is not great.

You take your department store sales and your consumer spending, aside from in the consumer durable and housing field, it has not fallen off up to this point very much.

The drop in that tax of three and a half billion dollars would, I think, go immediately to the spending stream.

I think at least there would be some exceptions, but I think it would go into the spending stream much quicker than public works would get into the general spending stream.

Senator FLANDERS. Mr. Chairman, I have been seriously considering the wisdom and the possible useful effects of making some drastic cuts in our excise taxes. I have not been able to see the picture on the individual income tax so clearly. But in my own thinking, I have run up against this situation.

Now, would I personally, whose car looks a little old and shabby but still works very well indeed, if the 10-percent excise to the dealer were taken off and he passed it on in proportion, would I be encouraged to buy a new car? And I come from the wrong part of the country.

Mr. ECCLES. Well, I think, Senator, you and I would be poor examples.

Senator FLANDERS. I do not know whether I should buy a new car or not.

Mr. ECCLES. Because we possibly have been able to live possibly the same under these conditions as under other conditions, but I think that is not true of the great mass of workers, the people that are on part time or out of a job or those that are fearful they are going to be out of a job, and they are those that have got in debt for this $107 billion of home mortgages, and this $44 billion of consumer debt that weighs heavily on the economy, and any reduction in taxes is going to tend to reduce that weight, and that is important.

What you are doing here is increasing the public debt; but that tends to validate the private debt structure, and the most deflationary force you can have is when debts start contracting rapidly.

We saw that finally ended in a bank holiday, the rapid contraction of credit, and I think that we should accept the present debt structure even though it is bigger than it should have been; we cannot turn the clock back, and I think we have got to accept the present wage structure.

You cannot reduce wages, and I think we have got to accept generally the present price structure.

The job is to hold them where they are, and if we try to force a reduction in them, it will not be brought about except by a depression, and a depression will cost the economy a great many more billions than it will cost us to validate the present position we are now in.

I think that is the cheapest thing that the economy, as a whole, can do.

But I want to warn, as I did here, that recovery will bring about the inflationary pressures again through excessive public spending.

Then we must have a budgetary surplus. It will also bring about an inflation through the wage-price spiral again unless something is done to deal with that problem that has been responsible, to a great extent, for the present inflation.

Senator FLANDERS. I do not know whether it is proper to ask Mr. Eccles at this time, the hour is late, if, sir, you have any simple solution to the wage-price spiral and could give it to us in 5 minutes, I think it would be very much worthwhile.

Mr. ECCLES. Yes.

Well, I do not have any simple answer to it. I do not think I could give it to you no matter how much time I had. It is not a simple matter.

We could deal with it, as I said this morning, by a wage—like Mr. Baruch suggested—through a price control and a wage control.

Well, I think that in a peacetime economy for a free system to try to put that on would be impossible to administer, and I do not think it would work.

I think that you can stop the wage-price spiral, as it was stopped, by the restrictive monetary policy.

You can do that, but that, of course, brings about the same problem we are confronted with now.

I think that—and I have suggested here that if a government is justified in enforcing the Sherman Act and the Clayton Act in order to prevent the monopolistic practices on the part of business, they certainly are fully justified to adopt measures that will prevent the monopolistic practices on the part of labor. That is the greatest element of cost.

Seventy-five percent of the cost of everything is labor, and you cannot deal with inflation if you are willing to permit the continuation of the monopolistic practice of labor in enforcing wages and fringe benefits on a business that they have to add onto prices.

If they can absorb them out of profit and have enough profits left to attract capital and to expand their industry to take care of a growing population, then they should absorb them. But I do not think that that is possible.

I do not think that the earnings of business have been more than necessary to give capital enough return to attract capital, on the one hand, and to provide for the expansion that is necessary on the part of industry.

I think that the banks would show that that is true, and, therefore, there is only one way that you are going to deal with this inflationary pressure, and that is to deal with the labor problem.

I notice that the English did that. I notice that Macmillan had the courage to face that problem. He will possibly lose his Prime Ministership if not before the election, why, he will certainly likely lose it then.

But at the same time, he has had the courage to face what was a very serious problem in England, and that was to prevent inflation.

It had to be prevented or it would have destroyed absolutely their international picture, and he had the courage to do it.

I think that is what we need here to have the courage to face up to the economic facts of life, and if we do not, why then, we are going to be charged with, and justly so, permitting a continuation of an inflation and the erosion of your money, and if that happens, why on earth people would continue to save and buy insurance, I would not know.

Senator Flanders. Mr. Chairman, I think what we have just heard is extremely logical. The logical is not always the practical, but it is logical, and it is left for us to determine whether to be logical or not.

I would like to conclude by trying to make a statement as to where this testimony and this discussion has brought me.

I am not presuming that it brings anybody else to the same point, but I have a fairly clear picture of where it has brought me.

First, that debt itself, the reverse of credit, is a useful thing, but it must not get out of hand.

Second, and that is not a new idea to me, this notion of the deficit ahead of us being unavoidable is something which I find a disturbing thing. But I cannot really argue myself out of the thought.

The question is, What are the best means for broadening the base on which our taxes rest so as to make the quickest recovery to a stable condition again?

I think Mr. Eccles has very effectively made the comparison between Government expenditures and tax reduction.

Government expenditures will be not too little, too late, but too much, too late, and will very likely come around at an exceedingly embarrassing time, so far as avoiding inflation is concerned.

Now, that leaves us with a question as to whether we shall reduce taxes. The advantage which he has stated as inhering in the reduction of taxes is that their effects are immediate.

The take-home pay of the worker, if we do it in the income taxes, applies once a week; the salaried man once a month; the excise taxes begin the day after the President signs the bill, if it is so worded that way. The effect is immediate.

The question there, as I indicated, Mr. Eccles, was that I was not sure that it would lead to more buying and more selling, and so to an increase in the volume of business. Because I examined my own natural ways of going at things, and I still seem to retain some of the sentiments of the saver, when I ought to be spending everything I have got, apparently. I am not sure that those decreases in taxes would make any great effect in my spending habits.

But Mr. Eccles makes the point that those in the lower income groups are going to spend more as they either get a decrease in taxes or as good decrease in price by virtue of the cutting off of the excise taxes.

So, Mr. Chairman, I am in a frame of mind to give serious consideration, particularly to the reduction of the excise taxes by not too great an amount and, likewise, although less attractively, to some reduction in the lower brackets of the income taxes, if that could be done in some way that would not fasten itself on us indefinitely.

So that is where I have arrived, Mr. Chairman, as a result of this conversation, and I thought, you ought to know so as not to be surprised by anything I might do in the future.

Mr. ECCLES. Senator, just one point there: I think the reduction of taxes in the lower income group, if it does not increase the spending of all of them, it can have the effect of causing them to not reduce their spending, which is the same effect.

In other words, nothing being done, there is such a thing as continuing to reduce the spending that they are now doing.

They will spend, I think, more than they otherwise would spend as a result of getting the increased income. I think that would be the overall effect of it.

I do not want this committee to think that I am opposed to all public works.

I recognize that the Federal Governmen will always have or should always have a large public works program. It must have.

With the growth of the population and the complexity of our economy, there are a great many necessary and useful things that only the Government can do, and to the extent that the Government can afford it, and they certainly can afford it if it is essential, if they can pay for it under conditions of full employment.

You must have the highway program, we know. It is absolutely an essential and that, of course, is expected to be paid for out of the gas tax, but we know that is absolutely essential, and maybe we are behind on it. Maybe we should do more than is being done.

The conservation of our water resources is absolutely esential if we are going to have a growth of our population. So there are a great many public works projects, many of them under way now, that I think will continue to be under way.

What I am saying is, I do not like to see the present situation used to undertake to expand greatly a public works program that otherwise would not be done; public works that are not necessary and useful.

So I did not want to get a misunderstanding of my position with reference to public works. It is this fast, big growth of public works that I think could be disastrous.

Senator FLANDERS. That is all, Mr. Chairman.

The CHAIRMAN. Senator Malone?

Senator MALONE. Mr. Chairman, it is getting late, and I suppose you would be getting about ready to recess until 10 o'clock tomorrow morning?

The CHAIRMAN. Don't you want to continue this evening?

Senator MALONE. It would be better tomorrow, since it is late.

Mr. ECCLES. Well, I can stay, Senator, as long as you can.

Senator MALONE. Could I question the witness a while now, say, 10 or 15 minutes?

The CHAIRMAN. Suppose you question him. I think there will be a vote.

Senator MALONE. And then continue until 10 o'clock tomorrow?

The CHAIRMAN. We will adjourn when they have a vote.

Mr. Eccles feels that he has to leave tomorrow afternoon.

Senator MALONE. I will not take too much time.

The CHAIRMAN. It is coming around in the regular circle, as usual.

Senator MALONE. That is right.

Shall I take 10 or 15 minutes now and we will then adjourn until 10 o'clock tomorrow morning and continue then.

The CHAIRMAN. Suppose you proceed as long as you can, Senator.

Senator MALONE. All right.

Mr. Eccles, you are from my part of the country.

Mr. ECCLES. That is right.

Senator MALONE. And I have known you for many years.

Our people in Nevada and Utah are very close in many things.

I recall when you were brought back to be Chairman of the Federal Reserve Board, and I do not recall whether you were Chairman in the beginning. Were you Chairman?

Mr. ECCLES. I first went into the Treasury, and later was asked to go over to the Federal Reserve.

Senator MALONE. Yes.

Money is quite a mystery to most people. I spent most of my life in the engineering business, so I am going to ask you again if I understood you correctly to say that there could be no money unless there were debt?

Mr. ECCLES. I think in our system, I think there was a time when we had various types of paper money and silver coin and gold. But I think that in our modern banking system, the kind of economy that in the Western World operate in, why, the money comes from the debt.

Senator MALONE. Are you speaking of a bank or of the Government?

Mr. ECCLES. I am speaking of a bank; I am speaking of bank money. That is what the money is.

Senator MALONE. That is, perhaps, what it has become. But what does the Constitution say about money?

Mr. ECCLES. Well, the Constitution says that the Government shall be responsible for the coinage of money and the determination of the value thereof.

Senator MALONE. Does it not say that it shall create money and fix the value thereof?

Mr. ECCLES. I think that is right. It shall create money and determine the value thereof.

Senator MALONE. And to fix the value of foreign coins?

Mr. ECCLES. That is right.

Senator MALONE. It has been some time since it has done that, but I think that is approximately what the Constitution says.

Suppose there were suddenly no Federal debt in the United States, but we owned the $22 billion or $23 billion gold that we purchased, and we coined money, with gold behind it, and fixed the value thereof. Would that conform to the Constitution of the United States?

Mr. ECCLES. Well, I am not a constitutional lawyer. I know how money is created.

Senator MALONE. How is it created?

Mr. ECCLES. The Federal Reserve makes possible the creation of money. The only money we have in circulation today is the silver certificate and the Federal Reserve note.

The Federal Reserve, of course, from my point of view, is the Government. I know we can get into a big argument on that, but I think that for all practical purposes it is a Government institution.

Senator MALONE. Now, to come back to the beginning: You know Congress could abolish the Federal Reserve, could it not?

Mr. ECCLES. The Congress created it. They can abolish it any time they wanted to.

Senator MALONE. Let us just forget that for a minute then. If we go back to the Constitution of the United States, as some of us believe we should do in several fields—the regulation of foreign trade for one—could the Congress create money based on the amount of gold it is reported to have in the vaults? They say they have $22.4 billion.

Mr. ECCLES. I think that is right.

Senator MALONE. What is that?

Mr. ECCLES. I think that is right, at $35 an ounce.

Senator MALONE. I expect you are aware of that all but $5.7 billion in our vaults could be claimed by foreign balances.

Mr. ECCLES. They have issued gold certificates against it.

Senator MALONE. Now, you are a banker and I am just an engineer, but I am about to tell you that the Chairman of the Federal Reserve Board testified that if the outstanding foreign balance of payments were presented for gold payment—that all but $5.7 billion would be paid to foreign nations, unless we refused such payments.

I will refer you to the three volumes of testimony already in circulation where the Secretary of the Treasury testified to practically the same thing.

In volume No. 3, Mr. Martin testified that if the foreign balances were converted and presented for payment, we would own $5.7 billion out of the $22.4 billion.

So it looks like we have been shortchanged, because we gave them the money through the Marshall plane, ECA, and so forth to create these balances. We have given them $70 billion since World War II, and the testimony also was that with the money we gave them under the Marshall and other plans they could create such dollar balances.

You are aware of that, I suppose?

Mr. ECCLES. Yes; I was favorable to it, and still am.

Senator MALONE. I presume you were for all of these giveaway plans since you were a part of the administration that started it.

Mr. ECCLES. Well, I just thought I would volunteer that.

Senator MALONE. Your record is in the books.

Mr. ECCLES. Yes.

Senator MALONE. It has not resulted in a very creditable showing.

Now, we will get off that for a minute and come back to the Constitution.

Gold is not behind our money now, but, for whatever gold we have you yourself or an American citizen cannot go to the Treasury and get gold, can you?

Mr. ECCLES. No.

Senator MALONE. Only a foreigner can do that.

Mr. ECCLES. That is right; only a foreign central bank.

Senator MALONE. Only a foreign nation, a central bank.

Mr. ECCLES. That is right.

Senator MALONE. But for an individual foreigner, when he holds a dollar balance, it is very easy to convert it to a nation balance, is it not?

Mr. ECCLES. Yes; but the individual cannot get the gold.

Senator MALONE. But he can convert it to the nation balance and the nation can get it.

Mr. ECCLES. That is right. He can convert it to pounds or any of the currency of the country that he has got his funds in.

Senator MALONE. But he can convert it. They can convert to the nation's credit, and the nation can then demand it; is that right?

Mr. ECCLES. Well, I guess the Nation could take it away from him if it wanted to.

Senator MALONE. He can convert it and turn it into a nation credit if he so desires. That was so testified by Mr. Martin. Do you agree?

Mr. ECCLES. I just do not understand what point you are making here.

Senator MALONE. This is the point I am making: That if, say, an individual has a certain number of dollars in foreign nations credit balance, it can very easily be converted to a nation credit, and then gold can be demanded from our United States Treasury.

Mr. ECCLES. Yes, I think that is true.

Senator MALONE. It is true, according to Mr. Martin, and he is the current Chairman.

Mr. ECCLES. That is right.

Senator MALONE. Now, we can get off that again, unless we have some other disagreement.

Suppose we did not put gold behind the money, just leave it the way it is, but this Congress made up its mind to create money and fix its value. Why could it not do it without the debt?

Mr. ECCLES. I do not know how it would accomplish it.

Senator MALONE. You say it could not be done?

Mr. ECCLES. Well, you could print currency, yes. You could print currency and circulate it.

Senator MALONE. Go on.

Mr. ECCLES. You could change the whole system. You could get rid of the commercial banks of deposit and the Federal Reserve banks, and operate on a currency system.

Senator MALONE. Well, would it be necessary to do that.

Mr. Martin testified that the Federal Reserve Board is empowered to print money, to create additional money, whenever they think that the industry and business of the country require it in the future for a sustained economic growth.

Mr. ECCLES. Well, he does not print the money.

Senator MALONE. He can create the money.

Mr. ECCLES. That is right. But here is what happens: A company or an individual who wants currency could go to their bank, and their bank will give them currency if they have a deposit. If they have a claim against the bank, they can convert that into currency.

The bank, in turn, in order to get that currency, must have a deposit in the Federal Reserve. They can ask the Federal Reserve to charge their account, the Federal Reserve bank of their district, and the Federal Reserve will provide them currency.

So the Federal Reserve has the authority to provide them with the currency in relationship to the deposit which they carry in order to meet the demands of the bank customer. That is the way the currency gets into circulation.

Senator MALONE. Yes; and he can create and put into circulation $1 billion or $2 billion additional, whenever he thinks a sustained economic growth may demand it in the future.

Mr. ECCLES. Well, he puts it in only when the economy——

Senator MALONE. When he believes the economy may demand it.

Mr. ECCLES. He does not put it in when the economy thinks so.

What he does is to provide excess reserves in the banking system.

The Federal Reserve itself does not put money into the economy except as that money is requested by the customers of the bank or the Government, of which the Federal Reserve is the fiscal agent. Now, that is the only way money is printed.

Senator MALONE. Put it this way: He does not have to do it if they request it. He can refuse it.

Mr. ECCLES. Well, yes; he can refuse—he cannot refuse to give the currency. He cannot refuse to provide currency if the deposits exist. They must provide the currency.

But the Federal Reserve can refuse to create the excess reserves in the banking system upon which the growth of the supply of money is based.

Senator MALONE. But he can refuse to provide it?

Mr. ECCLES. Provide the reserves?

Senator MALONE. Yes.

Mr. ECCLES. That is he cannot; the Open Market Committee can. It is not one man.

Senator MALONE. It is a seven-man board.

Mr. ECCLES. Well, the seven men alone cannot do it. There are 5 members of the Reserve banks; there are 12 of them.

Senator MALONE. Twelve of them.

Assume there are 12; we will have Mr. Martin here again, and your testimony will be available for comparison.

He has testified that his Board is the judge, and if he thinks or the Board believes that to "sustain economic growth" in the future they would need the money, he can create it.

Mr. ECCLES. Well, the Board reduces reserve requirements; that is one way.

The Open Market Committee buys paper in the market, and puts reserves in that. So there are two ways of providing reserves: One is the reduction of reserve requirements, and the other is through the Open Market operations.

(Discussion off the record.)

The CHAIRMAN. Suppose we meet at 10 o'clock tomorrow and let Senator Kerr finish his examination.

Senator MALONE. Agreed.

Mr. ECCLES. That is fine.

(Whereupon, at 4:35 p. m., the committee adjourned, to reconvene at 10 a. m., Thursday, April 17, 1958.)

INVESTIGATION OF THE FINANCIAL CONDITION OF THE UNITED STATES

THURSDAY, APRIL 17, 1958

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, Frear, Gore, Martin, Williams, Flanders, Malone, Carlson, Bennett, and Jenner.

Also present: Elizabeth B. Springer, chief clerk, and Samuel D. McIlwain, special counsel.

The CHAIRMAN. The committee will come to order.

Under the agreement of yesterday, Senator Kerr is recognized.

STATEMENT OF MARRINER S. ECCLES—Resumed

Senator KERR. Mr. Eccles, yesterday, according to the transcript and the way I read it, you made this statement:

> I think that the Treasury bill rate, commercial paper rate, is the thing that influences the rate the farmer pays.

Do you want to let that statement stand?

Mr. ECCLES. I do not recall making that statement. I think I made it in connection with——

Senator KERR. That will give you the connotation.

Mr. ECCLES. Let me explain it. That rate is the rate that influences the rate on the Commodity Credit paper that is sold in the market.

Senator KERR. Well, the farmer does not pay that interest?

Mr. ECCLES. The Commodity Credit suplies the funds to the Production Credit Corporation which is the Government agency that makes the loans to the farmer.

Now, the rate that they have been charging the farmer went up as the bill rate went up because the Commodity——

Senator KERR. Did it go down as the bill rate went down?

Mr. ECCLES. Yes. I understand that——

Senator KERR. Mr. Eccles, don't you know the Federal land bank is selling bonds now at around 5 percent?

Mr. ECCLES. Well, I do not think it influences the land-bank bonds.

Senator KERR. That is what determines the interest rate the farmer pays on the loans on his land?

Mr. ECCLES. No. The farmer who puts a long-term mortgage on his farm borrows from the land bank; he pays maybe an entirely different rate than the rate that the farmer pays when he borrows to produce his crop from the Production Credit Corporation. The Production Credit Corporation is entirely a different thing.

Senator KERR. Mr. Eccles, you don't think the farmer borrows from the Production Credit Corporation to get credit to make his crop, do you?

Mr. ECCLES. Oh, yes; a lot of them do.

Senator KERR. Does not your bank loan money to farmers?

Mr. ECCLES. Yes, but our competition is the Production Credit Corporation.

Senator KERR. All right. Now what interest rate are you charging farmers?

Mr. ECCLES. Well, we charge about the same as the Production Credit Corporation.

Senator KERR. What rate?

Mr. ECCLES. It runs about 6 percent.

Senator KERR. Six percent?

Mr. ECCLES. That is the rate the Production Credit is charging in Idaho, and it may be reduced to 5½.

Senator KERR. Has your bank reduced its interest to 5½?

Mr. ECCLES. Well, it depends entirely on the size of the loan. It depends on the type, whether it is a loan that liquidates during the period.

Senator KERR. Well, you could answer my questions.

I am asking you, does your bank charge five and a half or six?

Mr. ECCLES. Some of them. Some loans are 5½ and some are 6 and some are 6½. It depends on the credit.

Senator KERR. Some are 7?

Mr. ECCLES. Yes. I would say some of the smaller loans where they are not self-liquidating, they may be 7 percent, that is correct. They can go to the Government.

Senator KERR. The Treasury bill rate got down to 1.10?

Mr. ECCLES. Well, that is very recently. That is within the last 2 or 3 months.

Senator KERR. Have you made any loans to farmers at 1.10 recently?

Mr. ECCLES. I do not think you could. You are paying 3 percent to the farmers on their savings. You would have very great difficulty loaning on 1.10.

Senator KERR. That would have some influence on the rate you charged?

Mr. ECCLES. What was that?

Senator KERR. The interest you are paying on the savings in your bank?

Mr. ECCLES. Oh, sure, of course. It has some influence, sir.

Senator KERR. You do not seriously mean to tell this committee and stand behind it, that the interest rates that farmers pay are in any way determined by the interest rate the Treasury pays on 90-day bills?

Now, do you, Mr. Eccles?

Mr. ECCLES. I think what the farmer pays is determined somewhat by the Government, the Production Credit Corporation, which is a public agency.

Senator KERR. Didn't you say anything about the Production Credit Corporation yesterday?

You said, I think, the Treasury bill rate influences the rate the farmer pays.

Mr. ECCLES. I think it does influence him. It influences by the right of the Commodity Credit Corporation has to pay for money because the Commodity Credit Corporation is the agency that supplies the money to the——

Senator KERR. How much does the Production Credit Corporation lend?

Mr. ECCLES. They lend a good deal.

Senator KERR. About how much?

Mr. ECCLES. I do not know how much.

Senator KERR. Would you make an estimate?

Mr. ECCLES. I would not make an estimate.

Senator KERR. Do they lend a billion dollars?

Mr. ECCLES. I think it is possibly over a billion dollars.

Senator KERR. Let's find out.

Mr. Eccles, I make the statement without the slightest fear of you or anybody else challenging this statement, that there is absolutely no relationship insofar as any farmer has ever been able to detect it, between the Treasury bill rate and the rate the farmer pays.

Mr. ECCLES. I am saying that the Treasury bill rate is influenced by the excess reserves in the banking system.

Senator KERR. There is no question about that.

I think it is solely determined by that.

Mr. ECCLES. I am also saying that the intermediate credit banks, their rate is likewise influenced by the excess reserves in the banking system, and the rate that they charge to the Production Credit Corporations is the rate that influences the farmers' rate.

Senator KERR. Give this committee, Mr. Eccles, the prime rate of your bank for the last 12 months.

Mr. ECCLES. Well, it is whatever the prime rate has been. It has been 4 percent, or the last rate is 4½ percent. It has been cut back to 4 percent. That is the market rate today. We follow the rate that the New York banks, the Chicago banks, the money-market banks, charge.

Senator KERR. You do not follow the rates that the commercial bills bring?

Mr. ECCLES. No, we certainly do not.

Senator KERR. You follow the prime rate fixed by the New York banks?

Mr. ECCLES. We follow the competitive market rate just as every commodity does.

Senator KERR. You are just like any other banker, you charge all the traffic will bear.

Mr. ECCLES. We are just like any other merchant; we are just like the people who have any product to sell.

Senator KERR. Get all you can?

Mr. ECCLES. Whether it is oil, automobiles——

Senator KERR. Legal services, dental services, medical services?

Mr. ECCLES. That is right.

Senator KERR. You get all you can?

Mr. ECCLES. You meet your competition.

Senator KERR. Up or down?

Mr. ECCLES. Yes, sir.

Senator KERR. It is down when you have to, and up and ahead of it, when you can?

Mr. ECCLES. That is right.

Senator KERR. I will just be perfectly frank with you, and say to you that any business I am connected with gets all the traffic will bear, and be able to stay in business.

Mr. ECCLES. Yes, that is right.

Senator KERR. And that is what your operation is, is it not?

Mr. ECCLES. That is right.

Senator KERR. All right.

There was not any doubt in my mind about that.

Now you said yesterday though that the price paid for wages to the labor was the determinative factor in this inflation?

Mr. ECCLES. I think that is right.

Senator KERR. Do you think that the fees paid to doctors, dentists, other professionals, lawyers, have anything to do with the cost of living?

Mr. ECCLES. Well, I think that all of them have something to do with it.

Senator KERR. Now, you have a copy there of the Economic Indicator; I guess you have it, I gave you one yesterday.

If you do not have it, I will give you another one.

Turn to page 24—page 23.

Mr. ECCLES. I have it.

Senator KERR. Which line out there, food, housing, rents, apparel, transportation, medical care, personal care, reading and recreation; other goods and services, has had the largest increase as between 1953 and January 1958?

Mr. ECCLES. Well, I think, let's see, they are rather close, but I think medical care has gone up maybe more.

I think medical care, possibly medical care, seems to have gone up a little more.

Senator KERR. Medical care has gone up 20.4 points?

Mr. ECCLES. Yes.

Senator KERR. What is next?

Mr. ECCLES. Well, I have not figured it out.

Senator KERR. Well, it is personal care. It has gone up 15 points.

Mr. ECCLES. Yes.

Senator KERR. Next to that is rent. It has gone up 12.7.

Mr. ECCLES. Yes.

Senator KERR. Next to that is housing, it has gone up 9.4.

Next to that is transportation, which has gone up 9.

Next to that is other goods and services, up 8.8.

Next to that is reading and recreation, up 8.6.

Next to that is food, up 5.4.

Next to that is apparel, up 2.1.

In that time the overall has gone up 7, has it not?

Mr. ECCLES. Yes, I think that is about what it has gone up.

Senator KERR. Well, what is the average of these that we have taken here which is other than wages?

Mr. ECCLES. Well, of course these all reflect wages. You cannot take out of transportation or food or housing—after all, the wages are the determining factor in practically everything.

Senator KERR. Is wages the determining factor in what a doctor charges?

Who does he pay wages to where it has gone up 24 points?

Mr. ECCLES. He pays rent——

Senator KERR. You said wages.

Mr. ECCLES. No, but rent is based upon wages.

Rent is based upon the cost of construction, rent is based upon the cost of janitor service, heating, taxes, and all of those are a reflection of wages.

Senator KERR. You said a while ago that interest rates had gone up quite significantly.

Mr. ECCLES. They have gone up—that is right.

They went up for the last few years; particularly in 1957—1956 and 1957.

Senator KERR. People pay interest, don't they?

Mr. ECCLES. Well, some pay and some collect.

Senator KERR. Well, they do not collect what somebody has not paid, do they?

Mr. ECCLES. Well, I think that is right.

Senator KERR. You think it is, you are not sure?

Mr. ECCLES. No, somebody pays it, that is right.

Senator KERR. There is not any interest paid that somebody does not pay, is there?

That is what I said.

Mr. ECCLES. Well, all interest is paid by individuals or corporations. Also interest is collected by individuals or corporations.

Senator KERR. But none is collected that is not paid?

Mr. ECCLES. No; that is correct.

Senator KERR. And any increase in it is reflected in the cost of living?

Mr. ECCLES. Yes, I would think that it certainly is an element of cost.

To a business that borrows money, it is an element of cost like any other expense.

Senator KERR. Does labor operate any differently in what it tries to get in the form of wages than you do in your bank?

Mr. ECCLES. Yes, we have no control over what we get. What we have to do, we follow the market, the money market, and the money market is determined by Federal Reserve policy.

Federal Reserve policy determines what your money market is, and that policy is used as a means of tending to stabilize the price level.

That is the purpose of monetary policy.

Senator KERR. Did your bank sell any long-term bonds in December or November of 1956, and then buy back similar bonds before the end of the year?

Mr. ECCLES. I do not know. I don't have the information.

I would not know.

Senator KERR. Are you familiar with the fact that many, if not most, of them, did sell considerable amounts of their long-term bonds out of their portfolio?

Mr. ECCLES. Well, I would think if they had a loss and did not, it would be pretty foolish.

Senator KERR. It would be pretty foolish?

Mr. ECCLES. Yes.

Senator KERR. Well, most of them had a loss, did they not?

Mr. ECCLES. Well, I think without question, they did. It depends on how long they held their bonds. If they held them any length of time they had a loss.

Senator KERR. Then they could buy them back before the month was over, at about the same price, could they not?

Mr. ECCLES. Well, you could not buy the same bonds back.

Senator KERR. Similar bonds, similar maturities?

Mr. ECCLES. Yes, you could buy them with a similar maturity, that is correct.

Senator KERR. Which for all purposes were the same bonds?

Mr. ECCLES. Well, they would have possibly the same effect.

Senator KERR. Possibly?

Mr. ECCLES. Yes. It depends on how close the maturity was.

Senator KERR. Well, they could have bought them of identical maturities, could they not?

Mr. ECCLES. I do not think so.

Senator KERR. No one bank owned all the maturities on any one date, did they?

Mr. ECCLES. Oh, no. But I think that if you sell a bond, you would have to wait 60 days in order to buy——

Senator KERR. Buy the same bond back but not another bond of the same maturity?

Mr. ECCLES. Well, you would not likely have another bond of the same maturity. You could not buy another bond of the same maturity. You could buy a bond for——

Senator KERR. For the purpose of making a tax saving they could buy it of a week earlier or a week later maturity and effective as though they bought the same bond, could they not?

Mr. ECCLES. I think they had to have a wider spread than that.

Senator KERR. What was the minimum spread?

Mr. ECCLES. It would not make any difference.

It might be a maturity that might be a year longer or a maturity that might be a year shorter, the effect would not make very much difference.

Senator KERR. Would not make much difference?

Mr. ECCLES. No, no.

Senator KERR. Because they would buy back another long-term bond?

Mr. ECCLES. That is right.

Senator KERR. And save 52 percent of the loss they sustained on the bond they sold as a tax saving?

Mr. ECCLES. Yes, that is right. You would have the benefit of 52 percent against your earnings.

Senator KERR. Well, they had earnings?

Mr. ECCLES. Yes, that is right.

Senator KERR. Most of them?

Mr. ECCLES. That is right.

Senator KERR. Then, in December of 1957, those bonds that they had bought back in December of 1956, they could have sold and many of them did and made 10 points, didn't they, approximately?

Mr. ECCLES. If they sold them, that is right.

Senator KERR. And on that 10 points they paid 25 percent tax?

Mr. ECCLES. That is right.

Senator KERR. And that is all?

Mr. ECCLES. That is right.

Senator KERR. Then the next day they could have gone back into the market and bought in 1956, and insofar as their portfolio was concerned, have been in the identical position as of December 31 as though they had made none of the transactions, could they not?

Mr. ECCLES. Will you repeat that. I don't know that I follow that.

Senator KERR. Well, let's say that they handled a million dollars worth of long-terms that they sold in December of 1956, and bought back in December of 1956 another million dollars of long-terms.

Mr. ECCLES. Yes.

Senator KERR. If they had bought them at par and sold them at 85, they lost 15 points and they saved 52 percent of that in tax liability for the year 1956?

Mr. ECCLES. That is right.

Senator KERR. But they wound up December of 1956, with just as many long-term bonds as they had sold, and insofar as their portfolio was concerned, they were just as well off as if they had not sold any bonds?

Mr. ECCLES. I think that is correct.

Senator KERR. Then in December of 1957 if they kept a million dollars worth they bought in December of 1956 they had about 10 points profit in it?

Mr. ECCLES. Well, yes, that is right.

Senator KERR. They had a hundred thousand dollars profit in it? They sold them for the hundred thousand dollars profit and paid 25 percent capital gains?

Mr. ECCLES. That is right.

Senator KERR. Made the $75,000?

Mr. ECCLES. That is right.

Senator KERR. Then before the month was over, they go back in and they buy another million dollars of long-terms, maybe the million they sold in December of 1956——

Mr. ECCLES. Of course if they are all smart enough to pick the time, but the net result, I think you will find, of a bank's operation in the Government bond account over the last 4 or 5 years is a loss.

Senator KERR. Just stay with me on this example now.

Mr. ECCLES. The hindsight is always better than the foresight.

Senator KERR. Not if you are controlling the spigot. Not if you are controlling that Federal Reserve System.

Mr. ECCLES. The banks are not controlling it.

Senator KERR. Who is?

Mr. ECCLES. The Federal Reserve Board, and the open market committee.

Senator KERR. Who is the Federal Reserve Board?

Mr. ECCLES. You know who the Federal Reserve Board is, they are appointed by the President and confirmed by the Senate.

Senator KERR. How many are there?

Mr. ECCLES. Seven.

Senator KERR. How many are on the Open Market Committee?

Mr. ECCLES. There are 12.

Senator KERR. Who are the other five?

Mr. ECCLES. There are five, the New York Bank——

Senator KERR. Who are they?

Mr. ECCLES. The New York Bank is represented on the Open Market Committee.

Senator KERR. Well, they are presidents of the Federal Reserve Banks?

Mr. ECCLES. I don't know who the five are at the present time.

Senator KERR. You know they have to be presidents of the Federal Reserve Banks.

Mr. ECCLES. I do.

Senator KERR. And the presidents of the Federal Reserve Banks are elected by whom?

Mr. ECCLES. They are elected by the boards of the banks subject to the approval of the Federal Reserve Board.

Senator KERR. And who elects the boards of the banks?

Mr. ECCLES. The Federal Reserve Board appoints three members.

Senator KERR. And who elects the other six?

Mr. ECCLES. The small banks elect 1, the middle banks elect 1, the large banks elect 1 banker.

The small banks elect one business man, and the middle banks elect a business man, and the large banks elect a business man.

So 6 of the 9 directors are elected by the member banks.

Senator KERR. By the member banks?

Mr. ECCLES. That is right.

Senator KERR. And they do that on all 12 banks?

Mr. ECCLES. That is correct.

Senator KERR. And those directors select the presidents of those banks?

Mr. ECCLES. Subject to the approval of the Board.

Senator KERR. How many of them have been disapproved that you can remember?

Mr. ECCLES. Well, I know three while I was there.

Senator KERR. In how long?

Mr. ECCLES. Well, in and during the entire period I was there, three were appointed——

Senator KERR. How long were you there?

Mr. ECCLES. They were appointed and vetoed.

Senator KERR. How long were you there?

Mr. ECCLES. The others would have been disapproved, but they were not appointed. What happens is this: the personnel committee of each bank advises with the Board, with reference to the selection of a president. They find out beforehand whether or not that president is satisfactory to the Board, whether the Board will support or veto that president.

Therefore, you avoid the veto because it is a joint approval.

Seantor KERR. Well, now, you know that the Federal Reserve Board has always said that these banks have autonomy, that they have nine directors.

Mr. Burgess sat there and said the Board of Governors does not control those 12 banks. That they are controlled by their boards of directors.

Mr. ECCLES. Well, I do not agree with Mr. Burgess, because I think that the Federal Reserve Board exercises a great deal of control.

Senator KERR. I tried to make him admit that the 7 men were the czars of our economy, and he said they certainly are not—that there are 12 member banks, that each one of them has a president; that each one of them has 9 directors, and 12 times 10 is 120, and he said those 120 have more to do with the Federal Reserve System than the 7 members of the Board of Governors.

Mr. ECCLES. I do not agree with Mr. Burgess.

Senator KERR. You know it is a funny thing that this committee, or so far as I am concerned, does not seem to be able to get the lowdown on this thing.

Mr. ECCLES. Well, you can have a difference of opinion.

Senator KERR. You should not have a difference of opinion as to facts.

Mr. ECCLES. The Federal Reserve Board has the power over the discount rate; they have the power over the Reserve requirements; they have the power over salaries and expenses of the Reserve banks.

Senator KERR. Now that is true.

Yes; that is true.

Mr. ECCLES. They have all those powers.

Senator KERR. Who is the third highest paid man in the United States Government employed today?

Mr. ECCLES. I don't know.

Senator KERR. You don't?

Mr. Eccles, now, you have been in Government now a long time. Don't you know who the highest paid man is?

Mr. ECCLES. I think the President is the highest paid man.

Senator KERR. That is right.

Who is the next highest paid?

Mr. ECCLES. The Vice President.

Senator KERR. I don't know whether he is or not.

Mr. ECCLES. I think he is.

Senator KERR. I don't think so.

Mr. ECCLES. I do not know whether he is or not.

Senator KERR. I think it is the president of the New York Federal Reserve Bank.

You helped fix his salary; did you not?

Mr. ECCLES. His salary was $50,000 while I was there.

Senator KERR. Well, they have given him a raise since you left there. He is getting $60,000 now.

Mr. ECCLES. Well, I do not think that is too high.

Senator KERR. I am not saying it is too high or too low. I am just telling you he is, so far as I know, the second highest paid man in any Federal agency of this Government.

Mr. ECCLES. That may be.

Senator KERR. And that is determined by the seven members of the Federal Reserve Board?

Mr. ECCLES. That is right. They have approval of salaries; that is correct.

Senator KERR. You are telling this committee it is not the 120 directors and presidents as well as the 7 of the Board of Governors who are the economic czars of this Nation, as well as the 120 of this Nation as Mr. Burgess told us, you are telling us it is just 7?

Mr. ECCLES. I think it is the 7 members, plus the 5 presidents.

Senator KERR. You have just told me that these 7 members determine who those 5 presidents are?

Mr. ECCLES. They have the veto power; that is correct.

Senator KERR. I told you that I thought the directors could elect them and you said no, they could not.

Mr. ECCLES. They can elect them with the approval of the Board. The Board has the veto power.

Senator KERR. You said they had to come down here ahead of time and confer with the Board and get their consent.

Mr. ECCLES. I do not know what they are doing now but when I was Chairman that is what they did.

Senator KERR. That is what they did?

Mr. ECCLES. Yes.

Senator KERR. Then you are telling us that these seven men are the arbiters of our economic destiny?

Mr. ECCLES. I do not like to say they are the arbiters of our economic destiny.

Senator KERR. You said they fix the interest rates; you said they determined the amount of money. You said they brought this recession on. You said that they determine how much money banks can lend, how much interest they pay, and charge on what they pay. Now Rothschild said nearly 200 years ago, "Permit me to issue and control the money of a nation, and I care not who makes its laws."

Mr. ECCLES. Well, every central bank has the same powers. The Bank of Canada, the Bank of England——

Senator KERR. We are not in the Canadian economy. I am talking about ours.

Mr. ECCLES. Every central bank in the world exercises the same powers that the Federal Reserve does.

Senator KERR. You know better than that, Mr. Eccles.

Mr. ECCLES. Well, I do not—that is a fact.

Senator KERR. You know that the powers of the Bank of England are far different from the powers of this bank.

Mr. ECCLES. Well, the powers of the Bank of England——

Senator KERR. Well, that is the central bank.

Mr. ECCLES. All right. Of course you have a different system.

Senator KERR. Of course they have a different system and different powers.

Mr. ECCLES. There is a different system. You have about five banks. But the Bank of England fixes the discount rate.

Senator KERR. All right.

Mr. ECCLES. And they add to the reserves of the banking system, by their purchase or sale of securities in the market.

Senator KERR. Tell me, if you will, what are the reserve requirements of the member banks under the Bank of England?

Mr. ECCLES. Well, you have no reserve requirements.

Senator KERR. Then they do not have the power this bank has?

Mr. ECCLES. They have the power because they can add to the surplus funds, and they, by the change of the discount rate, influence the cost of money.

Senator KERR. Yes. They influence the cost of money.

Mr. ECCLES. That is right.

Senator KERR. But they do not have the power that this Reserve System has?

Mr. ECCLES. Well, the banks in England are not required under the statute to carry a fixed reserve. They carry about the same reserve, based on custom, and there are only five banks there and the banks pretty much operate in line with the agreement with the Bank of England.

Senator KERR. Let's do not get off now as to the comparative powers of our central bank with others.

Let's just stay on the subject of the power of ours.

Mr. ECCLES. Yes.

Senator KERR. You are telling this committee that this power is not vested in the 127 men which Mr. Burgess so stoutly proclaimed or certified or verified that they were vested in 7 men?

Mr. ECCLES. Yes, I think that is correct.

Senator KERR. Let me ask you to name those seven men.

Mr. ECCLES. Yes. But let me add this: I think the 120 would exercise considerable influence through their advisers, their counsel, but I think when it gets right down to the power the Board of seven——

Senator KERR. Now, Mr. Eccles——

Mr. ECCLES (continuing).—Have the power.

Senator KERR. I am not trying to influence what you say.

Mr. ECCLES. Yes.

Senator KERR. I am just trying to get you to make a positive statement that you are willing to stand by and stay with.

Mr. ECCLES. Yes.

Senator KERR. Now do the 7 men have the power or do the 127 have it?

Mr. ECCLES. The seven have it.

Senator KERR. The seven have it?

Mr. ECCLES. Yes.

Senator KERR. Who are they?

Mr. ECCLES. Well, there is Bill Martin. There is Matt Szymczak. There is Robertson. There is—what is his name—from Philadelphia, he is vice chairman. I cannot remember his name.

There is a man from Texas and a man from Portland, Oreg. I do not recall their names. They are right in the Bulletin.

Senator KERR. I do not want you to go to the Bulletin. I want you to tell the committee who they are if you know, and if you do not know, just tell me.

I have got the Bulletin here.

Mr. ECCLES. I don't remember their names.

Senator KERR. How many people in this country do you think could name them?

One out of a hundred thousand?

Mr. ECCLES. Oh, I would think maybe more than that.

Senator KERR. Mr. Eccles, if you cannot remember but three of them——

Mr. ECCLES. Well, they have been appointed since I left here.

Senator KERR. Yes, I know, but you would have been on that Board yourself for so many years and its Chairman, with the distinguished record that you made, if you cannot tell the names of but 3 of them, how many people in this country do you think could name the 7 of them?

Mr. ECCLES. There would be very few.

Senator KERR. Do you think there would be a hundred men who could name them?

Mr. ECCLES. I think so. I think a lot of people in the Reserve System could who are active.

Senator KERR. Well, outside the Reserve System?

Mr. ECCLES. Well, I think maybe some of the bankers could.

Senator KERR. That is quite a situation for seven men to have that kind of power and nobody even knows who they are, is it not?

Mr. ECCLES. I do not think so. I don't think so at all; no.

Senator KERR. You think that is——

Mr. ECCLES. I do not think that is true. I think the same thing would be true of the Supreme Court. If you asked them to name the Supreme Court——

Senator KERR. Well, the Supreme Court has not got the power that the Board of Governors of the Federal Reserve has.

Mr. ECCLES. I would not want to agree with that.

Senator KERR. You would not disagree with it?

Mr. ECCLES. I certainly would.

Senator KERR. Why the powers they have got, that you yourself have outlined, could be exercised to where the members of the Supreme Court could not even have the money to be paid their salaries?

Mr. ECCLES. Yes; but the Congress cannot wipe the Supreme Court out of business but they can the Federal Reserve.

The Federal Reserve is responsible to the Congress. They have to make a report to the Congress.

Senator KERR. That is a myth, Mr. Eccles.

Mr. ECCLES. And the Federal Reserve Board is required to carry out a pretty limited function. True, it is terribly important.

Senator KERR. Who was it in Congress you asked about the policy you announced with reference to the Federal Reserve Board supporting the price of Government bonds during the war?

How many Members of the Congress did you talk with before you formulated that policy?

Mr. ECCLES. I do not think I talked to any of the Members of Congress. As a matter of fact, there would be an awful lot of people to talk with.

Senator KERR. That is right.

You do not even know the 7 members of the Board of Governors would have a little trouble getting acquainted with the 400——

Mr. ECCLES. I know them personally but could not remember their immediate names.

Senator KERR. They have got the same name they had before.

Mr. ECCLES. I know them personally, but I am not good at remembering names.

Senator KERR. All right.

We will leave that one where it is, and let's go back now to the position of labor.

You admitted a while ago that not only labor but lawyers, doctors, dentists, bankers, miners, oil people operate on the basis of getting all the traffic will bear.

Mr. ECCLES. That is right.

Senator KERR. Is there anybody in the country you know of that is not doing all they can to improve their own economic position?

Mr. ECCLES. No. I think everybody does.

Senator KERR. That is the heritage of America.

Mr. ECCLES. That is correct.

Senator KERR. In other words, every organization that is in industry or business that you know of, every individual, every producer, every processor, seeks to get more dollars for what they produce or for what they perform, do they not?

Mr. ECCLES. They are in a competitive world, and if they don't, they don't stay in business.

Senator KERR. Don't term it that way. If they do, just let's say so; and if they don't, just say so.

Mr. ECCLES. I agree with you that they do.

Senator KERR. All right. Now tell me this, Mr. Eccles: How can everybody in this country, individually and in the organizations of which they are a part, strive to achieve a common objective without making substantial progress or without being in part successful?

Mr. ECCLES. Well, I don't get your point. Will you ask that again?

Senator KERR. Well, if workers are trying to get more for their labor, doctors are trying to get more for their fees, if industry is trying to get more for its products, if farmers are trying to get more for their production, if miners and producers of oil and gas and textile manufacturers are all trying to get more for their production, aren't they going to continue to succeed to some extent in doing it?

Mr. ECCLES. Well, I suppose they are. I am certain they are going to try to do it. I am not opposed to labor trying to get all they can get.

Senator KERR. Just don't make another speech, but answer the question.

Mr. ECCLES. I want to make this statement, because you are putting me in a position here where it would seem I am putting labor in a class separate from——

Senator KERR. No. I am trying to put them alongside of every other American that I know of.

Mr. ECCLES. All right. But they are—but the only difference is this: that in the case of business, they are subject to certain laws. You have the Clayton Act and you have the Sherman Act.

And all I am saying is, so far as labor is concerned you are not dealing with the individual. You are dealing with huge, powerful organizations that have been able to enforce their will and get wages and fringe benefits in excess of the increased productivity, and those have been added to prices. And I pointed out that a substantial part of our inflation was due to the use of those powers, and that you couldn't stop inflation so long as those powers were used in the manner in which they had been used.

I am not criticizing the individual worker for getting all he can get, and I am not criticizing the union leader for getting all he can get. I think the union leader, in order to keep his job in the union, is obligated to make the best possible deal he can make for his union.

Senator KERR. I am not trying to put you in a position of criticizing them. I am just trying to ask you, and I have, and you have agreed that they are trying to do what everybody else is trying to do.

Mr. ECCLES. Yes; that is correct.

Senator KERR. All of us.

Mr. ECCLES. That is correct.

Senator KERR. Then I asked you, if we are all seeking that objective, isn't it a lead pipe certainty to some degree we are going to succeed?

Mr. ECCLES. If we all succeed, we would have that much more inflation.

Senator KERR. But the point about it is that to some extent we are all going to succeed, aren't we?

Mr. ECCLES. That is right.

Senator KERR. And to the extent that any or all of us do succeed, we reduce the purchasing power of the dollar, don't we?

Mr. ECCLES. That is correct.

Senator KERR. All right. Then how are you ever going to have a stabilized dollar in the absence of absolute control of wages and prices?

Mr. ECCLES. Well, I have pointed out yesterday that it seemed to me that you can possibly get a stabilized dollar if wages are kept in line with productivity.

Senator KERR. Well now, has that ever been done?

Mr. ECCLES. It hasn't been done, but we are doing things all the time we have never done before.

Senator KERR. Will it every be done, in your judgment, in the absence of control of wages by law?

Mr. ECCLES. Yes, I think it could be done if——

Senator KERR. If labor would agree not to ask for an increase?

Mr. ECCLES. No. I don't ask for an agreement. I think what you would have to do——

Senator KERR. You would have to ask them to agree not to and follow it or follow it without agreeing.

Mr. ECCLES. You will have to subject them to laws.

Senator KERR. I said without laws.

Mr. ECCLES. I don't think you can.

Senator KERR. I don't think so.

Mr. ECCLES. There is not a thing you can do without it.

Senator KERR. I don't think without a law fixing wages and prices——

Mr. ECCLES. Well, I wouldn't say fixing them——

Senator KERR. Well, putting a ceiling on them.

Mr. ECCLES. No. I would think subjecting them to the monopoly laws.

Senator KERR. Now the steel industry is subject to the monopoly law, is it not?

Mr. ECCLES. Yes. All industry is supposed to be.

Senator KERR. It is operating today at what, about 47 percent of capacity. Forty-eight.

Mr. ECCLES. The last statistics I read, it was around 50 percent of capacity.

Senator KERR. Then you haven't read the papers for 2 or 3 months.

Mr. ECCLES. No; I read them every day, but I had not seen the statistics on steel.

Senator KERR. You tell me on what rate you think they are operating.

Mr. ECCLES. I thought they were operating at 50 percent. I didn't know they were below 50.

Senator KERR. Well, they are, but let's assume for the purposes of this discussion they are operating at 50.

Mr. ECCLES. Yes.

Senator KERR. How much has the price of steel gone down?

Mr. ECCLES. It hasn't gone down at all.

Senator KERR. Did you notice in the papers a day or two ago where they announced the prices were going to go up?

Mr. ECCLES. I didn't see any official price, but it was indicated that when the increased wages went into effect under the contract which the steel industry has it would be added on to prices. But there has been no announcement of an increase.

Senator KERR. Do you think they have limited their increase in price to the increase in the amount of wages paid?

Mr. ECCLES. Well, I don't know. I don't know.

Senator KERR. Do you think they have?

Mr. ECCLES. I don't know.

Senator KERR. Well, now, Mr. Eccles, you are a pretty smart man, you read the papers every day, and you were 1 of the 7 men that were the czars of this economy; you were there for a long time, and you absorbed a lot of information.

On the basis of your observation and your experience and your judgment, do you think they have limited their increase in the price of steel to the amount they had an increase in wages?

Mr. ECCLES. Well, I think they have increased the price of steel not only to the increase in wages, but also to the increase in the costs of expanding their plant and facilities. The steel companies have a good many costs outside of the costs of labor, I mean their direct labor. But I think the price of steel reflected the increased railroad rates. I think the price of steel reflected the cost of fuel. It would have to. I think the price of steel reflected the increased taxes. I think the price of steel reflected the increased depreciation based on increased costs of building their plant and facilities. I think the price of steel would reflect the increase in the interest rates.

Senator KERR. Then you do not think they have limited their increase in the price to the increase in the cost of labor?

Mr. ECCLES. No, not to the labor, the direct labor that they have employed. No. I don't think they have. I don't think they could.

Senator KERR. Well, they are subject to this antimonopoly law you were talking about.

Mr. ECCLES. That is right.

Senator KERR. Now, if they increase the price at a time when they are operating actually at less than 50 percent of capacity and increase it above the amount of increase in wages they gave, is the law effective?

Mr. ECCLES. I don't know that they would increase it above the increased wages that they pay unless other costs have gone up. I think if other costs have gone up, I think if they could add it on to the price, they would do it.

I am not sure that the price of steel is going to go up. It is going to depend entirely upon what competitive——

Senator KERR. Let us limit our discussion to what it did do. It did go up the middle of last year——

Mr. ECCLES. That is right.

Senator KERR. When they were operating at a good deal less than the limit of their full capacity, and they have gone steadily down from that rate to where they are now operating at less than 50 percent.

Mr. ECCLES. Well, I don't know. They were running pretty close to capacity a year ago. I think they were running around capacity a year ago.

Senator KERR. Mr. Eccles, don't make that statement without refreshing your memory, because you have got a great reputation here and I don't want you to impair it.

Mr. ECCLES. I say a year ago they were running close to capacity. That is my recollection.

Senator KERR. Then you ought to refresh your memory, Mr. Eccles, because they were not running at near capacity a year ago.

Mr. ECCLES. Well, I thought they were in the 90 percent, somewhere in the 90 percent, a year ago in March.

Senator KERR. Well, I tell you what let's you and I do.

If they were running at 90 percent or better, I'll buy your lunch. If they weren't, you buy my lunch.

Mr. ECCLES. Well, all I am telling you is my recollection. I haven't a staff. What I have is just what I happen to remember.

Senator KERR. And what I am telling you is that you have got a great reputation here, and I want to help you keep it.

Mr. ECCLES. I don't think whether I can remember all the statistics or not has got very much to do with my reputation.

Senator KERR. You have a reputation here as being a man of great knowledge, and I want to say I am one of those who respects you as one.

Mr. ECCLES. I have got my doubts about that.

Senator KERR. I don't want you to disillusion me.

Mr. ECCLES. I don't think anybody could change your views. [Laughter.]

Senator KERR. Now, Mr. Eccles, I doubt if you feel that way about it. I seriously doubt it, because I want to tell you that my views have been in part formulated by Marriner Eccles, and he has not only helped to formulate my views, he has helped to reinforce my views.

Now we were at the point of, or just about at the point of, establishing that there is no way to maintain the stabilized value of the dollar in a free economy in the absence of legal or legislative wage and price controls.

Mr. ECCLES. I think you have got to have legislation, whether it is a direct control of prices and wages or not. I think you have got to have legislation——

Senator KERR. That will bring about that result?

Mr. ECCLES. That is going to prevent prices from going up even when there are huge surpluses. In other words, the law of supply and demand is ineffective.

Senator KERR. It is a memory, is it not; not a reality.

Mr. ECCLES. The law of supply and demand?

Senator KERR. Yes.

Mr. ECCLES. That is right.

Senator KERR. You don't know any industry in which it controls it today, do you—the unfettered law of supply and demand?

Mr. ECCLES. Well, I suppose there are some of the smaller ones, yes, I think, where it does; but it certainly does not control in the case of——

Senator KERR. It controls, if any, but a very small percentage of our economy——

Mr. ECCLES. Steel, freight rates.

Senator KERR. Is that correct?

Mr. ECCLES. That is the way it seems at the present time.

Senator KERR. Well, now, let's see if we cannot agree on this statement: That under the legal structures we now have, there is no way to maintain a stable value of the dollar.

Mr. ECCLES. Well, that is the way it has functioned within recent years.

Senator KERR. Do you believe there is, Mr. Eccles, any way to do it under the legal structure we now have?

Mr. ECCLES. No, I don't. I don't think that under our present situation we can maintain a stable dollar.

I do think that by the use of fiscal and the use of monetary powers we can greatly influence it.

Senator KERR. You said they used powers and you said they used them in a manner that you would approve of, but that they continued to use them beyond the time that you would to bring about a stabilized dollar, and they haven't done it, have they?

Mr. ECCLES. I don't recall that I said they had used the powers beyond the point that I would use them.

Senator KERR. You said you thought the time had come to try to get out of this recession.

Mr. ECCLES. Well, I think the Federal Reserve had the same view. Otherwise, they wouldn't have reduced the discount rates, they wouldn't have reduced reserve requirements. I think they have completely reversed the monetary policy, and I think they did that with the idea of tending to help get out of the recession.

Senator KERR. That they had gotten us into.

Mr. ECCLES. I think they did it with the idea that the inflationary pressures that did exist certainly did not exist to the same extent, and I don't think so, either. I think that the wage-price spiral has not the same influence and pressure today that it had last year and the year before.

Senator KERR. You recommended yesterday a drastic reduction in taxes.

Mr. ECCLES. That is right.

Senator KERR. They are not recommending that.

Mr. ECCLES. Well, I don't know about that. I don't know what they are recommending, but I am recommending it.

Senator KERR. You told us yesterday that the prime rate had been, I believe—what was the lowest, 2½ percent?

Mr. ECCLES. The prime rate was 4 percent.

Senator KERR. What was it in 1954 or 1955?

Mr. ECCLES. I believe it was 3 or 3½.

Senator KERR. Well, don't you remember when it was two and one-half not very long ago?

Mr. ECCLES. Yes, it has been two and one-half during the postwar period, and when there was a lot of excess reserves, when the Federal Reserve was buying——

Senator KERR. If they had completely reversed their policy, the prime rate would be back down to three, would it not?

Mr. ECCLES. Well, I don't think so; no.

Senator KERR. You said they controlled the amount of money and the interest rates.

Mr. ECCLES. They do.

Senator KERR. You can remember 2 or 3 years ago, you say you can, when it was 3. I think it was two and a half. But whether it was 2½ or 3, it has not gone back down to that, has it?

Mr. ECCLES. No.

Senator KERR. Well, then, had they completely reversed themselves?

Mr. ECCLES. I don't think the Federal Reserve influences the prime rate, but it does not necessarily follow the bill rate. The prime rate is influenced by the demand for money.

Senator KERR. Is it not influenced by the supply?

Mr. ECCLES. It is influenced by the cost of doing business, by what banks are paying on savings rates.

Senator KERR. Is it not influenced by the supply of money?

Mr. ECCLES. I think that the element of cost of doing business with the banks, I think the cost of time funds, are factors which are tending to hold up the prime rate.

Senator KERR. Government savings bonds help hold it up, don't they?

Mr. ECCLES. I don't think they are much of a factor.

Senator KERR. Do you think the prime rate will ever be below the rate on United States savings bonds again? It would be unusual if it is, wouldn't it?

Mr. ECCLES. I would doubt it.

Senator KERR. Now we have talked a good deal about inflation, and you have related it entirely to the purchasing power of the dollar. You correct me if I misstate this next statement.

You and I have agreed that under the present legal structure, there is no way to maintain a stable value of the dollar.

Mr. ECCLES. I believe that is true.

Senator KERR. Do you know of anything worse than inflation?

Mr. ECCLES. Well, I think war could be worse than inflation.

Senator KERR. Well, war, of course——

Mr. ECCLES. Creates it.

Senator KERR. War can be worse than anything. I am talking about economics, Mr. Eccles.

Mr. ECCLES. No; I know nothing worse than inflation.

Senator KERR. I read this statement made in 1936:

> It is just as important for bankers that deflation be prevented as it is that inflation be prevented. Deflation, if anything, is more destructive to bankers than inflation.

Mr. ECCLES. I think that is correct so far as bankers are concerned. I think deflation can close them up, as we saw during the deflation of the thirties. But I don't think that inflation does.

Senator KERR. Well, then, do you think the deflation is any more harmful to the banker than it is to anybody else who is in business?

Mr. ECCLES. Well, I think the deflation to the debtor can bankrupt him. I think it can be very bad.

Senator KERR. What about to the worker, what about to the farmer, what about to the man who owns property?

Mr. ECCLES. Well, I think that deflation, where you have debts, is extremely bad. If you are unable to meet the debts, you go bankrupt, and I think that deflation is extremely bad to the debtor.

And inflation is extremely bad to the saver or the creditor.

That is why they are both bad.

Senator KERR. We are all in this buggy together, aren't we? All of us are under the same tent.

Mr. ECCLES. Oh, sure; that is right.

Senator KERR. Do you believe what blesses one blesses all? Do you believe that, generally speaking?

Mr. ECCLES. I have seen it where it doesn't work that way. I think, generally speaking——

Senator KERR. That is a sound principle?

Mr. ECCLES. I think, generally speaking, that what is best for the individual in the long run is best for the country as a whole.

Senator GORE. Would high interest rates possibly be an exception to the general rule?

Mr. ECCLES. No, I wouldn't say high interest is an exception. I don't think it is at all. I think maybe a high interest rate in an inflationary period is where the demand for investment funds exceeds the savings, that it induces people to save funds.

I think it tends to reduce expenditures and it helps to encourage savings, and I think a high interest rate can be very effective in a period of inflation, just as a low interest rate can likewise be helpful in a period of deflation.

Senator KERR. But not as effective?

Mr. ECCLES. It is not as effective. It creates a climate, but it does not necessarily force people to borrow if they have no profitable use for their funds.

Senator KERR. This statement I read to Mr. Eccles is a statement accredited to a man named Marriner Eccles.

Mr. ECCLES. Yes. I still agree with it. I agree with it.

Senator KERR. Then don't you think that for the purposes of this discussion we could agree that deflation is at least as bad as inflation?

Mr. ECCLES. I think that deflation is the result, the end result, of inflation.

Senator KERR. Well, regardless of whether inflation caused deflation or deflation caused inflation, or whether the hen was first or the egg first, isn't it a lead pipe mortal certainty that deflation is just as bad as inflation in relative proportions?

Mr. ECCLES. Well, I think that if deflation continues very long, it destroys your system, and I think the same thing is true of inflation. I don't know which is the worst. They are both very bad.

Senator KERR. If you don't know which is the worst, is it reasonable for us to assume that one is as bad as the other?

Mr. ECCLES. I am willing to assume that.

Senator KERR. The stock market has been slightly deflated in the last 8 months, has it not?

Mr. ECCLES. Well, it was greatly inflated before that, so the deflation has been very much less than the inflation. It would not be, if it had not been inflated as much as it was, it would not be deflated. Deflation comes as a result of inflation.

Senator KERR. It has been deflated about $60 billion, has it not?

Mr. ECCLES. Well, I do not know what the aggregate is. I think $60 billion looks like a lot, but I think you have got to know what the total value of all the stocks listed is, whether we are talking about——

Senator KERR. I am talking about the difference between the high and the present market.

Mr. ECCLES. On the New York Stock Exchange?

Senator KERR. On the stock exchanges in our country.

Mr. ECCLES. That is all stock exchanges?

Senator KERR. All stock exchanges. The fellow who owns stocks traded on the Chicago Board and the fellow who owns stocks traded on the New York Stock Exchange or the American Stock Exchange is just as much affected——

Mr. ECCLES. I didn't know whether you were talking about all exchanges, over-the-counter market, or talking about the exchanges, just talking about the listed stocks.

Senator KERR. I am talking about the listed stocks.

Mr. ECCLES. Just the listed stocks. I don't know what the total amount of the decline in all listed stocks are from their high points. It fluctuates, as you know, every day.

Senator KERR. Yes.

Mr. ECCLES. Just what that is, I don't know.

Senator KERR. Well, the information I have is that it is in the neighborhood of $60 billion.

But to the extent that that is correct, that represents deflation, does it not?

Mr. ECCLES. Yes, it represents deflation from a high point. That is right.

Senator KERR. All right.

Now we are told that there are 5,200,000 unemployed, about a month ago. That, in addition, there were about 250,000 not working who were classified as temporarily unemployed but not included in the 5,200,000.

How many of those do you think are casualties of deflation?

Mr. ECCLES. Well, I would say that practically, certainly 3 million of them.

Senator KERR. Would you say that is a situation which is worthy of the consideration of those who are in charge of the programs which brought it about?

Mr. ECCLES. I certainly do.

Senator KERR. Do you think that the Federal Reserve System is justified in exercising monetary controls which produce that kind of a situation?

Mr. ECCLES. I think they were justified in doing it; yes.

Senator KERR. Well, now, you said in your statement, and I thought it was a rather statesmanlike statement:

Simply stated—

I will go back.

A complete study of the financial condition of the United States, which this committee is undertaking, is of the greatest importance to the present and future welfare of our country. Simply stated, I believe the purpose is to ascertain what has been done, what is being done, and what can be done to maintain maximum production and employment on the basis of a stable currency. * * *

Mr. ECCLES. That is correct.

Senator KERR. Is that statement not self-contradictory?

Mr. ECCLES. Well, I don't think so. I think that is still the objective of this committee.

Senator KERR. You said:

In this conception, the Government is the compensatory agent for an economy based on principles of free enterprise and private property. It does not compete with private business, but it consciously uses its system of taxation and expenditures, supplemented by monetary and credit policy, with the objective of maintaining maximum production and employment, so far as that is possible within the framework of a stable currency.

This other was your statement of what you thought this committee had as its objective, the first statement I read you.

Mr. ECCLES. Yes. That is right.

Senator KERR. If I correctly interpret this last statement, it is what you believe the objective of Government ought to be.

Mr. ECCLES. Stable economy.

Senator KERR. Then I will ask you again if that statement is self-contradictory?

Mr. ECCLES. I don't think so.

Senator KERR. Well, if I read it correctly, it is.

Mr. ECCLES. Well, it wasn't meant to be.

Senator KERR. That is what I want to clear up. What I want to find out is this: Do you think that the objective of maintaining maximum production and maximum employment should be limited by an objective of higher priority, and that is the objective of a stable currency or stable dollar?

Mr. ECCLES. I think they are related. I don't think that we can lose sight of stability in the economy and merely operate on the basis of maintaining maximum production and employment without regard to stability.

I do not think that—I think that will wreck your system.

Senator KERR. Let me ask it this way: Which is more important, stabilized employment and stabilized production, or the stabilized value of the dollar?

Mr. ECCLES. Well, by stabilized production and employment, you mean maximum production and employment?

Senator KERR. Well, let's use the words full employment.

Mr. ECCLES. Yes.

Senator KERR. Full employment. I would not want to hold you to a technical interpretation of maximum employment.

Mr. ECCLES. Well, I think they are equally important.

Senator KERR. Well, now, you and I agreed a while ago that we cannot maintain a stable value of the dollar under our present legal structure.

Mr. ECCLES. But you certainly have got to make an effort to keep it from a runaway.

Senator KERR. I agree with that. But now let's say we have got to make the choice, we have got to make the choice between maintaining the stabilized value of the dollar or maintaining full employment.

Which would you say we should take?

Mr. ECCLES. I would undertake to maintain a stable economy rather than have a runaway inflation which will wreck employment and production if it is permitted to go far enough. It would completely stop all savings and would wreck your economy and I would say that you have got to use such tools as you have through monetary and fiscal policy to prevent inflation. You have got to do that.

Senator KERR. But you told me a while ago that we could not control inflation, that is if you define "inflation" as diminishing value of the dollar under our present legal structure.

Mr. ECCLES. I think in the long run it is one of rising costs, there is a difference between curbing it and using no effort at all to curb it. I think you can curb it.

Senator KERR. I understand that.

Mr. ECCLES. I think you can use the powers you have to curb it, but I doubt if that is going to stop a certain amount of it.

Senator KERR. I think that is correct.

Now then, let's say that you are the man who has to make the decision, and choose between maintaining a stable level or full employment.

Which has the higher priority in your judgment?

Mr. ECCLES. Maintaining a stable dollar.

Senator KERR. I appreciate that.

Mr. ECCLES. I would like to add this: the reason I say that is that in the long run it will create more production and employment than if you do not do it.

Senator KERR. Well, now, how much comfort do you think it is to the 6 million now unemployed that their suffering is going to contribute to somebody else's employment in the future?

Mr. ECCLES. Well, of course, I do not think it is any comfort. I do not think it is any comfort at all.

Senator KERR. Now, they have created a condition in this economy where we have nearly 6 million unemployed today, have we not?

Mr. ECCLES. That is about it; yes. I think that is about right.

Senator KERR. All right.

Now, they have not stabilized the value of the dollar, have they?

Mr. ECCLES. Well, it is not entirely, not entirely stabilized, but it is certainly much more stabilized than it would have been if nothing had been done to deal with it.

Senator KERR. Let me ask you this: Have they stabilized enough to meet the requirements that you would put on it if you were running it?

Mr. ECCLES. Well, I think they have done the best they can.

Senator KERR. I am not talking about that. I am asking what you would do. Let's say you are now confronted with a situation of a dollar of whatever stability the one we now have has, and we have 6 million unemployed.

Mr. ECCLES. I doubt if I had had the handling of it, I doubt if I could have done any better.

Maybe not as good.

Senator KERR. Well, let's use a little hindsight then as we think about the future.

Would you try to hold unemployment at the present level?

Mr. ECCLES. No, I certainly would not. That is why I made the statement that I made, that I would extend the unemployment pay.

Senator KERR. How long?

Mr. ECCLES. Well, at least up to 50 percent of this.

Senator KERR. Let's say you did that, and then they could not get a job. Would there be any more reason to extend it for them now than it would be then?

Mr. ECCLES. Well, it would depend at that time on whether or not the unemployed were decreasing and the economy was rapidly improving.

Senator KERR. Let's say it was about like it is now.

Mr. ECCLES. I think you may have to extend it further.

Senator KERR. Then you would extend it until such time as they could find employment?

Mr. ECCLES. Well, certainly not until you got 100 percent employed.

Senator KERR. Until you got what percent?

Mr. ECCLES. I would certainly want to extend it to a point where you did not have the mass, the large unemployment that you have got today and the idle facilities you have got today.

Senator KERR. You would then put into effect what amounts to a dole as a part of the price you would pay for a reasonably stable dollar?

Mr. ECCLES. I would do something else. I would reduce taxes in order to bring about recovery. I think that is the most important thing.

Senator KERR. You know our distinguished chairman and many others take the position that deficit financing is the most provocative of any condition that can exist to produce inflation.

Mr. ECCLES. Well, I, of course, do not agree that deficit financing necessarily will produce inflation.

Senator KERR. You told us yesterday that that is what produced inflation of the war period.

Mr. ECCLES. That is correct.

Senator KERR. How would it produce it then and not produce it now?

Mr. ECCLES. Well, I think it is the growth of the total debt. I do not think that the deficit financing by the Government necessarily produces inflation. I think that it depends on the growth of the total debt, public and private.

Deficit financing by the Government——

Senator KERR. Public and private debt are now at an alltime high.

Mr. ECCLES. That is right, and that is one of the reasons you have got inflation.

Senator KERR. And if you have inflation you are going to increase the public and private debt to an alltime high.

Mr. ECCLES. Yes, but public debt is contracting due to unemployment and idle facilities. The effect of inflation is always a contraction of private debt and as the private debt contracts the deflation becomes cumulative, and that is why an increase in the public debt during a period of a contraction in the private debt is not inflationary.

But certainly an increase in the public debt, deficit financing during a period of rapid growth of the private debt would only add to the inflationary pressures.

I think that we would have done well to have had larger budgetary surpluses during the past few years while the private debt was growing as fast as it was.

It would have been a compensatory or a stabilizing factor.

Senator KERR. Well, Mr. Eccles, I want to thank you; you have been very kind, and I want to ask you just one more question: Can you point to an inflationary period in our history where the overall damage to the economy was as great as the deflation—as great as that brought on by the deflationary period of the thirties?

Mr. ECCLES. No; I do not think we ever had an inflationary period that was as disastrous as the deflation of the thirties.

Senator KERR. Then would it be reasonable to assume that you agree with me that unless the present deflationary condition is lessened or reversed or lightened or reduced, that we face the possibility of suffering a part of the damage that was inflicted on us by the deflation of the thirties?

Mr. ECCLES. Well, I think it would be a small part. I think you have a very different situation——

Senator KERR. Well, until we reverse it it feeds on itself.

Mr. ECCLES. Than you had in the thirties.

Senator KERR. Until you reverse it——

Mr. ECCLES. Yes.

Senator KERR. Until we take actions to correct it.

Mr. ECCLES. It feeds on itself much more slowly.

You have factors now such as deposit insurance which does not bring about runs on banks.

Senator KERR. I understand it.

But until we reverse it, it will gradually be worsened, won't it?

Mr. ECCLES. It may not be. It could reach a point and run along without going through the wringer that it did in the thirties.

Senator KERR. I agree with that. I did not say we would get to the level. But I said until we take actions to cure it, it will gradually worsen, won't it?

Mr. ECCLES. Well, I am not certain that we would worsen it.

Senator KERR. If we thought it would cure itself you would not recommend any deficit financing?

Mr. ECCLES. Oh, no; I do not see any reason to stay at the present level indefinitely. I see nothing to gain by losing the value of our productivity that is being lost in a recession with idle men and idle facilities which are, of course, the basis for wealth.

Senator KERR. You said yesterday our labor force increases every year.

Mr. ECCLES. That is right. And we have got to increase or expand our production.

Senator KERR. If the labor force increases every year and productivity remain static, doesn't that worsen the situation?

Mr. ECCLES. That is correct. In other words, if you stay at a present level over a period of time it would be considered a much deeper deflation than it is now.

Senator KERR. Well, then, you will agree with me that if we do not take positive measures to improve the situation it is going to continue to get worse?

Mr. ECCLES. Well, that certainly is a risk you are taking, that is a risk you are taking that I would not take.

I do not think we are justified in taking it.

Senator KERR. I would not either, but I think in making the decision of what we should do we should correctly appraise the alternative.

My own judgment is that unless we take positive measures to improve it, that it is going to continue to get worse as the situation——

Mr. ECCLES. That certainly is a likelihood.

Senator KERR. You agree then that would probably be the situation?

Mr. ECCLES. The offsetting factor that you have today, of course, is the large military expenditure and foreign aid, if that is made, and also the huge municipal financing that is going on. That huge expansion of debt is still——

Senator KERR. Mr. Eccles, if those things operate to improve it, it will be the result of action taken; won't it?

Mr. ECCLES. Oh, sure. That is right.

Senator KERR. I did not say unless we take specific action. I asked you if it is not a fact that unless action is taken to improve it, that it will continue to worsen.

Mr. ECCLES. Well, I agree that unless there is an expansion in the public debt, the municipal debt, the situation is likely to worsen unless—let me put it this way: The situation is likely to worsen unless there is a growth in the——

Senator KERR. Unless there is positive action taken by somebody?

Mr. ECCLES. Unless there is growth in the public and private debt.

Senator KERR. Well, that would be positive action; would it not?

Mr. ECCLES. Well, yes. I think action is being taken every day of a kind, it is the question of the volume. It is a question of the extent to which the action is taken that determines it, and you have got to offset the contraction that has taken place by positive action on the part of the Government or——

Senator KERR. Or somebody?

Mr. ECCLES. That is right. You have got to do it.

Senator KERR. Or the situation is going to get worse?

Mr. ECCLES. That is correct.

Senator KERR. That is all.

Thank you very much, Mr. Eccles.

Senator Malone?

Again, I want to thank you very, very kindly and I want to say to you there is more meat in this statement you gave, and I want to say this to you, frankly and publicly, if that great brain of yours could be just partially disassociated from some of the shackles that seem to be around it, apparently by your permission, it could not be otherwise, I do not know anybody that could make a greater contribution to the sum total of wisdom needed at this time than you could.

Mr. ECCLES. Thank you, Senator.

Senator KERR. I would like to see it unfettered either by the loyalties that have made it captive in part, or by other things that have, in part, made it captive, and just see you brace yourself to take it off because I think you could do it.

Mr. ECCLES. Well, I have had my service.

Senator KERR. All right, Mr. Eccles.

Pardon me, Senator.

Senator MALONE. Thank you, Mr. Chairman.

I think you have covered quite a good deal of ground in the last day and a half.

Mr. Eccles, you said that both deflation and inflation are bad.

How would you prevent either one if you allowed the economy to operate without interference? On what principle could you establish it so that people in private business could judge something about the future prices of commodities, stocks, labor, and the cost of doing business?

Mr. ECCLES. I do not know of any way in a free economy that that can be accomplished.

Senator MALONE. Do you believe that any such result can be brought about under a free economy?

Mr. ECCLES. I do not know that it is desirable to accomplish it. I think if people knew exactly where prices of stocks or prices of commodities were going we might——

Senator MALONE. That was not the question and I did not indicate that I thought that it should be done. I asked you if there was a principle under a free economy upon which people could themselves judge it rather than a Government-controlled economy, which is what we have under the present system.

Mr. ECCLES. Well, I do not think it would be desirable.

Senator MALONE. You do not think it would be desirable then to stabilize the purchasing power of money through adopting the gold standard?

Mr. ECCLES. I do not think gold would stabilize the dollar.

Senator MALONE. By stabilize, what is your understanding of the term "stabilize"?

Mr. ECCLES. Well, I mean enable it to maintain a uniform purchasing power based upon what is termed the cost of living, the things that the average person uses their money for.

Senator MALONE. Again I have no reference to the fluctuation of prices of commodities. I had a reference to controlling the money, by law, through a gold-base principal and not controlled by men.

Mr. ECCLES. Well, I know of no way you can control it by principle, and I think that men will always control it.

Senator MALONE. Men always did control it by overinvestment, overconfidence, or lack of confidence but always, or at least for a long term of years until we went off the gold standard, it was at least tied to something that a board or commission could not just expand it at random.

Isn't that true?

Mr. ECCLES. Of course we were on a gold standard at the bottom of the depression and it did not stabilize prices.

Senator MALONE. No one has ever said anything about stabilizing prices in a free economy. I do not think you can ever stabilize prices in a free economy. What you could stabilize is a medium of exchange so that you at least know what a dollar was worth.

Mr. ECCLES. But in terms of gold—people are interested in what a dollar is worth in terms of what a dollar will buy but not in terms of gold.

Senator MALONE. That is a good answer from your standpoint. But what I am trying to find out from you is whether or not you think there should be a principle established so that people do their gambling, which they are always going to do, on what the commodities are going to be worth next year (that is about all the stock market is), or whether you want it so that the seven men, or the 123 men, whichever you decide, control it and may print more money or put more in circulation or take it out of circulation themselves, in order that they themselves may try to stabilize the purchasing power on the basis of what Mr. Martin, chairman of the Federal Reserve Board has called permitting monetary credit to foster a "sustained economic growth."

Mr. ECCLES. Well, I would much prefer, of course, that it be left to a public body, an agency of the Congress, that is responsible to the Congress, responsible to the public and ultimately to the voter.

I would prefer it left to those men to carry out an objective of maintaining adequate credit within a framework of stability.

I would much prefer to leave it to them.

Senator MALONE. Then you would like to leave it just as it is and not ever have a gold standard or a metal standard of any kind with a price for the metal?

Mr. ECCLES. I would prefer to leave it as it is, yes, if it is a question of tying it to the alternative which is tying it to gold. Of course today you have a reserve gold standard, but——

Senator MALONE. What is that standard?

Mr. ECCLES (continuing). But not a convertible gold standard.

Senator MALONE. What do you call a reserve standard?

Mr. ECCLES. Well, I call a reserve gold standard the gold that is back of the currency issued by the Federal Reserve Banks, Federal Reserve notes, and the deposits of member banks that are carried in the reserve banks.

There is a percentage of gold that is represented by gold certificates, because the Treasury removed the gold, very foolishly from the reserve system to Fort Knox, and then issued to the reserve banks gold certificates.

That reserve was changed by law during the war period when it was inadequate, when the percentage of gold required was not sufficient to meet the percentage that the old law provided for, and the Congress proceeded to reduce the requirement, and I think if we lost gold the Congress would proceed to do it again.

You are not going to stop the issuance of a media of exchange for the purpose of tying it to any standard.

Senator MALONE. What is this reserve now? What percentages of the reserve are in gold?

Mr. ECCLES. I don't remember. I have forgotten. I think it is 34——

Senator MALONE. 25 percent.

Mr. ECCLES. I think it is 25 on deposits, and maybe thirty or 35 on notes. It was 35 and 40 at one time.

Senator MALONE. How much money is in circulation?

Mr. ECCLES. About $31 billion. It is less than $31 billion. It is around—it is between $30 and $31 billion.

Senator MALONE. That includes——

Mr. ECCLES. What is that?

Senator MALONE. That includes the reserve notes you are talking about?

Mr. ECCLES. No, no. You mean the gold certificates?

Senator MALONE. Yes.

Mr. ECCLES. No, no, those are not in circulation. The money that is in circulation is the Federal Reserve notes, and I suppose the silver certificates.

Senator MALONE. Then you are supposed to have enough gold in deposit some place to cover that issue of $31 billion. It is supposed that the Government owns that much gold?

Mr. ECCLES. Yes. Well, that is right. The Government has issued certificates to offset it.

Senator MALONE. Did you know that the present Chairman of the Federal Reserve Board testified that if all of the dollar balances in Europe that could be converted to the nations balance were demanded that we would have only $5,700,000,000 worth of gold?

Mr. ECCLES. Well, that would not concern me. I think that may be true.

Senator MALONE. Well, would it concern you if they were demanded and paid and you did not have the gold that the law requires?

Mr. ECCLES. That would not concern me. I would just provide a reduction of the reserve.

Senator MALONE. It would not concern you if they did not have any gold at all, would it?

Mr. ECCLES. Well, I think that that is not likely to happen as long as the dollar is a currency that the world has got confidence in. I think that if we reached a point where we had—where the dollar was becoming inflated like the franc is and other currencies, that people would be running from the dollar, and when people begin to take dollars out, you have to either suspend the right to do it, which you could do, or you would have to make the transfer to the central bank of the country drawing the money in gold. Gold is the medium for settling international balances.

Senator MALONE. Then if you did not have any gold or if we refused to pay the balances in gold that these countries presented, what would be the result in the confidence of the dollar on the world exchange?

Mr. ECCLES. Well, I think that it would shake the confidence of the world in dollars. I do not think that is likely so long as we keep a reasonable stability of the dollar.

If we permit a runaway inflation, where our dollar, our purchasing power, is diminishing, those that can get gold are going to want to get it.

Senator MALONE. None of this seems to come to a very definite point.

What I was trying to find out for my own information as well as for this committee and the Congress if they study what we find out from you as an expert, is what would happen if we did not pay in gold——

Mr. ECCLES. I do not pose as an expert.

Senator MALONE. Well, that is comforting. But while you are on the stand you have been called because you have been chairman. By the way, how long were you a member of the Federal Reserve Board?

Mr. ECCLES. Nearly 17 years.

Senator MALONE. When did you first take office?

Mr. ECCLES. In November of 1934.

Senator MALONE. When did you become Chairman?

Mr. ECCLES. Well, the first Reserve Board, the Secretary of the Treasury was the ex-officio Chairman and member, the Comptroller of the Currency was an ex-officio member, and there were six Board members.

Senator MALONE. But what year did you become Chairman?

Mr. ECCLES. That was in 1934, and there was one Governor, and I was known as the chief executive officer and the Governor of the Board.

The Banking Act of 1935 changed the structure and eliminated the Secretary of the Treasury and the Comptroller as ex-officio members and set up a Board of Governors of seven members, the old Board went out of existence, including myself, and a new Board was appointed and I was reapponted and I was designated as the Chairman——

Senator MALONE. That was 1935?

Mr. ECCLES. Well, it went into effect, the new law went into effect on February 1, 1935; I stayed in as Chairman from February 1936 until 1948, when Mr. Truman did not reappoint me and I stayed on for another 3 years and then resigned.

Senator MALONE. That was in 1951?

Mr. ECCLES. That was 1951.

Senator MALONE. I knew you were there for a long time.

Mr. ECCLES. I was a Governor, which was the chief executive officer, from November of 1934 to February of 1936. I was then Chairman from February of 1936 to February of 1948.

Senator MALONE. Now, the present Chairman testified not only that we would have only the $5.7 billion of gold if all of the dollar balances were presented, but that it would probably have a severe effect on the value of our money on the exchanges of the world if we did refuse to pay in gold, which, of course, he testified he could do.

Do you agree?

Mr. ECCLES. Well, it is hard to judge the effect that would be created throughout the world if we were unable to pay the foreign balances in gold. I could not predict it.

Senator MALONE. Would you agree it would depress the value of the dollar severely? That is the summation of his testimony.

Mr. ECCLES. It would not—not necessarily so.

From a domestic point of view the purchasing power of the dollar would be largely determined by the amount of dollars that were available in relation to the goods and services that were available in our domestic market.

Senator MALONE. Your idea then it would depend upon the amount of dollars in circulation in the long run. If you sold more bonds, put more dollars in circulation, it would be worth less, is that it? It would have nothing to do with the payment of gold?

Mr. ECCLES. That is right. I think that would be true under present conditions. There have been exceptions.

At the time of the bank holiday when the economy was at its lowest ebb, we had the greatest volume of money in circulation we had ever had.

Senator MALONE. Generally speaking and under ordinary average conditions the more money in circulation, the less purchasing power. Would that be true?

Mr. ECCLES. Yes, it would certainly reduce the purchasing power if there was an excessive supply of—I don't mean currency in circulation. I mean bank demand deposits, which are principal media of exchange.

We have five times as much demand deposits in banks as there possibly is currency.

Senator MALONE. How much would you estimate that we have?

Mr. ECCLES. Well, I may have forgotten. I would say it must be close to a hundred and fifty billion.

Senator MALONE. But you do not believe that since we have paid the dollar balances, credits in gold, over a longer period of years that our refusal to pay such balances in gold would have any material effect on the dollar on the foreign exchange?

Mr. ECCLES. Well, yes, I think the effect on the dollar would possibly be before our refusal.

I think that the only risk of having the gold—the foreign balances that are in this country withdrawn in gold would be if we had a substantial inflation, further inflation.

I think that is the thing that would cause foreign countries to want to convert their balances to gold.

I think if that did not happen the likelihood of withdrawing gold, I think there is little likelihood of them drawing out gold.

Senator MALONE. That was not exactly the question.

The question was, if we refused to pay our balances in gold would it depress our currency on the international exchange?

Mr. ECCLES. Well, I do not know whether it would be depressed any more than it would have been depressed to cause them to draw out the balances. It possibly would. I think that the country's inability to meet its international balances could affect the value of those currencies.

We do have this situation: We have countries where they permit—they are in a position to transfer gold in settlement of foreign balances only to the extent that they have—take England, for instance, England has exchange control. They do not permit the pound sterling to be drawn out freely by either their citizens or their companies, and there is a good deal of pound sterling that is known as block sterling that is not permitted to be drawn out, and yet they maintain the price of sterling—the price of sterling has remained pretty stable.

They permit gold to be transferred whenever they find it necessary to secure dollars or other currencies that they find necessary to get the raw materials and other things that they have to have.

Senator MALONE. They have no principle of such payments in gold.

Mr. ECCLES. They do not permit the people to run from the pound into dollars or into gold or into other currencies.

They are locked in.

Senator MALONE. Do you think that is a good system?

Mr. ECCLES. Well, I think it is the only system they could use under the circumstances, under the war situation.

Senator MALONE. What war situation?

Mr. ECCLES. That they were left in. The Second World War.

Senator MALONE. We have been through that now for some time, have we not?

Mr. ECCLES. Yes, but they still have a lot of blocked sterling.

Senator MALONE. Sterling is a manipulated currency, is it not?

Mr. ECCLES. Well, I do not know what you mean by manipulated. England has always manipulated their currency, blocked it, fixed a false value, and by other methods.

Senator MALONE. They fix the value and they fix the purchasing power and they fix their imports by import permits and exchange permits and many such regulations by executive order.

Mr. ECCLES. Well, I think the pound sterling has remained pretty possibly as stable as nearly any of the foreign currencies in relation to the dollar, and also in relation to gold.

Senator MALONE. You think the money that we have given them had anything to do with that?

Mr. ECCLES. Oh, I think so. I think without our lend-lease, and without the British loan, I think they might have gone under. I think they might have gone under.

Senator MALONE. It still masquerades under a loan.

Mr. ECCLES. Under what?

Senator MALONE. A loan.

Mr. ECCLES. You say it masquerades?

Senator MALONE. Yes. They still call it a loan.

Mr. ECCLES. Well, it is a loan.

Senator MALONE. Sure, in name only.

Mr. ECCLES. The British loan; that is right.

Senator MALONE. Well, a British loan is generally understood as one that is not paid, is it not?

Mr. ECCLES. Well, they paid some of the loan.

Senator MALONE. With the money we gave them.

Mr. ECCLES. We of course are rather hesitant to take goods in payment of it. We do not move with alacrity to reduce tariffs and take goods.

Senator MALONE. No, I am not interested for that is not the question I asked you. I am interested in what England does with their manipulated currency. I went to Hong Kong in 1948 to find out just what the pound was worth when they said it was worth $4.03.

Do you have any idea what it was worth on the international exchange in Hong Kong at that time, 1948?

Mr. ECCLES. No, I do not.

Senator MALONE. It was worth $2.66 and you could spend it any place in the world because it was a free market. If you got it any place else they could block it.

The same situation obtains now to a considerable extent. It is a bluff, and with our help they maintain it, God bless them.

But to come back to our own: The fact is that we have consistently paid our international exchange balances in gold. That is right, isn't it?

Mr. ECCLES. That is right.

Senator MALONE. And if we did, as it was so testified by Mr. Martin, honor all of these balances if they were presented, we would have about $5¾ billion worth of gold left in the Treasury.

He testified he did not have to pay it, just as you have said under questioning by the Senator from Oklahoma.

Now the direct question then is: If we did refuse to pay in gold do you think that would have a severe depressing effect on our currency in the world market?

Mr. ECCLES. Well, I do not know how severe. I don't know.

Senator MALONE. That is about the best answer you have given today.

Mr. ECCLES. Well, I really do not know.

Senator MALONE. And I think you are right. You do not know, however, Mr. Martin testified that such refusal would severely depress the value of the dollar in the foreign exchange and would probably cause a severe depression in this country.

Mr. ECCLES. I don't know.

Senator MALONE. Now, we will pass on to the next question.

Right now, if you were Chairman of the Board, what would be your action in the present situation?

Mr. ECCLES. You mean in the domestic economic situation?

Senator MALONE. That is what we are interested in, at least I am interested in our own people.

Mr. ECCLES. Yes. Well, I would do just about what the Board is doing.

Senator MALONE. It is my opinion that gold may be Russia's secret weapon.

They have gold. If they put the ruble on the gold standard with 30 or 40 billion dollars in gold behind it on the world market, the ruble could well soon replace the dollar as the criterion of exchange.

I insert in the record at this point a Wall Street Journal dispatch of April 22 showing the rising price and interest in gold.

(The dispatch above referred to is as follows:)

[From Wall Street Journal, April 22, 1958]

VIEW OF SOME EXPERTS: LONDON GOLD PRICE RISE HELD BLOW TO UNITED STATES DOLLAR

(By Jerome Oelbaum)

Is the American dollar—for decades the stalwart standard for international monetary exchanges—losing value in terms of other currencies?

Some experts claim it is and point, for substantiation, to a little publicized rise in gold prices on the key London market. Others take the position that the gold gains are largely the result of technical market factors.

RELATIONSHIP CHANGES

In any case, there is no doubt that gold prices in London have been unusually strong over the past 2½ months and that this increase has created a new relationship between United States and foreign gold markets.

Prized by both national central banks as monetary reserves, and by hoarders as protection against currency depreciation, gold moves in large quantities throughout the world. World gold production—excluding the output of the Soviet Union—jumped to about 30 million fine ounces last year. At the United States pegged price of $35 per ounce, this amounts to more than $1 billion.

The Federal Reserve Bank of New York, acting as agent for the Treasury, stands ready to sell gold to foreign central banks and buy it from them at that price. In practice, the bank charges a one-fourth of 1 percent handling charge so that the effective selling price is actually $35.0875 per ounce and purchases are made at $34.9125.

HELD FAIRLY STEADY

During 1957, prices in the London market, where any nonresident of the sterling area can buy gold, provided he can put up United States or Canadian dollars, generally stayed within the bottom and top limits of the United States peg. This meant, as one gold expert, Dr. M. A. Kriz, has pointed out, that people or central banks could sell gold more profitably in London than in New York. At the same time, it was cheaper for central banks to obtain gold in London.

That situation has almost turned around completely because of the uptrend in London. It is still more profitable for sellers to dispose of their gold in London. But for the central bank, entitled to acquire United States gold, New York has become a cheaper market for buying. The hoarder, shut off from that inexpensive supply, has to buy his gold wherever he can.

The price turn developed in mid-January when the London price crossed over the $35 border and then rose steadily until the first week in April. On April 8, gold hit approximately $35.1100 an ounce, compared with the United States selling price of $35.0875.

The exact London price is actually difficult to determine. Every morning, representatives of five bullion dealing houses meet at the House of Rothschild with their buying and selling orders. They arrive at a price called the gold fixing.

But this price is expressed in pound sterling and the exactitude of the dollar price depends on getting the sterling-dollar exchange conversion rate at the precise moment this fixing takes place.

TAKES FRESH UPTURN

The London gold quotation has drifted downward since that first week. By the 11th of April it had sunk to $35.0759. But this was followed by a fresh upturn which by last Friday carried the gold fixing back to $35.0925.

What led to the January–April rise? One widely accepted explanation is that the Middle East unrest inflated demand at a time when gold offers were low. The major source of new gold is South Africa. The bulk of this metal is marketed in London, the Bank of England acting as selling agent.

The more dramatic explanation is that the dollar is weakening, or at least enough people believe it will decline and are, therefore, switching from dollars to gold.

TWO POINTS OF VIEW

The recession, the argument goes, may mean a new pump-priming effort by the United States administration sooner or later. Prices will go up, or, alternatively, not go down as fast as otherwise. Eventually, the purchasing power of the dollar will decline relative to other world currencies.

On the other hand, if prices do go down, today's dollars are cheap and tomorrow's will be hard in terms of the amount of goods than can be bought. Gold prices are fixed. Thus it would be wise, according to this viewpoint, to buy gold now and turn it back into dollars later. Those dollars will be more valuable in the sense that they will buy more.

Senator MALONE. This situation, considering that foreign nations could and probably would demand all but $5.7 billion under those conditions. There has been a good deal of talk about the stock market. Does the stock market really mean anything in reflecting the actual value of stocks when the Chairman of the Reserve Board or the Board or the 123 men, whoever does it, can at any time raise the stock market margin or reduce it within almost total limits, either requiring 100 percent or 1 percent margin.

Doesn't that in the long run regulate the flow of stocks?

Mr. ECCLES. Well, it prevents a credit inflation that might otherwise happen, and which did happen in 1929.

Senator MALONE. In other words, the stock market does not reflect anything particularly as long as the margin can be regulated in that manner?

Mr. ECCLES. Well, I think it reflects a good deal.

Senator MALONE. What does it reflect?

Mr. ECCLES. I think that most of the stocks are purchased for cash. I think that the amount of stocks purchased from brokers on margin is a very small portion of the stocks that are dealt in.

Senator MALONE. Would you estimate about what you believe would be the proportion?

Mr. ECCLES. No, I do not know. I would not know.

Of course I think that there is a good deal of buying and selling on margin, but it is largely for speculative rather than investment account.

Senator MALONE. Isn't that speculative buying a very influential factor in the price of stocks?

Mr. ECCLES. Well, I do not think it is possibly any more so than is true with bonds and even some commodities. I think certainly that when people feel they can buy something and sell it for a profit later and pay a capital gains tax, it is the privilege they have, and they may do it on credit or they may do it out of cash.

Senator MALONE. But, if the Chairman of the Board or the Board itself can suddenly say you must lay down 90 percent of the amount you buy or you only have to put down 5 percent does that not have some influence on the amount bought or sold by the speculator?

Mr. ECCLES. I think it does. It certainly would have influence.

Senator MALONE. Would it not have enough influence to create a wide margin in the fluctuation of stocks?

Mr. ECCLES. Well, I think it would create quite a wide margin if you are talking about a 70 percent or a 5 or a 10 percent.

I do not think you could ever get to that if the Board had no control at all, I do not think that the brokers, after the experience of 1929 would be loaning on a 10-percent margin.

Senator MALONE. Now tell me, do you know what latitude the Board does have on fixing this margin?

Mr. ECCLES. I don't think it is limited.

Senator MALONE. Do you think it would be 99 percent or 1 percent?

Mr. ECCLES. While I was Chairman we put 100 percent on.

Senator MALONE. You could have 1 percent?

Mr. ECCLES. You could put 1 percent but I think it would be meaningless. That does not mean that brokers or banks have to loan on a 1 percent margin.

Senator MALONE. That is correct, but it would allow them to do just that.

Mr. ECCLES. If the Board reduced the reserve requirement entirely you could loan on any margin that the broker or the bank was willing to accept.

Senator MALONE. That is the point I was trying to make.

In other words, buyers could put no money down. Could the Board do that?

Mr. ECCLES. Yes; it would be my judgment they could eliminate margin requirements altogether.

Senator MALONE. Then my only question was, do they fix the limits within which brokers and bankers and others dealing in stock can operate?

Mr. ECCLES. That is correct; that is the power the Congress gave them under the Security Exchange Act.

Senator MALONE. I wanted it clear in the record.

Mr. ECCLES. And that is a power the Congress could take away.

Senator MALONE. What I am really leading to is, do you think Congress should take it away or limit it?

Mr. ECCLES. No, I do not. I think it served a very useful purpose. I think selective controls, I think they should have more of them.

I was in favor of the Federal Reserve having control of consumer credit and mortgage housing credit.

I think if they had such controls I believe the excesses that I believe have been reached during the past 2 or 3 years in both those fields might have been lessened.

Senator MALONE. Put the Board in complete control of the economy.

Mr. ECCLES. You would have had a very stabilizing force to have curbed the growth of consumer credit and the growth of housing credit to somewhere in relationship to the growth of the national product during a period of maximum employment and production.

Senator MALONE. Then you agree with Mr. Bell—Elliot Bell, who is editor and publisher of Business Week, when he said, and I quote:

> Neither the President nor anyone else is commander in chief of our economic defenses. We have a vast multiplicity of Government intermediaries engaged in Government operations affecting the general economy locally without coordination. We have a diversity, private institutions engaged in major financial operations, entirely outside the discipline affecting commercial banking systems and in some cases entirely without any discipline in taxation.

And you think more power should be given the Board to regulate the entire economy?

Mr. ECCLES. Well, I think, and I am on record over a good many years, that there should be some unification of our banking system.

We have a great many banks that are not members of the Federal Reserve System. I would say that every bank where they carry demand deposits should be a member of the Reserve System.

Senator MALONE. Mr. Bell goes on to say:

> Simple commonsense indicates we ought to at least have some authority in Government that would be responsible for thinking in terms of overall economic policy.

Do you believe that?

Mr. ECCLES. Yes, I believe in it.

Senator MALONE. In other words, just turn the whole economic system over to the Board, consumer credit and all?

Mr. ECCLES. I don't know—I think the Board should have control over consumer credit, control over housing credit, as well as control over stock-market credit and I think all banks that are depositors should be members of the Federal Reserve System.

Senator MALONE. Mr. Bell goes on to say—and this is really your policy, as I understand it now——

> Within recent months such a body—

talking about a Board of Governors of the Federal Reserve System—

and Chairman of the Council of Economic Advisers and such others as may be from time to time desirable all under the chairmanship of the President—

reading Bell's statement—

I have suggested a national economic council and—

he goes on to say—

within recent months such a body has been set up on such an informal basis due to the initiative of Secretary Anderson.

It should be established on a formal basis and clothed with the necessary authority. They are surely needed at this very moment for more guided protection in our defense against a recession as an essential part of our national defense.

You believe that congressional action should be taken for the Board to have this full power or set up another Board?

We generally set up another Board; so many Boards that we do not know where they all are.

Mr. ECCLES. I do not know that I would want to formalize it. But I feel the Treasury and the Federal Reserve and the White House in which the budget resides, I certainly think that—and that would cover the economic counselors that were set up under the Employment Act of 1946, the economic advisers to the President, I certainly think that those people should certainly meet informally and have a consistent fiscal and monetary policy.

Senator MALONE. Well, informally, you mean just to advise but not have any authority?

Mr. ECCLES. Well, I do not think that the committee would necessarily need to have authority.

I think the authorities which they already have are adequate.

Senator MALONE. They—who do you mean by "they"?

Mr. ECCLES. I mean the Treasury and the Federal Reserve and the Budget people and the Council of Economic Advisers and the President.

Senator MALONE. Then if you did not clothe them with authority, what place would they fill?

Mr. ECCLES. Well, the Federal Reserve has certain responsibilities, objectives under it, and the Employment Act of 1946 has some objectives.

Senator MALONE. It seems to me that what you want is to have an advisory board set up to advise the advisers, including the Federal Reserve Board.

Mr. ECCLES. I think that is right. They would advise with the Federal Reserve, and the Federal Reserve would advise with the Council of Economic Advisers.

Senator MALONE. Mr. Martin testified that is what he does. He advises with the Secretary of the Treasury and all Cabinet members, but we find he was the final arbiter.

In the final analysis, the Chairman and the Board of Federal Reserve have the final authority. You agree with that?

Mr. ECCLES. That is right.

Senator MALONE. If he already advises with those people what good would another advisory board do?

Mr. ECCLES. Well, I do not know that it would add anything. It would not add anything. If they meet periodically, and if they consider these fiscal and monetary problems in the light of the state of employment and production, then it seems to me they should be able to accomplish the purpose.

Now there may be disagreements but they certainly ought to be able to reconcile those disagreements.

Senator MALONE. Mr. Bell said, speaking of the Board:

It should be established on a formal basis and clothed with the necessary authority.

Do you disagree with that statement?

Mr. ECCLES. Well, I think so. I do not know what form that legislation could take. I do not like to see any more formalized legislation that gives additional powers.

It seems to me they have the powers and they have the responsibility and if they fail to discharge them they certainly are responsible to the Congress and are responsible to the public, and I do not think that anything else is necessary.

Senator MALONE. Well, the Board now has the authority to issue more money at any time they want to issue more bonds or to make money more plentiful, do they not?

Mr. ECCLES. Well, they do not issue currency.

Senator MALONE. What do they do?

Mr. ECCLES. Well, I will tell you——

Senator MALONE. Just wait a minute.

Suppose that Mr. Martin today, after consultation with the Board and whoever he consults, decided we needed more money in circulation, just how would he do it?

Mr. ECCLES. He cannot put it in circulation.

The only way it gets into circulation is for the depositors in the bank to draw out the currency and if they draw out more currency than is now in circulation, the banks, the member banks, go to the Federal Reserve bank of their district and they have the Federal Reserve bank of their district ship them currency and charge their balances with the Federal Reserve banks.

They, in turn, disburse this currency to their customers and charge the customers' balances.

Senator MALONE. Then the banks have authority to put more money in circulation?

Mr. ECCLES. No; they do not.

Senator MALONE. Not Mr. Martin? He testified before this committee that he could put more money in circulation for what in his judgment would be needed for sustained economic growth.

Mr. ECCLES. They have authority to put it in circulation. But it can only get in circulation by the public preferring to draw out currency rather than maintain the deposit in the bank or rather than disburse their funds by checking account.

The great bulk of business is done by checking accounts, and the volume of currency that goes into circulation is not determined by the Federal Reserve, and it is not determined by the member banks. It is determined by the public who have the deposits.

Senator JENNER. Would not lowering reserve requirements put more money in circulation?

Mr. ECCLES. No; all lowering of reserve requirements would do would give to the member banks excess reserves with the Federal

Reserve bank. It would mean they had surplus reserves and that would have the effect of causing those banks to try to put those reserves to work, and to put them to work they would go into the money market and buy Treasury bills first.

Senator KERR. Or loan the money?

Mr. ECCLES. Well, that is a slow process. The immediate effect of it is to buy Treasury bills, bankers' acceptances and commerce paper, that is the first thing they do.

Senator JENNER. When you lower the reserve they have got to move out?

The bank cannot stand still.

Mr. ECCLES. No; they will try to use it.

Senator JENNER. Sure.

Mr. ECCLES. Now the first thing they will do is pay over what they owe the Federal Reserve.

Now the banking system has been in debt all last year to the Federal Reserve. At one time they were in debt up to nearly a billion dollars. In order to take care of customers they were loaning beyond their means and they were going to the Federal Reserve and borrowing money.

The first effect of easing the money market by the Federal Reserve was for the banks to pay off their loans at the Federal Reserve. When they had surplus funds some of them always had surplus funds; some of them were always in debt.

You have got to remember there are an awful lot of banks.

But looking at the banking system as a whole, when the banking system as a whole had free reserves, and by "free reserves" it means that the excess reserves which they carry with the Federal Reserve exceeds the amount that is being borrowed from the Federal Reserve.

The difference between the excess reserves and the amount being borrowed from the Federal Reserve banks is known as free reserves.

Now those free reserves force interest rates down in the short-term field. But the funds are available to loan.

It takes the pressure off of the collection of loans. It does not necessarily mean that it puts a lot more loans out, because business does not borrow unless it needs the credit and with a reduction in inventories which have been going on, businesses have been paying off loans.

Private loans are being reduced, in spite of the fact that the banks are looking for loans, and in spite of the fact that the pressure of trying to collect loans is less. Of course a bad loan they will certainly try to collect under any condition, or a doubtful loan, but where there is good credit, banks are not put under the pressure to collect those loans today.

Senator MALONE. Let's get back to this one particular thing of how additional money goes into circulation.

Mr. Martin testified that he had the authority, the board had the necessary authority to extend credit or put a few additional billion of dollars in circulation if in his judgment it would be needed for sustained economic growth.

(Off the record.)

Senator MALONE. How does the Federal Reserve Board put more money in circulation when it decides industry is going to need it in the next 2 or 3 years for a "sustained economic growth"?

Senator KERR. The Federal Reserve Board creates the opportunity for——

Senator MALONE. I want this in the record for the public to read if they are interested in the management of their economic systems.

Senator KERR. I am giving it for the record and he is writing it down.

It creates the opportunity for additional money in the form of credit to be put in circulation either by its open market committee buying government bonds in the market and thereby increasing the amount of credit which member banks have in the form of deposits with the Federal Reserve, which automatically increases their capacity to lend, or by reducing the reserve requirements which makes the amount of reserve they have on deposit more effective or which permits them to lend larger amounts against a given amount of reserves than they had been able to or the Federal Reserve can itself issue currency, up to four times the amount of gold which we have got.

Senator MALONE. The witness has denied that on three occasions.

Senator KERR. Well, Mr. Eccles, I am making a statement here and you could either verify it or correct it.

Senator MALONE. I will take him over now.

Senator KERR. I want to finish my answer to your question.

Senator MALONE. You finish it here and I will ask him.

Senator KERR. I thought you wanted information.

Senator MALONE. Yes, I want you to complete your very clear statement—then I want the witness to verify it or deny it.

Senator KERR. I say the third form, the third manner in which the Federal Reserve can put more money into circulation is to issue additional currency in accordance with their authority to issue four times as much currency as there is gold in their accounts, and they now have out approximately $30 or $31 billion in currency.

They can issue up to 80-some billion dollars under the present law and the present amount of gold stocks and they could issue that currency if they wanted to and either through the Treasury or the member banks put it into circulation.

Senator MALONE. Yes. That is the point the witness did not seem to understand—at least he denied it.

Senator KERR. That is the third way they can increase the amount of money in the channel of trade and commerce either in the form of currency or credit.

Mr. ECCLES. If they cannot——

Senator MALONE. Wait a minute, I will ask you the question?

If they wanted to reverse the process so there would not be as much credit then they would simply reduce the amount in circulation, call in the currency that they had issued or——

Senator KERR. As they bring it in——

Senator MALONE. Or reduce the amount of reserve.

Senator KERR. No, increase the reserve requirements.

Senator MALONE. Yes.

Senator KERR. Or either slow down their buying through their open market committee or through their open market committee sell governments.

Senator MALONE. That is the method used I am sure.

Senator KERR. Into the market.

Senator MALONE. Mr. Reporter, will you start from the beginning of Senator Kerr's statement and read it and see if the witness agrees with it?

I want the people to read the record.

I think we understand it.

Mr. Eccles, you are a witness now.

Go ahead and read it.

(Reporter read as directed.)

Senator MALONE. Senator Kerr is very good about it, and he has answered the question that they can put more currency directly into circulation.

I understood you on two occasions in answer to my question to say they could not do that.

Mr. ECCLES. Yes, I do not agree they can put more currency into circulation. They have the authority to provide the currency, if the bank customers demand the currency or want currency.

They have the power and authority to increase the amount of currency. They cannot turn currency over to the Treasury because they are limited in the amount of direct Treasury obligations that they are able to buy.

Senator MALONE. What is that limit?

Mr. ECCLES. It is a temporary authority of $5 billion, and I think that it is, the authority has been renewed either from year to year or every 2 or 3 years.

I had great difficulty in getting that authority and retaining the authority while I was chairman.

The authority was used in order to level out the money market during tax periods, and the credit was given to the Treasury on the basis of an overdraft.

Senator KERR. Will the Senator yield there for just a second?

Senator MALONE. Yes. I want to clear up this point without evasion.

Senator KERR. Does the Federal Reserve own $25 billion worth of Government bonds?

Mr. ECCLES. I think it is a little less than that.

Senator MALONE. Well, in that neighborhood; for the purpose of this question the exact amount does not matter.

Mr. ECCLES. $23 billion or $24 billion.

Senator MALONE. Yes. In addition to any amount of bonds they own they can honor an overdraft of the Treasury up to $5 billion?

Mr. ECCLES. That is right.

Senator MALONE. They can buy any amount of Government bonds in the market that they see fit?

Mr. ECCLES. In the market, not from the Treasury.

Senator MALONE. When they buy them they can pay for them in currency?

Mr. ECCLES. But they do not, how can they pay for them——

Senator MALONE. I am not asking if they do; I am trying to find out what authority they have.

Mr. ECCLES. Well, I suppose they could give bales of currency to Government bond dealers if they wanted to take currency.

Senator MALONE. Answer his question.

Senator KERR. You know they could.

Mr. ECCLES. But it does not mean anything, they could put it right back square in the bank. It would not make any difference.

Senator KERR. If the Federal Reserve mailed it to the bond dealer and the bond dealer put it in the bank, it would be circulated?

Mr. ECCLES. But there would be no difference whether you give them currency or credited it, the effect on the system would be the same.

Senator KERR. The point I was making, they had the authority to issue that currency and put it out if they wanted to?

Mr. ECCLES. But they have no way of keeping it out.

Senator KERR. I did not say to keep it out.

Mr. ECCLES. They have got the power to buy it by merely issuing credit.

Senator KERR. Or issuing currency?

Mr. ECCLES. They can issue credit.

Senator KERR. He was not asking about what the point was, he was asking you about the authority.

Senator MALONE. That is what I wanted to know.

Mr. ECCLES. Well, all right. They have the authority because they can, based on the gold reserve, they can put into circulation under the present gold reserve a certain amount of currency.

Senator KERR. Then you do agree with my statement?

Mr. ECCLES. I want to qualify it. I do not want to say yes or no. I think these yeses or noes leave a wrong impression and I think when I make an answer I have got a right to not just answer it yes or no.

Senator MALONE. No, I do not think you have.

If they have that authority I would like for you to answer his question, yes or no.

Whether it is advisable to do it or whether they did keep it in circulation or put it in the bank is the subject of another question.

Mr. ECCLES. I have answered the question that they can issue whatever amount of currency—that the amount of currency they can issue is related to the amount of gold they have got.

Senator KERR. And they can issue four times as much as the gold stock.

Mr. ECCLES. That is possibly true.

Senator MALONE. All right. Of course it is true and you, of course, know it as well as Mr. Martin, who testified he could do it—your answers merely confuse.

We can get away from that subject. My time necessary for questioning would be much reduced if you would just cooperate a bit.

I have heard all this before, but since you are a witness and are being questioned, we should keep the record straight.

You see we are trying to build a record so that the people of the country can read and understand. The committee also wants a record from which recommendations can be made to Congress; isn't that right?

Senator KERR. Correct.

Senator MALONE. Now, then, for the purpose of the record, they can issue currency against the gold that we have currently then on deposit. That would be $22.4 billion, or whatever it is, that we have on deposit in gold in depositories like Fort Knox, without reference to the foreign credit balances against it?

Mr. ECCLES. Yes; $22 billion and something.

Senator MALONE. Yes. Now they do not have to take into consideration the foreign balances against their gold that could at any time be presented for collection; is that your opinion?

Mr. ECCLES. That is correct.

Senator MALONE. They can issue such currency against the gold whatever they have on deposit here at the time?

Mr. ECCLES. That is right.

Senator MALONE. Regardless of who actually owns it; is that right?

Mr. ECCLES. That is right.

Senator MALONE. I asked Mr. Martin this question and I will ask you: If he inquired into the financial condition of a bank and that bank said that they were worth $15 million and it later developed that they owned only $1 million of it, and $14 million deposits could be drawn out the next day, what would he do with a banker who claimed his bank had that much money?

What do you think they would do with him?

Mr. ECCLES. I think the banks would be not very much different than the Federal Reserve is.

When they got a run on the bank and the people wanted their deposit in currency, the banks were unable to meet that demand when there was a run.

Senator MALONE. That was not the question. The question was if the banker claimed he owned the $15 million.

Mr. ECCLES. The Federal Reserve would not be able to meet the demand of gold, if——

Senator MALONE. Would you mind if I stated the question to you again?

The question was, if he inquired as to what the bank owned and what were its assets, and the banks told him $15 million and that included the deposits, would he be correct?

Mr. ECCLES. Yes, that is right, if——

Senator MALONE. In other words, the assets of the bank are all the money deposited in it?

Mr. ECCLES. That is the liability, the deposits are the liability.

Senator MALONE. Yes. Well, now, you are on the subject. Then isn't it a liability against this gold, the dollar balances that could be demanded?

Mr. ECCLES. Yes, it is a liability against gold, that is right.

Senator MALONE. How are we permitting the Federal Reserve to issue money against gold against which there are already liabilities?

Mr. ECCLES. Well——

Senator KERR. Isn't the simple answer to that question, Mr. Eccles, that that is the law?

Mr. ECCLES. Yes, but we can suspend the gold payment.

Senator MALONE. If we do suspend it you think it would have a depressing effect on our currency. Mr. Martin testified it would severely depress the dollar value on the world exchanges.

Mr. ECCLES. I think——

Senator MALONE. Just wait until I say this, and then answer it and if you will answer it as shortly as you can it will require less time to get the necessary answers.

Mr. Martin testified that it would have a very severe depressing effect on our currency in the world market if we stopped the payment in gold and also that it probably would cause a great depression in this country.

That is in the record. I can read it to you if you insist.

Then aren't we allowing him to do something dangerous—this is for future recommendations to Congress, as I understand these hearings—if we are going to maintain the value of our money, the stable value on the world exchanges, aren't we allowing a very dangerous situation by continuing to allow him to issue money against gold against which there are already foreign claims?

Mr. ECCLES. I do not think so. I would be very much opposed to changing the present law myself.

I would take the chance on the demand for gold——

Senator MALONE. But you are taking that chance.

Mr. ECCLES. That is right. I would be willing to take that chance on the assumption I could hold the dollar more sufficiently stable to keep them from withdrawing the gold and if it got down to the point where we did not have the gold, of course now we have some excess, $5 billion something in excess, and if it got down to the point where we did not have the gold then I would do what other countries do, just suspend gold payments.

Senator MALONE. And then the same thing would happen to our currency that happens to other nations' currencies? To that you agree?

Mr. ECCLES. Well it has not happened to the English currency, is one example.

Senator MALONE. I think a good deal of bluffing goes on there with our money.

What other nation would hold our currency up?

You know the trouble with us is that Uncle Sam has no uncle. Who do you think would put up the money for us to hold our currency stable on the world market?

We put it up for England.

Mr. ECCLES. I do not think the money we are putting up for England at the present time, we have not put up very much money for a considerable time.

Senator MALONE. How much do they owe us, do you think, if they paid all the debts with interest?

Mr. ECCLES. Well, I think the only debt that has not been canceled is the British debt that was made in 1946 of $4,350 million. Up until last year they had met——

Senator MALONE. The debt was $3¾ billion? You are right—ever so often we cancel the debts and start over.

Mr. ECCLES. Well, it was $4,350 million; $850 million represented the sale of war goods that were in England, and $3.5 billion represented a dollar credit that they got.

Senator MALONE. The so-called loan in 1946 was $3¾ billion?

Mr. ECCLES. They made the payments.

Senator MALONE. Any payment was always less than the current money gifts.

Let's keep the record straight.

Mr. ECCLES. What is that?

Senator MALONE. That they never pay their debts.

Mr. ECCLES. I may be wrong; my memory maybe does not serve me correctly.

Senator MALONE. $3¾ billion in 1946, and a few billion since?

Mr. ECCLES. Three and a half billion.

Senator MALONE. Would you correct the record?

Mr. ECCLES. It would not make any difference.

Senator MALONE. Correct your testimony. Will you do that?

Mr. ECCLES. I am leaving town. Will you correct that?

Senator MALONE. Who is the man? Will you identify yourself for the record?

Mr. ECCLES. He is from the Federal Reserve.

Senator MALONE. Identify yourself.

Mr. SHAY. Jerome W. Shay, of the Federal Reserve.

Senator MALONE. Are you going to correct the record? How much money did the Congress give England in 1946? Was it three and three-quarters billions or three and a half billions?

It is not necessary for you to answer now.

Mr. SHAY. We can supply that information, sir.

Senator MALONE. Will you?

Mr. SHAY. Yes, sir.

Senator MALONE. That will save time.

In other words, we do not call the lend-lease and the billions to Europe obligations. We have put out $70 billion, I guess you know that, since World War II, to foreign European and Asiatic nations of which England got a very substantial share.

We have never asked repayment as far as I know, but our taxpayers are getting "leg weary."

Do you think we ought to write off the $3¾ billion just making it even, so that no one knows that it is anything?

The loan referred to was subsequently ascertained to be $3¾ billion at 2-percent interest.

Mr. ECCLES. Well, if I had been writing the ticket at the time I would not have put it in the form of a loan.

I though that lend-lease should have been extended until there was a recovery in Western Europe.

I think that the end of the war did not determine the period when we should have discontinued lend-lease. And if I had been writing the ticket I would have given the British the additional three billion and a half.

Senator MALONE. Yes, I believe you would, but I am just too close to my taxpayers to give away their hard-earned money.

You think it should be written off now.

Mr. ECCLES. I would be perfectly willing to write it off.

Senator MALONE. And also the $4 billion that is recommended now and the entire $70 billion before this $4 billion if Congress grants it, and they have been in the habit of going along with the White House now for 25 years, and I guess there is no reason to suppose they will change.

I do not vote for the billions to Europe myself. But I am only one vote.

So you think it all ought to be just written off for the recovery of European and Asian countries?

Mr. ECCLES. I did not say that. I was referring to the British loan. I do not know the structure of the $70 billion you refer to.

A great deal of that was grants, military grants, and some were economic. There was some credit——

Senator MALONE. Would you then complete your testimony and show how much of it was economic?

Mr. ECCLES. No, I have not——

Senator MALONE. You said you would write it off.

Mr. ECCLES. That is right.

Senator MALONE. I wish you would correct your testimony in regard to the amount.

Mr. ECCLES. I am not going to get that information because in the first place, I have got a lot of other things to do. I have not got a staff to do the research work. I came over here——

Senator MALONE. Your answers indicate you do not remember very much about it.

Mr. ECCLES. Well, who would remember the complete division of $70 billion since the concluding of the Marshall plan?

There is nobody who is devoting their entire time to it that would remember.

Senator MALONE. You were for the giveaway program when you headed the Reserve Board. In my opinion the public never was for it, and I think it is helping to wreck our economy.

Mr. ECCLES. I do not know how much is loaned and how much is grants.

Senator MALONE. That is better—just say you don't know and we will drop it. Why don't you say you don't know?

Mr. ECCLES. I did say it.

Senator MALONE. We will drop it.

Mr. ECCLES. No, I would like to be treated with a little courtesy.

Senator MALONE. I am treating you with courtesy; however I would like some direct answers.

Mr. ECCLES. I do not think you are. I will answer your questions.

Senator MALONE. You do not answer them until it seems inevitable.

I never did get a direct answer from you in the issue of additional currency until Senator Kerr answered it.

Mr. ECCLES. I do not think that I am required to come over here—I can be subpenaed, that is true.

Senator MALONE. That is right, you can, however we do not want to do that.

Mr. ECCLES. That is right. I came over here voluntarily——

Senator MALONE. That is right, you did.

Mr. ECCLES (continuing). As a courtesy to this committee, and I expect to be treated courteously.

Senator MALONE. I expect to treat you courteously. But I expect to get answers to my questions or else have you say you cannot answer them—or just not question you at all.

Mr. ECCLES. I will give you some answers as I can and I will do it honestly.

Senator MALONE. As you care to.

Mr. ECCLES. And if you will do it courteously, I will answer it courteously.

Senator MALONE. The thing that brought this on is that you never did answer the currency question until Senator Kerr answered it for you; you evaded it.

Mr. ECCLES. I did not understand the question.

Senator MALONE. If you did not understand it, you do not understand the English language. That is not courteous either, I understand that.

Do you understand that there are about $40 billion a year that we appropriate now for war expenditures?

Mr. ECCLES. Yes, I think it is around $40 billion.

Senator MALONE. It looks now as though about $10 billion more will be appropriated, which will make about $50 billion.

What do you think would happen to this country if we did have peace suddenly and the war economy expenditures were discontinued?

Mr. ECCLES. Well, if the entire military expenditures were discontinued all at once, why we could have a very serious depression. I do not think there is much chance of that. I would like to say this on the question of these expenditures, that I have been as critical as anyone about the size of both the military expenditures and the foreign aid expenditures.

Senator MALONE. What would you do with them if you had it to do?

Mr. ECCLES. Well, I feel that we could have possibly gotten better results with possibly less money if it had been efficiently and wisely spent. I think that there has been a great deal of waste by the military. And I also think in our foreign-aid program that some of that I would not support and some of it I would. I think a substantial part of this foreign-aid program has been pretty wasteful.

Senator MALONE. You are right. All of it has been wasteful. How much would you support?

Mr. ECCLES. Well, I would have to know what was being asked for. It would be difficult to say but certainly it seems to me that $4 billion or $5 billion that is the amount usually, it has been the amount of the foreign aid, military and economic for some time, that it is not doing anything like the good, helping the United States anything like I think it is claimed.

Five billion dollars is a very small amount in the backward countries of the world, when you consider that they make up two-thirds of the world's population and are growing twice as fast as the industrial nations and what we are doing to improve their lot is—what we can do in relation to our size and our wealth is pretty small with the rate of population growth that is now going on, $44 million last year, $44 million, that some of the ideals we have, it seems to me, of improving the backward countries of the world, with what aid we can give is an illusion.

Senator MALONE. We have some backward areas of our own—undeveloped like Utah and Nevada—and some of the areas that were developed are gone now because of our free trade and giveaway policies.

As a matter of fact, I have never voted for it. I have been in all these nations and we have less friends then when we started the program.

On the Senate Floor when we left last year they were then talking about developing underdeveloped countries. That is what you were speaking of?

Mr. ECCLES. That is what I was speaking of primarily.

Senator MALONE. I said at that time that if any of the Senators wanted to go with me I would show them quite a bit of underdeveloped area out in our part of this country and I would also show them quite a bit of country that had been developed by private capital and had gone back to the brush on account of congressional policy.

I want to ask you a question, since you have touched on it, about the imports.

In 1934, you were part of the Government at that time, we passed an act transferring to the President the constitutional responsibility of Congress to regulate foreign trade through adjusting the duties. Under that same authority, in 1947, (you were still part of the Government) they organized what was called the General Agreement on Tariffs and Trade (GATT) and transferred that regulatory authority to Geneva.

Now, the 36 nations of GATT are regulating our national economy, adjusting duties or tariffs as we have come to call them, and further dividing our markets among themselves.

Do you believe that that should be continued—that we should extend the 1934 Trade and Agreements Act and leave it in the hands of Geneva and the President, to regulate our foreign trade and our national economy? Let the President—the State Department—continue to trade our industries for their foreign policy.

Mr. ECCLES. Well, I think that I do. I am not sufficiently familiar with its operation in the last 6 or 7 years.

Senator MALONE. It is operating just like it did under your administration. It has not changed at all. We are still importing the products of $2 per day labor and importing unemployment.

Mr. ECCLES. There are certain aspects of it that I do not like. There are other aspects of the foreign trade field that I do like. If it is a question of discontinuing our reciprocal trade program or continuing it, I think I would favor continuing it, rather than wiping it out.

Senator MALONE. Do you know how it works?

Mr. ECCLES. No, not entirely, not entirely.

Senator MALONE. Let me ask you a specific question and your answer would depend on my accuracy in interpreting it, so that nobody is bound. It provides, so the testimony of Mr. Dulles before this committee shows, that under the present program the President may at any time trade a part or all of any industry to foreign nations if he believes that it would further his foreign policy.

Assuming that Secretary Dulles is correct, do you believe that that is right and should be done?

Mr. ECCLES. Well, I think it may depend upon the importance of the industry. It would depend upon the ability to substitute something else for it certainly——

Senator MALONE. Of course having that power stops investments in domestic industries. I am asking you if you believe he should have that power, that is all.

Mr. ECCLES. You mean the President?

Senator MALONE. Yes, and the Secretary of State, who acts for him, and does the work.

Mr. ECCLES. No, I do not. I have felt for some time that the attitude of the State Department is primarily international, and that not enough consideration is given by them to the domestic interests. That was the experience that I had when I was over here, and I still feel that the State Department is leaning heavily in favor of the international, and I think neglecting altogether too much the domestic problems.

Senator MALONE. Then you do not believe they should have that authority?

Mr. ECCLES. No; I do not think they should have it. I am not in favor of putting restrictions and tariffs to the point that we do not do any foreign trade. I think that we must have a lot of foreign trade but I do not think that any one person should have that much power.

Senator MALONE. Then would it surprise you to learn that if we do not extend the 1934 Trade Agreements Act, which is generally known as the Reciprocal Trade Act, although the two words do not occur in the act, that we revert to the 1930 Tariff Act that puts in the hands of the Tariff Commission, an agent of Congress, a flexible tariff policy to be continually adjusted to equal the difference between the cost of production of an article here and that article or a similar article in the chief competitive nation and recommend that as a tariff? Then if that nation's economic situation worsens or gets better the Tariff Commission would adjust the tariff to meet that change; not to keep a product out, not a high tariff, not a low tariff, but to make the difference in the costs of production, so that Americans can compete for the American market.

You are aware of that, are you not?

Mr. ECCLES. No; I do not know the details of it. I had nothing to do with the administration of it.

Senator MALONE. Well, assuming that is correct, would you favor such a situation?

Mr. ECCLES. Well, I do not know enough about it to say either yes or no.

Senator KERR. Would the Senator yield for a moment?

Senator MALONE. Yes.

(Off the record.)

Senator MALONE. Do you know that the General Agreement on Tariffs and Trade organized in 1947 by the Executive (by the State Department, actually, but under the auspices of the Executive) transferred the regulation of our foreign trade to Geneva, Switzerland? These 36 foreign nations are, through multilateral trade agreements, further dividing our markets by the lowering of our tariffs. When they make these multilateral trade agreements they agree to lower tariffs on certain of their products, as they do on ours. But did you know that under the regulations (there never was a law—Congress never approved GATT) they do not have to keep their part of the agreement as long as they can show that they are short of dollar balance payments?

Did you know that?

Mr. ECCLES. No, I did not—I am not familiar with this operation.

Senator MALONE. Now, assuming that this is true, would you be in favor of continuing it?

Mr. ECCLES. Well, I have already expressed myself in reference to the reciprocal trade agreement, and also with reference to the law that existed in 1934.

I am not sufficiently familiar——

Senator MALONE. You have said that you are against the President or the State Department having that power—so I presume that you don't oppose 36 foreign competitive nations having it. I am telling you what it provides and on that basis would you answer it?

Mr. Eccles, are you in favor of 36 competitive foreign nations making these agreements?

We keep our part of the lowered tariff agreements but they do not need to keep theirs if they can show that they are short of dollar balance payments, and we divide our wealth until it is equal with theirs.

In other words, they put on import restrictions, they use tariffs, they use import permits, exchange permits, and in most cases manipulation of the value of their money in terms of the dollar to control the flow of trade.

They do all of these things.

Now, are you or would you be in favor of continuing that arrangement?

Mr. ECCLES. Well, I think——

Senator MALONE. Assuming that is true.

Mr. ECCLES. Well, I think so. I think so, for this reason: That these countries that are trading with us that are short of dollars, it would indicate that they are spending more dollars than they are receiving.

In other words, their imports are possibly in excess of their exports, so that the balance of trade is in our favor and there is a dollar gap.

You know that taking the foreign trade as a whole, there is a very substantial dollar gap and it has been largely met by this foreign aid, military and economic aid program, that has made possible the volume of foreign trade that we have had. And I think that we are hurt by imports, it is true, certain industries, but the country would likely be hurt in certain industries by the lack of exports, so that it is a dilemma.

If you are going to have foreign trade you have got to have imports as well as exports.

Senator MALONE. We have very little profitable trade; we subsidize our exports and give them billions of dollars to buy our goods.

When we went off of the gold standard, we started a spiral of inflation that priced this Nation out of the world markets. So it is blamed on the working men, but wages had to follow inflation.

Mr. ECCLES. I do not think the working men were responsible during the thirties.

Senator MALONE. Your testimony is a matter of record.

Mr. ECCLES. Yes, but that is within the recent years. You are talking about when we left the gold standard. I do not like to see that tied in 20-some-odd years ago with today's situation.

Senator MALONE. I favor a raise in wages and pensions to keep pace with inflation, and I think that is about what has happened.

When we went off the gold standard inflation really started. Mr. Martin testified last fall that a 1947 dollar was worth 47 cents. Probably now a 1934 dollar is actually worth about 35 cents, so we priced ourselves out of the world markets almost immediately.

We cannot compete with any world market since they have our machinery and our know-how and our skilled labor to train their men.

I am sure you know that.

Mr. ECCLES. They have their own, we have some of theirs, too.

Senator MALONE. People who are making the statement that we can compete on a free trade basis with low-wage foreign nations having our know-how and machinery are, of course, simply uninformed to give them the best of it. I was in northern Chile. You know, of course, that they have there the finest, latest, copper smelter in the world. Our engineers are building these late model plants all over the world and taking 5 or 6 percent American workers to train the low-wage natives. Then they use cheap water transportation to ship their products here.

We are subsidizing our exports. As you just said, we pass a 4 or 5 or 6 billion a year foreign aid program. Then, as you know, we loan money to these nations through the Import-Export Bank to build the plants to compete with us. So what you are really saying is that you are in favor of buying our own foreign trade—of subsidizing it, of giving them the money to buy it.

Mr. ECCLES. I do not know that we do that. If we took more of their goods, we would be subsidizing it more than we do if we did not take the goods we take.

There is a deficiency. We export more of our goods than we import of their goods, and that leaves the deficiency.

Senator MALONE. It was a good deal like this when we were questioning the State Department here on the sugar bill. You know that we extended it last year or the year before—time moves pretty fast. At that time the State Department was adamant that, after we had satisfied our own beet and cane sugar growers and those in Hawaii, the Philippines, Puerto Rico, et cetera, we purchase 88 percent of the remainder of our consumption from Cuba. So I asked this State Department official why he was so adamant that Cuba retain that 88 percent of exports to us.

He said, why they buy our wheat. Well, I said, that is very interesting. When they buy our wheat do they pay our support price or do they pay the world price. He said they paid the world price. I then asked, when we buy their sugar what do we pay, the world price or our support price? He said, "We pay the support price."

So I computed the cut, and it is in the record, that every hundred pounds of wheat we export to Cuba costs the American taxpayers $1.35 and yet they call it foreign trade.

We are doing that all over the world. I think you know that. Do you not?

Mr. ECCLES. Well, we are giving a lot of our surplus agricultural products and taking local currencies, I know in payment of our surplus products.

Senator MALONE. And then giving these currencies back to the nation. What would happen if there were no controlled currencies in the world and they were all valued at their market value? Could they not buy our goods with their own currency if they just let it alone and did not over valuate it in terms of the dollar and then we could use that currency to buy goods from them that we might need?

Mr. ECCLES. I do not think it is possible to——

Senator MALONE. It is not possible that they might do that, I agree with you.

Mr. ECCLES. I do not think it is possible to get away from an emergency currency or emergency economy.

Senator MALONE. We create the emergency—we have had one for 24 years now. I want to hurry this along. I want to talk about nations like Bolivia as an illustration when I was there in 1954. You always have to turn your dollars in to a central bank and take what they say the dollar is worth in their currency, isn't that true?

Mr. ECCLES. Wherever the country has exchange control the dollar has to be turned in and take the local——

Senator MALONE. Practically all of them have it. And they fix the exchange value by executive order.

Mr. ECCLES. That is right, practically every place where they have exchange control.

Senator MALONE. That is right. Now then, when you turn the dollar into a Bolivian central bank they gave you 500 Bolvianos, when I was there but it was worth 1,700 on the street so they took two-thirds of it the first go around, and that is the reason you cannot take their currency for anything.

So if there was a present official currency exchange of 1,700 Bolivianos the same as the market rate then could you not take the Bolivianos in payment of what they bought here and if you needed anything from Bolivia use their Bolivianos to pay for it?

Mr. ECCLES. Well, I do not think that you would get imports from Bolivia except you gave them dollars, I do not think you would get any imports otherwise.

They have to have the dollars to pay for the things they need to buy here.

Senator MALONE. You know for a long time currency was based on gold or silver or both and when you exchanged your currency for that, you reserved a foreign nation a piece of paper money that represented the same number of grains of gold or the same number of ounces of silver as you exchanged for, so it was a free exchange. No one profited or lost.

Now, as long as that obtained, there was honest trading.

I will ask you then, can there be honest trading when they manipulate the price of their money in terms of the dollar?

Mr. ECCLES. Well, I do not think they manipulate it.

Senator MALONE. Of course you know they manipulate it.

Mr. ECCLES. I do not think a country manipulates its money.

Senator MALONE. That is a statement out of this world.

Mr. ECCLES. In relation to the dollar, and I do not think that either gold or silver would create a stable currency.

We had gold, and we were on the gold standard——

Senator MALONE. We are on the gold standard now, you say, except only a foreigner can possess the gold.

Mr. ECCLES. We are on a gold reserve standard.

Senator MALONE. We have gone all through that.

Mr. ECCLES. But we are not on a convertible standard.

Senator MALONE. But I understood you to say they do not manipulate their currency in terms of the dollar, and I know you do not mean that.

Mr. ECCLES. I do not think they do. I think that the—I do not know; there may be dishonest operations.

Senator MALONE. I certainly would consider it dishonest, but it is our fault, since we do not have to try it. France has an official value on their money today, which is about one and a half times the actual value.

Mr. ECCLES. You have got a black market. You have got a lot of black markets.

Senator MALONE. You would not have a black market if there is a free exchange on the exchanges of the world, would you?

Mr. ECCLES. Well, there is a free exchange. There is a free exchange of francs.

Senator MALONE. There is, of course, no free market for francs in France. They specify the number of francs equal to a dollar according to their law. I have been in France several times, and if you are in France you have to abide by it unless you go out on the black market. But if they had no set value and you just took the market value, there would be no black market, and you would just as soon have the number of francs that the market said the dollar was worth, as the dollar, would you not?

Mr. ECCLES. Well, there would be no stabilization of the currencies in relation to one another internationally, none whatever, and I think that would be a chaotic condition.

I think it is bad enough today. I think the attempt by the fund, by the international fund, to maintain stable currencies, creates a much better international trading condition than would otherwise exist.

Senator MALONE. There would be no chaotic condition if the nations would let their currency alone on the exchanges.

Mr. ECCLES. And I am favorable to the job the fund is doing. I think it is a very difficult one, and I realize that the currencies of the world, a good many of them, are not very stable.

Senator MALONE. Only about 3 or 4 nations in the world allow the market value of their money to obtain.

The rest are manipulated. I hope you will check your statements on that subject before you appear before another committee.

Now let's go back.

The Constitution of the United States pointedly separates the regulation of the national economy and the foreign trade from the fixing of foreign policy. It puts the first in the legislative branch. It puts the second in the executive branch.

Isn't that true?

Mr. ECCLES. I do not know.

Senator MALONE. That is a good answer; let's pass on to the next one. No explanation is needed.

If that is true, then, that by the 1934 Trade Agreements Act we tied the two together and put them under the Executive, then Congress now cannot control or prevent the Executive trading part or all of any American industry in order to advance its foreign policy, nor has Congress anything to do with the manipulations in Geneva nor with the regulations of GATT that state that foreign nations need not live up to their agreements as long as they are short of dollar balance. Do you think we ought to return to the Constitution of the United States or should we continue this setup?

Mr. ECCLES. Well, I think, of course, it is up to the Congress to make that decision, as you know.

Senator MALONE. That is right. But you are a witness.

Mr. ECCLES. As I said a while ago, all of the pros and cons on this complicated, important subject, I am not familiar with.

Senator MALONE. All right. That is good right there.

Mr. ECCLES. I have not studied it.

Senator MALONE. You do not know and that is all right. I will take that for an answer.

Now then, you are perfectly aware that there is practically no industry, whether it is minerals or textiles or crockery or machine tools or cattle or wool, in which the United States can compete successfully with foreign nations that have American capital and American know-how.

Are you aware that that is true under present conditions with our tariffs down to about 15 or 20 percent of what the equalization amount would be?

Mr. ECCLES. Well, I know on balance that we export more than we import.

Senator MALONE. We give them the billions to buy the goods and subsidize them.

If you want to save time, if you want to answer the question, do you know that?

Mr. ECCLES. No, I do not know it.

Senator MALONE. All right. Good. You know our mines are shut down in Utah, don't you, except the copper mines and they are laying off men? You do know that?

Mr. ECCLES. Well, the Park Utah is not shut down.

Senator MALONE. No, it is not entirely shut down but they have been laying off a good many men. I am talking about the tungsten and manganese and the various other minerals.

Mr. ECCLES. Park Utah are not paying union wages; they are paying a less wage and they are operating.

Senator MALONE. Do you know that most of your mines though are shut down or laying off men? They are in Nevada.

Mr. ECCLES. Yes, I think the silver and the lead, tungsten——

Senator MALONE. Not the silver at all.

Mr. ECCLES. The Silver King, the Park Utah, the Tintic Standard are, I think, shut down.

Senator MALONE. That is right. Let's pass the minerals, they are only part of the picture.

Do you know the textiles are severely injured? They are coming in from Japan made by 20-cents-an-hour labor and the only way our firms are in business now, apparently, is Mr. Dulles asks Japan once in a while to slack up a little on exports to us out of the goodness of their hearts.

Mr. ECCLES. Yes, I know Japan is importing a good many textiles.

Senator MALONE. Do you know the crockery business is entirely out?

We have almost none in the United States except the higher class ware.

Mr. ECCLES. I do not know to what extent it is out; no.

Senator MALONE. Well, it is practically gone, you do know that, don't you?

Mr. ECCLES. No, I do not know it.

Senator MALONE. Well, send your wife down to the store sometime and she will tell you what is on the shelves.

Machine tools are on the way out. You would not know that either?

Mr. ECCLES. Well, I thought our machine-tool business was doing pretty well. I happen to be connected with companies that had to buy a good many materials, and we had long delays. There was a big backlog of orders.

Senator MALONE. Do you know that the machine-tool business in Germany and other places is flourishing and the product is coming in here practically without tariff to equalize the wages and taxes?

Mr. ECCLES. Yes, I would think that would be true of the Germans.

Senator MALONE. Then you do not believe that that has anything to do with our, whatever they call it, recession or depression, or distressed conditions?

Senator KERR. Recession.

Mr. ECCLES. No, I think that has very little to do with that.

Senator MALONE. It is a very interesting piece of information. You know cattle now are starting to come in from Venezuela?

Mr. ECCLES. Cattle, you say?

Senator MALONE. Yes.

Mr. ECCLES. Well——

Senator MALONE. Do you?

Mr. ECCLES. Well, I did not know. I didn't know we were getting cattle from Venezuela, I know we are getting a lot of oil from Venezuela.

Senator MALONE. Cattle are going to be shipped in at 15–16 cents a pound.

Domestic oil production is down because of imports.

Did you know that if we now returned to the Constitution of the United States and the Tariff Commission, an agent of Congress, regulated the tariff to make the difference in the cost of producing an article here and a like article abroad, regulating it flexibly so that it just meets that difference—not high or low—that perhaps most of these industries would be back competing with each other for the American market.

That would make considerable sense, would it not?

Mr. ECCLES. Well, all I know is that you cannot sell more than you buy.

Senator MALONE. Well, let me ask you this final question. Did you know that right at this moment, if you deduct the amount of cash we are giving these countries and the amount of subsidy we are putting into the products that we export, we are exporting a less percentage of our exportable goods than we were in 1934 when the Act was passed?

Mr. ECCLES. No, I did not know that.

Senator MALONE. Well, I will tell you that it is a fact.

Would you be in favor of that if it is a fact?

Mr. ECCLES. Well, I do not know enough about the details——

Senator MALONE. That is a good answer.

Mr. Chairman, I have completed my questioning, am finished and thank you very much. The committee is appreciative.

Senator KERR. Mr. Eccles, we want to express, the chairman of the committee called me and asked me to do it for him, our sincere appreciation to you for coming here and spending the time with us that you have, and making the contribution that you have.

(Off the record.)

Mr. ECCLES. Thank you. I was glad to make the trip over here to meet with the committee and to express my views and if they have been worth anything then I feel well repaid.

Senator KERR. Thank you very much.

Senator MALONE. Could I say on the record I appreciate your being here and some time we will have a talk.

Senator KERR. We will recess, and reconvene at 10 o'clock tomorrow morning.

(Whereupon, at 1:05 p. m. the committee was adjourned, to reconvene at 10 a. m., Friday, April 18, 1958.)

INVESTIGATION OF THE FINANCIAL CONDITION OF THE UNITED STATES

FRIDAY, APRIL 18, 1958

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 Robert S. Kerr presiding.

Present: Senators Kerr (presiding), Anderson, Martin, Williams, Flanders, and Jenner.

Also present: Elizabeth B. Springer, chief clerk, and Samuel D. McIlwain, special counsel.

Senator KERR. We are happy to have Dr. Slichter with us this morning.

We regard him as one of the best known American economists today. He has been Lamont University professor of economics at Harvard University since 1940.

Without in any way expressing the view of the author of the statement, or expressing approval of the operators of the magazine that made the statement, I concur in what Fortune magazine called him, as being the public's economist, labor's economist, and the businessman's economist.

Doctor, we are happy to have you here and you may proceed with your statement.

STATEMENT OF SUMNER H. SLICHTER, PROFESSOR OF ECONOMICS, HARVARD UNIVERSITY

Mr. SLICHTER. Thank you, Mr. Chairman.

It is a pleasure to be here. My remarks will fall into five parts. I wish to look briefly at the longrun prospects of the economy which I think have been little affected by the current recession.

Then I wish to discuss briefly the nature and causes of the recession itself.

Then I wish to examine the prospects for recovery a bit, and I should like to discuss what might usefully be done to promote recovery by business and Government; and finally, I shall conclude with a few remarks, not very long, on some aspects of the problem of inflation.

The long-run prospects of the American economy rest primarily upon three things: (1) The capacity of the economy to raise productivity, (2) its capacity to increase the demand for goods, and (3) its capacity to finance economic expansion.

The capacity to increase productivity depends more upon the people and their institutions than upon natural resources.

One can verify that statement readily by looking at various economies around the world. Some economies, such as Denmark, for example, have high productivity, although their resources are not particularly rich.

Institutions are important because they determine opportunity and security, but most important of all are the qualities of the people—their desire to better themselves, their courage, their spirit of enterprise, and their know-how. In this day and age the kind of know-how that counts most in determining productivity is the know-how of the scientists, the engineer, and the business administrator.

Both the number of technicians and the scale of research in the American economy are growing rapidly. An even faster growth would be desirable, since we have Russian competition to meet, but nonetheless know-how in our industry is growing faster than it has grown at any time in the past.

For example, the number of scientists and engineers employed in specialized research more than doubled between 1941 and 1953, increasing from 87,000 in 1941 to 192,000 in 1953. Between 1953 and 1956, expenditures of industry on research and development more than doubled.

That does not count the money the Government spent on research, and you will find in this morning's paper a report of the McGraw-Hill survey, which shows that in this year 1958, business enterprises plan to increase their research expenditures by 14 percent.

I think one should regard the research as representing a new industry. I have called it at various times the industry of discovery. Its product is knowledge. It is a booming industry, and in the midst of this recession it is expanding by 14 percent.

Senator ANDERSON. Doctor, do you prefer to complete your statement before any questions?

Mr. SLICHTER. Well, I should be glad to be guided by the pleasure of the committee in that respect.

Senator MARTIN. I am wondering if it would not be better if the doctor would go right ahead because we will all start asking questions.

Senator ANDERSON. This was merely for clarification. You said this amount you listed here was industry's own money. Does it include Government-contracted research?

Mr. SLICHTER. No.

Senator ANDERSON. That is what I wanted to get clear. Industry does spend a lot of money for the Government. This is their own money spent for themselves?

Mr. SLICHTER. That is right.

Senator ANDERSON. I am sorry to break in.

Mr. SLICHTER. That is a helpful clarification.

Well, since I am going to say some controversial things, and you are going to wish to argue with me, we might as well get through with my statement.

Senator ANDERSON. It was not that point at all. I merely wanted to be sure that the record would indicate that these Government contracts are excluded even though the private firm is the contractor. This is their own money?

Mr. SLICHTER. Yes. American management in the last half century has developed methods especially in cost control and industrial engineering that have been much admired by visiting productivity teams from abroad, but important new improvements in the art of management may be expected.

We need and we are gradually getting businessmen who are also scientists and engineers and who are good at working with scientists and engineers. Furthermore, it is reasonable, I think, to expect special efforts in business to speed up staff work and to solve the difficult problem of reconciling originality and individuality among managers with good team work.

Productivity per man-hour had a sensational spurt between 1947 and 1952, increasing by 21.7 percent in that 5-year period. That spurt was probably more apparent than real, and it seems to have reflected abnormalities in the figures for 1947.

I will not discuss those abnormalities but I think that people ought to be warned against basing comparisons upon the 1947 figures.

In the next 5 years from 1952 to 1957, the increase in productivity per man-hour was much less, 12.6 percent, and then in the 2 years 1955 to 1957, the increase was only 2.6 percent, that is 2.6 percent over a 2-year period.

It is of interest that the labor productivity in agriculture in recent years has been rising more than twice as fast as labor productivity outside of agriculture.

Thereasons for the poor productivity record for 1955 to 1957 are not understood. They may be due to faults in our statistics. But we do not understand those figures as yet.

The second determinant of the long-run prospects of the economy are its capacity to increase the demand for goods.

As rising productivity makes goods more abundant, perhaps we shall eventually pause and ask what all this eager striving for more output is for. But up to the present few Americans have asked that basic question.

The same advances in technology which raise productivity also tend to increase demand, because through these advances in technology people are offered new kinds of goods—bicycles, phonographs, automobiles, telephones, radios, television sets, refrigerators, outboard motors, movie cameras, and many, many other things—that people have been eager to incorporate into their standard of consumption.

They do that by spending a more or less constant proportion of their rising per capita incomes on consumption. Economists for some years have been struck by the fact that as per capita incomes rise the proportion of per capita income saved does not rise.

Success in increasing the demand for goods depends also in part upon the spirit of enterprise in the community, and upon the number of persons who have the optimism and courage to start new concerns. I do not think people realize generally what a high business birthrate we have in our economy. The number of enterprises outside of agriculture increased by well over 1,300,000 from the first of January 1947, until the middle of 1957—from 2,995,000 on January 1, 1947 to 4,332,000 on June 30, 1957. There are almost a thousand business births a day. There were 341,000 in 1953, 331,000 in 1954, 380,000 in 1956 and in the first half of 1957 business births were occurring at more than a thousand a day. There were 211,000 in that same period. There is a high infant mortality among business concerns, too, and the discontinued businesses in the first half of 1957 were 176,000.

The third basic determinant of the capacity of the economy to expand is its capacity to finance expansion.

I think our economy must be regarded as well supplied with funds to finance the expansion of industry, and this is true in spite of the great increase in tax rates on both corporations and individuals.

Gross private savings is virtually as large a proportion of the gross national product as it was back in 1929, when tax rates were low. It was 15 percent then, and 14.7 percent in 1957. Personal savings as a percentage of disposable income has risen in spite of high taxes from 5 percent in 1929 to 7 percent in 1956, and 6½ percent in 1957. There was a small drop in the ratio of gross business savings to the gross business product from 12.1 percent in 1929 to 11.3 percent in 1956.

Since 1950, gross private saving increased 56 percent, from 40.7 billion in 1950 to 63.6 billion in 1957. It does not make much difference what date one takes, one finds a substantial increase in gross private saving.

Although one has heard much about the scarcity of savings in recent years, interest rates have been extraordinarily low by historical standards.

The yield on high grade municipal bonds in 1957, according to Standard and Poor's, was 3.60 percent in comparison with 4.27 percent in 1929, and there was a similar drop in interest rates on AAA corporate bonds which were 4.73 percent in 1929 and 3.89 percent in 1957.

It is of interest, too, I think, that business today relies much less upon short-term debt for financing its operations than it formerly did.

Between 1929 and 1957 when the privately produced output increased nearly threefold—from $100.1 billion in 1929 to $395.5 billion in 1957—the loans of all commercial banks increased only about half as fast—from $35.7 billion to $93.9 billion—and the ratio of corporate sales to short-term corporate debt increased from 3.3 in 1929 to 5.5 in 1956.

Senator KERR. May I interrupt right there, Doctor?

On page 5 you give the figures of what the loans of all commercial banks were in 1929 and 1957 as $35.7 billion and $93.9 billion, in the fifth line on page 5.

Mr. SLICHTER. Yes.

Senator KERR. If those figures are accurate then the 163 percent figure does not reflect that?

I just wonder which of the two would need correction.

Mr. SLICHTER. Well, let's see; $93.9 billion minus $35.7 billion.

Senator KERR. I see.

What you are saying is that there has been 163 percent increase?

Mr. SLICHTER. Right.

Senator KERR. I apologize.

I thought you had said that the 1957 figure was 163 percent of the other figure.

Mr. SLICHTER. No; I am talking about the increase.

Senator KERR. I beg your pardon.

Mr. SLICHTER. In spite of the large volume of investment-seeking funds, the view is often expressed that there is a shortage of capital willing to take long chances for the sake of the possibility of large profits.

The high business birthrate shows that there are many people who are willing to start enterprises. It is common knowledge that many of these persons could use more capital, but the high infant mortality rate among new concerns shows that a large proportion of business starters have more courage and hope than judgment and skill.

Senator KERR. Is that an economic or philosophical observation?

Mr. SLICHTER. I think it is both. [Laughter.]

I think we ought to—I think it is an admirable characteristic of our civilization that we have so many people with that amount of courage and hope but I wish the infant mortality could be cut. It is high.

At any rate, the supplier of venture capital has a difficult problem of choice, and he must have a fair proportion of big successes to compensate for his losses.

As we learn better how to judge business risks, perhaps investments in new concerns will show more satisfactory results. But the assertion that new enterprises as a whole are failing in substantial measure to get the amount of capital which they could put to good use and which they really deserve to have in view of the quality of their management, must be regarded as unproved. It may be true, but we do not have substantiating evidence as yet.

Similar to the view that there is a shortage of venture capital is the view that there is a shortage of capital available for intermediate-term loans to small enterprises, not venture capital but loan capital—that is, capital for loans too long to be suitable for commercial banks and too small to be suitable to be handled in the open market through investment bankers. There is some shortage of medium-term loan capital, but there is an even greater shortage of attractive risks. These facts are demonstrated by the recent experience of industrial development corporations.

Each of the New England States has an industrial development corporation. These corporations have been of great use. The Massachusetts Business Development Corp. is the largest of the six. The most striking fact about these industrial development corporations is that they have grown only at a moderate pace. The Massachusetts corporation made or participated in 99 loans totaling $13,894,500 between 1953 and the end of 1957. This modest growth reflects the difficulty in finding attractive investment opportunities. In a highly competitive economy, such as ours, in which profit margins tend to be low, the new concern must have a product of unique merit or it must have some unique operating advantages or other special characteristics in order to offer an attractive risk for a development bank.

I think I should add here that, before going on to talk about the recession, just a couple of observations on 1 or 2 aspects of the capital market.

The cost of small loans running from $1,000 to $10,000 is a little bit less in the New York banks than it is in the banks of the South and of the West. According to reports published by the Federal Reserve, the average cost in New York of a loan in the category of $1,000 to $10,000 in March of 1957 was 5.26 percent, and in 11 southern and western cities it was 5.42 percent.

And it is of interest that the spread in the interest rate on small bank loans and large bank loans narrowed during the period of credit restraint. In 1955 the average rate on small loans, $1,000 to $10,000, was 5 percent, and on loans of 200,000 or more was 3½ percent. In other words, there was a 1½ percent difference. By 1957 the difference had dropped to 1 percent. The rates had gone up in each case—from 5 percent to 5.5 percent in the case of the small loans, and from 3.5 percent to 4.5 percent in the case of the large loans.

I do not think that any of these three basic determinants of our capacity for long-term growth—our capacity to increase productivity, our capacity to increase demand, or our capacity to finance expansion—has been affected by the recession. And with that observation, I pass on to the second part of my remarks, to discuss the nature and causes of the recession.

The current recession is concentrated in the manufacture of durable goods, both industrial equipment and consumer durables, in mining, some parts of construction and in transportation.

There is a rather startling concentration of the drop in employment in durable goods manufacturing. More than half of the drop in no farm wage and salary employment which we have experienced since last August, 53.8 percent, was in durable goods manufacturing. And yet durable goods manufacturing accounts for less than one-fifth of nonfarm jobs.

In the fields of retail and wholesale trade, Government service and miscellaneous industries, which supply more than one-half of the nonfarm wage and salary jobs, the drop in employment in March was only one-third as large as in durable goods manufacturing.

Although the recession has been concentrated in durable goods manufacturing and related parts of the economy, it has been spreading slowly, and it has become broader.

For example, most of the small drop of employment in trade and in the service and miscellaneous industries has come about since December.

There was very little employment drop in these industries between August, when the recession started, and December.

The recession is marked by widespread attempts on the part of business concerns and banks to improve their liquidity. This attempt to reduce short-term liabilities and to build up short-term assets is normal in a recession. Evidence of the pursuit of liquidity is found in the higher level of new long-term corporate bond issues, some of which have the purpose of paying off bank loans; in the rapid liquidation of inventories for the purpose of paying off short-term liabilities; and in the reduction of business loans by banks, which have fallen in the case of the weekly reporting member banks, by $1.409 million between December 31 and April 2. This fall compares with the rise of $225 million in the corresponding period last year.

The pursuit of liquidity is also evidenced in the strong preference for short-term securities resulting in a widening spread between short-term and long-term interest rates, and in the reluctance of business concerns to start new projects involving long-term capital expenditures.

Once business enterprises have improved their liquidity to their satisfaction, they will undertake many expenditures that they are not now willing to make.

The pursuit of liquidity at times in the past has been quite disastrous, producing reenforcing reductions in disbursements and incomes. An encouraging feature of the present recession is that the pursuit of liquidity has not produced a self-sustaining spiral of contraction.

On the contrary, the recession has been characterized by a widening gap between the rate of final sales and the rate of production.

Back at the peak of the boom in the third quarter of last year, we were producing at an annual rate of about $2.7 billion more than we were selling—that is, we were adding to our inventories at that rate of about $2.7 billion a year.

By the first quarter of 1958, final sales were exceeding production by around $7.5 billion a year.

Between the third quarter of 1957 and the first quarter of 1958 production dropped by about $10 billion a year. But final sales dropped only about one-third as much by $5.5 billion a year. This marked excess of final sales over production.

The first quarter of 1958 was made possible partly by the failure of cuts in production to pull down the buying of goods by the Government and partly by the small effects of cuts in production upon the general level of personal incomes, which in March were only 1.7 percent below the all-time high of last August. And sales appear to have been helped by a small drop in the rate of personal savings between the third quarter of 1957 and the first quarter of 1958.

Sometimes one hears an easy credit policy in a period of recession criticized on the ground that it is futile, that it does not do much good. Sometimes the expression is used that you can't push a string.

Senator MARTIN. You can't push a what? I did not hear you.

Mr. SLICHTER. You can't push a string.

Senator MARTIN. Oh, yes.

Mr. SLICHTER. That is not true. An easy credit policy facilitates the achievement of liquidity. It accelerates this process of getting more liquidity, which is a part of getting ready for expansion.

Senator KERR. Isn't one of its great advantages the fact that it reduces the strong pressure for accelerated liquidation which is one of the principal causes of expanding deflation?

Mr. SLICHTER. Well, that could be. We have had recessions in the past at which the rate of liquidation has been determined by the banks rather than by business enterprises. I do not think that is true in this recession.

Senator KERR. Don't you think the fact that that is not true is maybe certainly one of the most important reasons for the fact that this recession is not a good deal deeper than it is?

Mr. SLICHTER. I think that is true, and of course the easy-credit policy has helped the new issue market, and has helped this important process of shifting from short-term indebtedness to funded indebtedness.

Now on the causes of the recession: I do not think we should pretend to understand the causes of the recession too completely at this early date.

The data need to be examined much more thoroughly than has been possible up to now.

Senator FLANDERS. Mr. Chairman, may I interrupt for a moment?

Senator KERR. Yes, Senator.

Senator FLANDERS. I must confess, Professor Slichter, that since I am not sure that I can stay through, I am reading ahead, but in reading ahead, I have come to a word which was just used by our chairman, which I want to make sure is defined.

I understood, Mr. Chairman, that you just used the word "deflation" as I understood it, in some sense as describing what we are in now. Was I correct in that?

I am raising this question again because on page 15 which we will come to in due time, he speaks, the professor speaks of the cutting of debts could be dangerously deflationary.

I am wondering if there is any use of the word "deflation" such as I understood you to use or which perhaps I could apply to this passage in the future, which is anything other than a drop in the price level.

Senator KERR. Well, let me say, in answer to the question, that at the beginning of this hearing my concept of the word "inflation" was more or less limited to the situation that exists when there is an excess of dollars trying to buy goods that are in short supply.

As it has been commonly used here, and I would say generally, that the depreciated or the depreciating value or purchasing power of the dollar is the result of inflation. However, since it is being more or less used here as being synonymous with inflation or as the definition of inflation, I have begun the use of the word "deflation" as the opposite situation to the situation of inflation as I have just outlined it.

Senator FLANDERS. It is not fair, either to the rest of you or to Professor Slichter, to move ahead to page 15, but I wonder if we cannot ask him in what sense he uses the words "inflation" and "deflation."

Senator KERR. I think that would be very well.

Mr. SLICHTER. I think on page 15 where I speak of the repayment of consumer indebtedness as being deflationary, I am understanding by deflationary influence, and influence which tends to limit the demand for goods.

Senator FLANDERS. And that is quite without reference to the price level?

Mr. SLICHTER. That is right. The price level may resist——

Senator FLANDERS. I think it is important to know.

Mr. SLICHTER. May resist deflationary influences.

Senator FLANDERS. Do we ever use the contrary word, "inflationary," in any reference except with relation to the price level?

Mr. SLICHTER. I think we use inflationary influences with reference to the demands for goods. You may have inflationary influences tending to put up the prices of goods, and you may have Government price controls, for example, which prevent the price level from rising. We had in the war what we called, if I remember the expression, "concealed inflation." Prices did not go up, but the goods weren't on the shelves.

Senator FLANDERS. Well now, however, let us leave the "a-r-y" off of both of them, and can you speak of inflation and can you speak of deflation without reference to the price level?

Mr. SLICHTER. Ordinarily I don't think I would try. Ordinarily I mean by inflation a rise in the general level of prices, as distinguished from a rise in the prices of a particular part of the output of the country; and I would mean by deflation, a drop in the general level of the price level.

But the country may be in the grip of inflationary influences or it may be in the grip of deflationary influences, and it may be suffering from those influences without an upward or downward movement of the price level. Hence, I do not think that it is wise to regard the absence or presence of a problem as indicated by the movement of the price level.

The price level may not be a symptom which reports either inflationary influences in the economy. The deflationary influences may not push down the price level, but they may push people out of jobs, and the economy will be in the grip of these deflationary influences with the price level remaining unchanged, but with people losing their jobs because of the inadequacy of demand or some other causes.

Senator FLANDERS. Could we not, Professor Slichter, perhaps use the terms "expansive" and "contractive" in place of "inflationary" and "deflationary," particularly since those latter terms seem in some ways to be unrelated to inflation and deflation?

Why not say expansive and contractive influences. Because I do see or think I see, in your explanations, a kind of a gap between the meaning of inflationary and inflation, and between the meaning of deflationary and deflation.

Mr. SLICHTER. Well, I am trying, as I sit here——

Senator FLANDERS. They are connected, of course.

Mr. SLICHTER. To think whether expansive could be always substituted for inflationary and contractive could always be substituted for deflationary. I am not sure.

I think the substitution could be made most of the time, but I do not see any reason for not talking about inflationary influences or expansive influences as one sees fit.

An expansive influence that doesn't increase demand faster than the accompanying increase in productive capacity might not be an inflationary influence.

Senator KERR. Is it not entirely possible that an expansive operation might be the cure for an inflationary condition, if it were an expansion of productivity of goods that were in short supply?

Mr. SLICHTER. Well, yes. That is, if one is thinking of expansion of supply rather than expansion of demand. But I can see difficulty in trying to eliminate the use of the expression "inflationary influences" and substitute "expansive influences." I think we have this sort of situation:

Every once in a while an economy tries to grow too fast for its own capacity to grow; and when it tries to grow faster than its capacity to grow—which is determined by the size of its capital goods industries and by the annual increment in its labor force—you have something more than expansive influences. You have inflationary influences.

Senator FLANDERS. Mr. Chairman, my difficulty—I am not sure I am out of it yet, but perhaps I can explain it a little more clearly—was to apply the term "deflationary" to a period in which, so far as measured by the Consumer Price Index and, as I remember, the Wholesale Price Index as well, we are not having deflation in the sense of the purchasing power of the dollar.

So to speak of this as being deflationary puzzled me, and I was anxious to get the definitions clear in my mind. Perhaps you can.

We are not in a deflation in the sense of the purchasing power of the dollar.

Mr. SLICHTER. No. We are in a difficult time in which we have some problems created by deflationary influences, and we have some influences affecting prices which are making prices rise in spite of the fact that in terms of production, for example, we are in a period of contraction. Or perhaps I should reword that and say because of the fact that we are in a period of contracting production, prices are rising.

Senator FLANDERS. Thank you for your observations.

Mr. SLICHTER. Well, I had observed that we must not expect at this early date to have the perspective that is really needed in order to understand all aspects of the recession, but I am going to do the best I can to tell you how it appears to me.

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

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

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

It is always true to a considerable extent that the economic activity of today is determined by the economic activity of yesterday. If last year's sales increased by $4 million, an enterprise may decide to expand its investment by $6 million. This year the concern may get another increase in sales, but the increase this year may be, not $4 million, but $2 million. The enterprise is expanding, and it expands its investment; but if it expands its investment in the same ratio to sales as in the previous year, it will increase its investment this year by $3 million instead of $6 million. As a result, the firms from which this concern is buying raw materials and equipment experience an absolute drop in the size of their orders. So the adjustment of the economy to a slower rate of growth tends to take the form of a temporary contraction.

Decisions to cut the current rate of buying of plant and equipment were made late in 1956 and early in 1957. In durable goods manufacturing, which felt the effect of the drop in automobile sales in 1956 and the failure of the sales of durable household goods to increase, appropriations for new capital expenditures, according to the quarterly survey of the National Industrial Conference Board and Newsweek, apparently began to fall either in the third quarter or the fourth quarter of 1956.

In nondurable goods manufacturing, where orders held up better than orders for durable goods, the drop in capital goods appropriations began in the second quarter of 1957. This drop in new capital appropriations was accompanied by a drop in new orders of manufacturers. And that drop in the new orders of manufacturers began in durable goods manufacturing in November 1956, and in nondurables in January 1957.

It is important to note that the actual outlays on plant and equipment by manufacturers continued to expand for a long time after new appropriations for capital spending were being cut. In fact, the expansion of spending for business plant and equipment did not reach a peak until the third quarter of 1957, by which time new appropriations for capital spending among the companies in durable goods manufacturing, reporting to the National Industrial Conference Board and Newsweek, had dropped to less than half the appropriations of the third quarter of 1955, and to nearly 30 percent below the new appropriations in the third quarter of 1956.

The actual rate of spending, which was largely on old projects, was at a peak.

The fact that new capital appropriations began dropping late in 1956 and new orders early in 1957 is interesting in the light of the testimony of Mr. Martin before this committee last August 15, to the effect that—

> the inflation spiral * * * seems to have begun about a year ago in the summer of 1956.

And yet Mr. Martin would have us believe that the inflationary spiral was beginning about the time the new orders were starting to drop and the new appropriations were starting to drop.

Senator KERR. In other words, he referred to a date as being the beginning of an inflation spiral that was in actuality the beginning of the opposite.

Mr. SLICHTER. That is right. More or less, that is roughly true.

It is never true that the economic activity of today is completely determined by the economic decisions made yesterday. Various outside events initiate new responses of consumers and businessmen. And these outside events may encourage or discourage expansion. These outside events may include the acquisition of new knowledge opening up important investment opportunities; changes in the desires of consumers (the introduction of the immensely popular 1955 automobile is an example); failure to offer products that arouse demand (again the automobile industry furnishes an example in the 1958 car, which is a weird collection of headlights and fins and tails and wings, and so on, that, people do not seem to care for); or the outside event may be a change in credit policy or in fiscal policy.

In 1957, three outside influences (excessively tight credit policy change in fiscal policy, and later the introduction of unacceptable automobiles) tended to aggravate the contraction which was being started by the drop in appropriations for new capital expenditures. Tight credit policy tended to aggravate the tendency of the economy to contract because it retarded growth in new areas which might offset to some extent the drop of investment in business plant and equipment.

For example, overdoing credit restraint undoubtedly retarded the rise of investment in housing which had begun in the late spring of 1957. A faster rise of investment in housing would have partly offset the plans of business to cut investment in plant and equipment. The demand for household goods is closely related to the number of new houses built. Hence the fact that the expansion of housing, was slow limited the demand for durable household goods.

I should like to look briefly for a moment at some aspects of the problem of credit policy.

Credit restraint, in my judgment, was needed throughout 1956 and perhaps early in 1957. It is difficult to decide just when the restraint became excessive, but certainly by July of 1957 we had abundant evidence that some relaxation in credit restraint was needed.

I will take the June 1957 figures because they were the latest ones available when, in August, the Federal Reserve decided to make the last turn of the screw. The July figures were not then available. But the output of nondurable manufactured goods had not increased from the peak of December until June. It was 130, seasonally adjusted in each month.

The index of durable goods seasonally adjusted fell from 167 in December 1956 to 163 in June.

Senator KERR. Of 1957?

Mr. SLICHTER. In June of 1957.

The index for the production of primary metals, which is largely steel and aluminum, dropped from 145 in December 1956 to 132 in June.

The index for the production of nonelectrical machinery had dropped from 157 in December 1956 to 151 in June.

The index of the production of electrical machinery had dropped from 223 in December 1956 to 209 in June 1957.

Senator KERR. What was it in 1956?

Mr. SLICHTER. 223 in December 1956. In June, 1957, it was 209. The production of consumer durables had dropped from 141 in December of 1956 to 129 in June of 1957.

New orders of manufacturers had dropped from a high of $30 billion seasonally adjusted in November 1956 to $27.1 billion in June.

Senator KERR. Is that an annual rate, Doctor?

Mr. SLICHTER. No; that is a seasonally adjusted rate.

Senator KERR. But I mean seasonally adjusted annual rate.

Mr. SLICHTER. No; that is seasonally adjusted monthly rate.

Senator KERR. Monthly rate?

Mr. SLICHTER. It is seasonally adjusted, and they were less than new orders in June 1956, which were $27.7 billion.

Production of manufacturers had been exceeding new orders for many months, and unfilled orders had fallen steadily from $64.2 billion in December 1956 to $61.1 billion at the end of May, I believe, and to $60.3 billion at the end of June.

Senator JENNER. Is that the total production?

Mr. SLICHTER. These are unfilled orders of manufacturers. The unfilled orders of manufacturers incidentally are not seasonally adjusted. The Government does not publish seasonally adjusted figures on those. The other figures I have been giving you are seasonally adjusted.

Expenditures on consumer durables had fallen from a seasonally adjusted annual rate of $35.9 billion in the first quarter of 1957, to $35 billion in the second quarter.

Expenditures on furniture and household equipment in the second quarter of 1957 were at seasonally adjusted annual rate of $14.9 billion which was below the second quarter of 1956, and the same as the fourth quarter in 1956. I think one may say about sales of furniture and household equipment that the trend was horizontal, had been horizontal, showing no signs of increase for well over a year.

I did not think we were going to have a recession. I did not see this recession coming, but I wrote a letter to the New York Times on the 31st of last July in which I expressed the view that the No. 1 problem of the country had become not the problem of controlling inflation, although that problem still remained, but had become the problem of increasing production.

Now the credit authorities were not as prompt as one would like them to have been in adjusting credit policies to the change in the business situation when it developed, although of late the Federal Reserve has been doing much better.

But by October of 1957 it was fairly evident that we were in a recession, and yet the bill rate in October averaged 3.591, which was the high for the year, the high monthly average for the year.

In October of 1956 the bill rate had averaged 2.961.

Senator ANDERSON. It is now barely over one and a quarter.

Mr. SLICHTER. I have forgotten what it was on the last auction. I believe it was a little over one. I have a poor memory.

Senator ANDERSON. That is correct.

Senator KERR. That is correct.

Mr. SLICHTER. But in December of 1957 the bill rate was still above 3 percent, it was 3.102, and not until the week ending February 12, I believe, did the amount of Federal Reserve credit exceed the amount of the preceding year.

There was less Federal Reserve credit in December 1957, after this recession was fairly well advanced, than there had been in December 1956.

So our credit authorities were slow in adjusting their policies to the changed economic situation of the country once it became apparent that the country's economic situation had changed.

The yields on long-term United States Government bonds, as late at February 1958, were slightly higher than in February 1957.

Now, we had another outside influence aggravating the tendency for the economy to adjust itself to slower rate of growth by contraction. The second aggravating influence was fiscal policy.

New defense contracts were cut from around $18 billion in the first half of 1957 to $12 billion in the second half.

This cutting of orders seems to have been partly the result of the debt limit and partly the result of the failure of the Defense Department to keep up to date in deciding what to buy and what not to buy.

It postponed much buying in order to reevaluate its program, I would not find fault with that, but the accidental timing of this reevaluation and its effect upon the economy were unfortunate.

Then finally we have this failure of the automobile industry to produce a car that appealed to the public. The unattractiveness of the 1958 was a late influence aggravating the recession. One wonders whether poor automobile sales are simply a result of the recession or whether they are a cause of it.

I think that poor sales are partly a result, but when one compares the drop in the buying of cars with the drop in the buying of homes, which cost even more than cars, and when one compares the drop in the buying of cars with the drop of most household durables, one comes to the conclusion that people do not care for most of these 1958 cars, and that the failure of the cars (with a few exceptions) to meet favor has aggravated the recession.

That is a piece of bad luck for all of us.

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

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

If one looks back several years, one finds that early in 1954 the economy was getting expansion from that recession as a result of three principal influences: (1) the drop in the rate of liquidation of inventories, with an eventual shift to the accumulation of inventories; (2) a rise in consumption expenditures made possible in large part by a drop in the rate of personal saving; and (3) a slow rise in investment in housing which was helped by a strong easy credit policy.

Now early in 1955 the nature of the influences producing expansion changed. The rate of personal savings ceased to fall, so we lost that stimulant. The investment in inventories became erratic and we lost that stimulant. The economy as a whole, however, continued to expand because the demand for housing continued to grow, and there developed a strong demand for durable consumer goods particularly these 1955 automobiles which were immensely popular.

Both of these last 2 sources of demand reached their peak, either just before or just after the middle of 1955, but about the time these influences for expansion petered out, 3 new influences took over. They were growing expenditures for goods and services by governments, State, local, and national, business outlays on plant and equipment, and net foreign investment.

These three influences sustained further expansion until early in 1957, and then they petered out, consequently, one way of looking at the recession is to say "Well, when these last influences for expansion petered out they were not replaced by other influences for expansion."

We might have had a recession late in 1955 had the influences for expansion which were then petering out not been replaced by growing expenditures by governments for goods and services, by growing business outlays on plants and equipment and by net foreign investment. But when these last three influences for expansion ceased to grow in 1957 there were no new sources of growth to take over and we had a recession.

Technological research, though going on at a high rate, was not ready with enough new products or investment opportunities. The electric light and power industry, it is true, began a rapid expansion. It is expanding faster this year than ever before. The housing industry began to grow slowly and a few other industries began to grow.

The outboard motor industry is having a wonderful year this year; it is soon going to be impossible to find a quiet lake in the United States on which to fish, and the home movie camera industry is doing exceedingly well in spite of the recession.

But we do not have enough of these influences for expansion to sustain the high level of activity that we had through the third quarter of 1957.

How could the recession have been averted?

I do not think that we understood the operation of the economy well enough last year to have enabled us to have taken the proper action at the needed time.

I don't think we know enough today to avert this particular kind of recession, but we know a lot more than we knew a year ago, and perhaps in a few more years we shall have gained enough insight so that we can stop this sort of thing that hit us in 1957.

The difficulty as I see it, arises from the long lead time in modern industry between decisions to spend and the actual date of spending. This lead time seems to be growing the more engineers and scientists are used to determine what you are going to buy and just what kind of a plant you are going to put up. If millions are to be invested in a plant, many difficult decisions and much staff work are necessary between the time when you decide to put up this plant and the time when you let contracts.

As a result of this long lead time decisions by business to reduce the starting of new projects may be laying the foundations for a future recession when actual spending on old projects is still rising and when the immediate problem is one of controlling inflation.

This was true in late 1956 and early 1957, when deflationary decisions began to be made in the durable goods industries before the end of 1956, and in the nondurable goods industries early in 1957.

The dilemma presented policymakers by this kind of situation is how simultaneously to discourage both deflation and inflation, how to discourage future cutbacks in spending while discouraging present increases in spending. We do not yet know how to handle this problem—the problem is too new and our understanding of it is too incomplete. The problem is aggravated by the fact that considerable time is required for the statistics to show a trend. Hence, before one really knows that deflationary decisions need to be combated, the contraction may be imminent.

The effect of credit restraint in a period of boom is probably to aggravate any tendency to postpone the initiation of new projects. But I do not regard this conclusion as necessarily an argument against the use of credit restraint to force the stretchout of spending on old commitments.

But if one tries to control present inflation by credit restraint, thereby causing business concerns to cut down their future plans for capital goods spending, if one does that, then it seems to me that special steps are needed to offset the bad effect of credit restraint upon future spending plans.

I see no way of simultaneously discouraging present intentions to spend and encouraging future intentions to spend.

Hence when present spending and, incidentally, future spending is discouraged, measures to offset the discouraging effect of credit restraint on future spending are needed.

One procedure might be to offset impending cuts in private investment with increased purchases of goods and services by the Government, but the authorization of these government purchases should not be delayed until the recession begins, because the Government, as well as business, requires considerable time before it is ready to make contracts after the decision to spend has been made.

So apparently the time to authorize increased Government spending is immediately after the reports show that private industry is reducing the initiation of new projects, no matter how much spending on old projects may still be growing. The difficulties in getting the people of the country to understand this point are self-evident. These difficulties lead me to conclude that our ability to deal with this sort of problem is perhaps 10 years off.

Increased authorization for Government spending will need to occur in the midst of the boom, when many people today would say that it is perfectly crazy for the Government to be authorizing more spending. But the Government spending is really not going to take effect until a year or two later.

Well, so much for the causes of the recession, which I think are mainly important because they show how far we are from having acquired the understanding of our economy that is needed to permit appropriate policies to be formulated. We are all of us in the same boat. All of us need to get better insight before we can claim that we know how to avert this sort of thing completely.

What about the prospects for recovery?

The contraction is still going on; it is hard to find any figures indicating that the contraction has ceased. There is some evidence that the rate of contraction is slowing down, but when one looks at the seasonally adjusted March employment figures, there was quite a drop in employment between February and March.

Actual employment went up a little but when one corrects for the ordinary seasonal increase, we had a fairly sizable drop. Carloadings, which you will find in the paper this morning, are down 22.7 percent as compared with last year. They are one of the best weekly indicators of the level of activity.

The 13 advisory boards reported to the American Association of Railroads the other day that they thought carloadings in the second quarter would be down about 10 percent as compared with the second quarter of last year.

Well, if carloadings are down only 10 percent as compared with the second quarter of last year, that would mean we would be starting up. But unfortunately these 13 advisory boards, though they are pretty close to all parts of industry, have not been too successful in predicting carloadings. They predicted a drop of only 3.8 percent in the first quarter of 1958, as compared with the first quarter of 1957.

I have forgotten what the actual drop was, but it was somewhere around 15 or 20 percent. At any rate, the 13 advisory boards did not have very good luck in making that prediction. Let's hope their 10-percent prediction for the second quarter is better, but it is not borne out by carloadings of this week which are down 22.7 percent.

The most encouraging single figure, it is only a single figure, though fairly sizable one, is on engineering construction awards.

In January engineering construction awards were down 24.8 percent as compared with January 1957—24.8 percent. In February they were down 18.2 percent. Now in the last 6 weeks ending April 7, the last 6 weeks ending April 17, they were 12.8 percent of the above year.

Senator JENNER. That would take a year to reflect in the economy though, would it not, an engineering contract?

Mr. SLICHTER. These contracts have been awarded, but not all of that money will be spent at once.

Senator JENNER. It will be a year before the result of this engineering contract would actually be in operation, at least?

Mr. SLICHTER. Of course, some spending will begin under some of those contracts quite soon, but since they are heavy engineering contracts much of the spending may extend over 2 or 3 years.

I don't know what proportion of the $2,351,000,000 in engineering construction awards made in the 6 weeks ending April 7 will be spent in the next 3 months. The spending on these contracts will be a sustaining factor over a considerable period of time, but these contracts will have much more prompt effect than some of the appropriations which Congress has authorized for the simple reason that before these appropriations which Congress has made take effect, contracts must be made. In the case of the engineering construction awards the contracts have been made.

But you are right, this money will, some of it still will be spent a year and possibly 2 years from now.

I wish I could give you——

Senator JENNER. For example, on the highway program as I understand it, we let an engineering contract for consulting engineers to lay out a highway and your figure there represents $2 billion that usually is normally 3 to 4 percent of what the actual cost of that highway is going to be.

But they have to lay out the highway, and then they have to report back and it has to be approved by the State governments and then by the Federal Government, and contracts have to be let.

In other words, it is usually a year or a year and a half before that engineering contract reflects an actual consummation of the project.

Mr. SLICHTER. Well, I am not sure whether I made plain what the word "engineering" refers to.

Senator JENNER. I used the highways, for example.

Mr. SLICHTER. It does not mean a contract with a firm of engineers. These are——

Senator JENNER. Consulting engineers who lay out a project?

Mr. SLICHTER. No, this refers to the projects themselves.

Senator JENNER. I misunderstood you.

Mr. SLICHTER. And the title which is used is "Engineering construction awards."

Senator JENNER. Well, I have the same thing in mind.

Senator MARTIN. Mr. Chairman, may I, in order to clarify things, ask a question here.

Senator ANDERSON. Yes, I wish you would clear up Senator Jenner's point because I am off with him.

Engineering contract awards—does that mean a firm of engineers lets a contract for the construction of a building or does it mean the prospective owner has awarded a contract to an engineering firm to draw plans?

Mr. SLICHTER. It means the former, a construction contract for a heavy engineering project—a bridge, a road, sewage and waste disposal, airports, a pipeline, a powerplant.

Senator ANDERSON. It means the former? Senator Jenner and I were off on a different tack.

Senator MARTIN. Mr. Chairman, as I understand the gist of your testimony so far, Professor, in a general way, you feel that Government ought to plan its projects during times of inflation so that we would be ready to go ahead with that when we get into a recession?

Senator JENNER. How are you going to do it?

Mr. SLICHTER. I would answer that question with a qualified "Yes." I think that you need to step up in periods of inflation plans for Government spending that would be consummated a year or two later. But I do not think it is feasible to concentrate Government spending on highways and schools and dams and many other things in years of recession, because fortunately we do not have enough years of recession. If one looks back over the last 50 years, one finds that we had a very limited number of years of recession. Consequently we have got to be doing our Government spending all of the time. We can try to step it up a bit in years of recession, but to the extent that we learn how to avoid recessions, we are less able to concentrate Government spending in those periods.

Senator MARTIN. Isn't it—and I apologize for taking the time——

Senator ANDERSON (presiding). Go ahead, Senator Martin.

Senator MARTIN. The Government has in its employment engineers and other experts, and during inflated periods, they could go ahead and make plans for roads, post-office buildings, flood control, rivers and harbors improvement and so forth, and when we get a recession we are ready then to employ men to go ahead with the work.

Isn't that a sound approach?

Mr. SLICHTER. I think it is, and I think that in view of the lag between the time when a decision to build a road or a dam or to start a flood control project is made and the time when spending on that can start, whenever we see that business is cutting down its capital expenditures and we are going to feel the effects of these cuts in a year or two, we should step up, as best we can, our plans to spend on flood control, roads, schools, and what not.

But I do call your attention to the fact that we are getting about 3 million people added to our population each year, and we cannot go too far in waiting for recessions to give these people the schools, the water supply, the roads, and other things, that they need.

Senator MARTIN. But we also have 3 million more consumers each year?

Mr. SLICHTER. That is right.

I think there are 4 present trends in the economy that may be predicted with reasonable certainty.

One trend is that Government spending will continue to rise though apparently for some months to come the rise will be moderate.

The Federal Government, in particular, seems to be moving rather slowly in this field. I hope that turns out to be an incorrect statement.

A second trend is that the liquidation of inventories will continue for some months longer, though the rate of liquidation will probably soon drop. It is impossible to judge how far the current drop in inventories will go.

In the current recession the drop in inventories will be stimulated by the planned cuts on outlays in plant and equipment.

Up to the end of February the drop in the book value of the trade and manufacturing inventories since August was about half as large as the total drop in the recession of 1953–54. In the recession of 1953–54 liquidation of inventories continued for 9 months after new orders of manufacturers began rising. New orders of manufacturers began rising after December 1953. We continued to liquidate inventories until September 1954. The volume of new orders of manufacturers, according to the February figures which are the latest, has not begun to rise, and it is very doubtful that the March figures will show a rise in these new orders.

I think one may expect some drop from the present exceptionally high rate of inventory liquidation which is about $7.5 billion a year.

Liquidation of inventories in manufacturing was high in December so that February marked the third month of high liquidation of manufacturers' inventories.

March will be a high month of liquidation. It looks as if April might be, too. That is quite a long stretch of very high inventory liquidation.

Now, a third trend that one may predict with some certainty is that expenditures on business plant and equipment will continue to decline.

A drop in these outlays is indicated in the recent reports of the Department of Commerce and the Securities and Exchange Commission, and the McGraw-Hill survey which is in the paper this morning, coincides roughly with the Department of Commerce, Securities and Exchange survey.

The McGraw-Hill survey reports that business plans to spend about 12 percent less on capital and plant and equipment this year than last.

Senator ANDERSON. Right there, Doctor, if I may, that would be as good a place as any to ask this question.

Should Government spending be geared to this private business spending which you have just mentioned is going to be down 12 percent?

Should Government spending be geared to that in any way rather than to defense requirements or the international situation, or domestic, social needs of our revenue capabilities, what might it be geared to?

Mr. SLICHTER. Well, insofar as the Government can expand its expenditures to offset a drop in plant and equipment expenditures by business that is desired.

Senator ANDERSON. I ask the question because there is a good deal of interest in the Congress at least on the ways that Government spending might be effective in helping turn the recession in the other direction, and you just mentioned this McGraw-Hill survey that indicated a very sharp reduction in business spending.

Mr. SLICHTER. You see the time to make the decision to increase Government spending was, I suppose, last summer but none of us knew it at that time.

Senator WILLIAMS. It is your theory that the Government spending should be gaged based upon the needs a year or two hence?

Mr. SLICHTER. Well, that is one of the considerations.

The Government spends for a great many purposes, and I certainly would not say that defense spending needs to be geared to the ups and downs of business.

Senator WILLIAMS. I meant your——

Mr. SLICHTER. Defense spending needs to be geared to other considerations. But insofar as we can——

Senator WILLIAMS. That is right.

Mr. SLICHTER. But insofar as we can find ways to increase Government spending to offset drops in business spending on plant and equipment, that should be done.

Senator WILLIAMS. That is what I had in mind. That leads to the next question: In order to do that, you have got to estimate a year in advance as to what you think the needs of the economy will be and I want to ask you what you think you should gage for next year and the year thereafter. We can speak retroactively but if we are going to gage Government spending on the needs of the future, projects which are not strictly essential must be planned a year or two in advance.

The great difficulty many of us have had is to gage what will be the situation a year or two in advance.

What is your opinion as to future prospects?

Mr. SLICHTER. May I give you that in a little while because I am going to discuss that in detail and it is such an important question that I have got a page or two devoted to it, and I think it will be better from your standpoint if I were to discuss it then.

Senator MARTIN. Doctor, the reason Senator Williams is asking the question now, it is necessary for him to leave for another engagement.

Mr. SLICHTER. Well, to put it in a nutshell, without qualifications, the Government spending that has already been provided for that will take effect to a considerable extent in the fiscal year 1958–59, will produce a deficit in the cash budget of at least 5 or 6 billion dollars. In view of the drop in plant and equipment expenditures that one may expect and the growth that we need in the economy, that deficit seems to me to be of the right order of magnitude. It is about large enough to offset the drop which we may expect in expenditures on private plant and equipment.

But I think you need to have better information than I can supply as to when and how rapidly expenditures will occur under the legislation that you have already put on the books or that you are about to put on the books.

Senator WILLIAMS. My reason for asking is that I understood you to express the opinion a moment ago that you felt the rate of Government spending should be accelerated and that you were somewhat disappointed that it was not being accelerated faster.

Mr. SLICHTER. Yes.

Senator WILLIAMS. And if it were accelerated——

Mr. SLICHTER. Yes; I am sorry we are not able in the first half of 1958 to spend at a higher rate. The more we can spend now rather than 9 or 12 months from now, the better, because we have more slack in the economy now than we shall have 6, 9, or 12 months from now.

I think we shall need a deficit in the cash budget throughout the fiscal year of 1959, but the time when spending would do most good, if it could be wisely done, if the Government could decide what to buy, would be right now.

Senator WILLIAMS. When you speak of needing a cash deficit of $6 billion to $9 billion do you mean to refer to a deficit of that size as a virtue?

Mr. SLICHTER. Yes, in a year of moderate recession.

Senator WILLIAMS. Something that should be planned for?

Mr. SLICHTER. Yes, if one anticipates a deficiency in the private demand for goods.

Senator WILLIAMS. And anticipated and created?

Mr. SLICHTER. Yes.

Senator WILLIAMS. You think it is desirable?

Mr. SLICHTER. I think in some years it is desirable, and I think next year is such a year.

Just as you want surpluses in some years, too.

Senator ANDERSON. Thank you. You may resume.

Mr. SLICHTER. The fourth trend is a fairly steady rate of investment in housing. We were getting a slow rise of investment in housing through 1957, beginning in the late spring. That was interrupted. Spending on housing has held up fairly well. The new measures to stimulate housing will probably require several months to take effect. In the meantime one may expect little change in housing, followed in several months by some expansion.

Now, the principal uncertainty in the economy is what consumers will do about paying their debts and spending their incomes.

In the recession of 1953-54 consumers cut their rate of savings substantially, and continued slowly to increase the amount to their short-term indebtedness.

But today consumers owe more than they owed several years ago, and in February consumers cut their indebtedness by moderately more than the usual seasonal amount.

Now the decisions of consumers to cut their debts rapidly could be dangerously deflationary. We lack experience to guide judgment concerning the probable behavior of consumers, but the strong long-term upward trend in consumer indebtedness, the plans of consumers to buy more secondhand cars than they purchased last year, and, the use of easy credit terms as a selling device give reason to believe that a rapid reduction in consumer indebtedness will be voided. And there appears to have been an encouraging drop of about $1.5 billion a year in personal savings between the last quarter of 1957 and the first quarter of 1958.

The net result of these several trends, the rise in Government spending and the drop in the rate of liquidation of inventories on the one hand and the drop in expenditures on plant and equipment and the slow drop in the liquidation of consumer indebtedness on the other hand will be no greater change in the level of economic activity in the next several months.

I think we must look forward in the immediate future to no great improvement, no great deterioration. The recovery will begin slowly when the rise in Government spending and the drop in the rate of liquidation of inventories more than offset the drop in spending on plant and equipment, and the slow reduction in short-term consumer indebtedness.

It is difficult to judge when this will be. My guess is that it will occur in the second quarter, so that the first quarter will, by a small margin, mark the low point of the recession.

Senator ANDERSON. The first quarter of 1958?

Mr. SLICHTER. That is right. At any rate, in the first phase of recovery that two principal expansive influences will be rising Government spending and a declining rate of liquidation of inventories.

Now recovery is like launching a missile. You have a series of stages, and the second phase of this recovery will probably begin in the latter half of 1958. Government spending will continue to grow, we shall feel more effect in the second half of 1958 from spending which has been recently authorized by Congress, and liquidation of inventories may give way to small accumulation.

Two, new expansive influences will develop. Housing will begin to expand and consumers will probably begin to increase their short-term indebtedness. Now consumers are paying off their indebtedness at a terrific rate, at a rate of about $3.4 billion a month. In order to prevent this indebtedness from dropping, it is necessary to persuade consumers to go into debt at the rate of over $40 billion a year because they are paying off debts at the rate of over $40 billion a year.

Some time in 1959, but certainly not before, business outlays on plant and equipment will start to rise, and that will mark the third phase of the recovery. A slow rise in spending on plants and equipment is preferable to a rapid rise, because there is likely to be a reaction from a rapid rise.

It should be understood that the United States does not have the instruments through which to combat a sudden upsurge in the buying of durable consumer goods. For example, after the poor car year of 1958, the automobile industry may come forward with models that meet the people's fancy, and some other kind of car, possibly a small economical car, may become the rage, that might happen in 1960, and we might have a rush to buy cars that would be quite as disturbing as the 7.2 million car year of 1955. I wish we had control over the terms of consumer credit so that if that were to happen, we could require larger downpayments and larger monthly payments. In other words, it would be desirable, in my judgment, for the Federal Reserve to have the authority over the terms of consumer credit which it had during the Korean war, and during the Second World War.

Senator ANDERSON. The use of installment buying?

Mr. SLICHTER. That is right. Because we have no way at the present time of stretching out a demand for cars that might hit us in 1960 or 1961, stretching that out over a couple of years.

Senator ANDERSON. In connection with the point you made a while ago about Government programs, but I saw in my reading the last day or so a comparative profit statement, with Caterpillar profits down 83, 85 percent, no small part of which was the production of an enormous amount of tractors and anticipating that the road program would get underway more rapidly than it did.

It did not and they have got these tractors on hand.

Does that illustrate your point that it takes a while for these Government programs, even though we passed a road bill, to actually be felt by the business economy.

Mr. SLICHTER. I think that is true. Of course there was, for some reason or other, a mistaken expectation in the road building machinery industry that the roadbuilding program would grow faster than it did. The industry got ready for it. That was desirable, but the industry got ahead of the program. That was partly their own mistaken judgment, I am afraid, and it applied not only to the makers of earth-moving machinery of which Caterpillar tractor is one, but I believe that it applied to the cement industry as well, which anticipated a great demand for cement and which has very fortunately from the standpoint of the country, prepared to meet that demand. But the cement industry got a little ahead of the game, too.

Senator MARTIN. Mr. Chairman, is there really any reason for wise businessmen to get ahead of the game. This great interstate highway system that we are now erecting takes time to locate the roads, it takes time to move utilities, it takes time to get the rights-of-way. It seems to me that good businessmen ought to have sufficient vision to realize that a time lag is necessary.

I think it is unfortunate that we do not have plans ready for the erection of the necessary roads, building the necessary tunnels and bridges and building the necessary post offices and things of that kind. I think Government should have plans ready for those things at all times.

Then when you get in a period of recession you are ready to move ahead.

Isn't that a sound economic approach?

Mr. SLICHTER. It is a sound economic approach. It is an ideal which I think will be realized only over a period of time. I do not like to call it a counsel of perfection because I think that we can achieve it, but we have never been foresighted enough to do it, and when we get the plans ready we want to execute them.

So what you are proposing——

Senator ANDERSON. That is the point.

Mr. SLICHTER. What you are proposing is that we have a big backlog of unexecuted plans, specifications all prepared, so all that is necessary is to advertise for bids. To achieve that goal we must exercise self-restraint; we must not carry out those plans. I think we are pretty good at getting plans, but when we get them we carry them out.

Senator MARTIN. If you will permit this comment, I might say that there is another difficulty relative to this.

As Governor of the Commonwealth of Pennsylvania, I had an enormous number of plans prepared for roads and things of that kind, but in this short time, instead of a 2-lane road we required a 4-lane road. So it is an awfully difficult thing, and I think the big thing is for all of us to be patient because we are a rapidly advancing nation. We are expanding in every line, and we just have got to be a little patient.

Mr. SLICHTER. Of course, plans get obsolete if they are on the shelf very long.

Senator MARTIN. Yes; no doubt about that.

Mr. SLICHTER. Well, what about the possibility of stimulating recovery.

I think one should bear in mind that a high rate of unemployment is going to be with us for quite some time, probably well into 1959. And I fear that our delay in attacking the problem of the recession may lead us to try to overstimulate the recovery.

The month of June will probably see the high month of unemployment.

I suspect there will be 5½ million people at least unemployed in June. It is characteristic of recoveries from recessions that business succeeds in increasing the productivity of labor, and that makes the absorption of the unemployed go on rather slowly.

What steps might business take to stimulate recovery?

In general, one has to say, I think, that the main contribution that business can make is to do better and faster what it is trying to do all the time. Business is all the time trying to find ways of selling more goods, finding out what people want, discovering new markets. Hence, the main thing one can say about the contribution that business might make is that it just do these usual things more vigorously and aggressively than ever.

I have three specific aspects of business activity on which I wish to comment: I think in many businesses it would be useful to prepare the way for the introduction of new and more attractive products by clearing out stocks of old products. That means price cutting on old goods. But it is price cutting that will have important advantages for the price cutter because it will prepare the ground for expanding the sale of new and better products.

Business did a pretty good job of holding down prices in the face of rising costs during the recent expansion.

For example, the index of the prices of consumer durables, and this includes a good many of the commodities with the so-called administered prices (automobiles, radios, TV sets, household appliances) dropped from 113.8 in 1952 to 110.3 in February 1958. Most of the drop occurred between 1952 and 1954. Between 1955 and February 1958, the retail prices of consumer durables increased by just under 5 percent. In the same period the total consumer price index rose nearly 7 percent.

And the price indexes of services, except rents, rose from 120.1 in 1952 to 138.4 in the first 11 months of 1957.

So consumer durables, about which more or less fuss has been made for some reasons that baffle me, really have got about as good a record as any category of commodities.

Sometimes one hears it said that people can't afford to buy these consumer durables because prices have gone up. Well, between 1955 and February 1958, when the price of consumer durables went up by less than 5 percent, disposable personal income went up 12 percent.

Well, business might speed up its efforts to bring out new products or new models of old products. Since years are usually required to develop new products, the amount that can be done to speed the introduction of new products is limited.

In the case of products that are to be introduced late in this year or early next year some acceleration may be possible, and it may be feasible in the case of some articles to incorporate in 1959 models some features originally planned for 1960 models. That, however, can only be done, I think, on a limited scale because one has to test out new features before one introduces them.

Part of the process of making new models attractive is to surprise the consumer with attractively low prices. I think the element of surprise is important. And I think the recession is giving many enterprises both the incentive and the opportunity to take stock of their operating methods and to eliminate inefficiencies and wastes. Passing on much of the savings in cost to consumers is likely to be the most effective form of advertising.

A third principal step that business concerns might take is to review their investment programs for 1958 and 1959. Reports of the Department of Commerce show that investment programs initiated by manufacturers in 1958 will represent expenditures of about $10 billion, or 29 percent less than the programs initiated last year.

Now if this low rate of initiation were to go on, the actual rate of investment by manufacturers in plant and equipment would drop to 10 billion. That would be the lowest rate of investment in manufacturing in any postwar year—even 15 percent below the investment of 1946, when one corrects for changes in the price level.

Various factors have influenced the investment programs for 1958. One has been the desire for liquidity which I have already discussed. Another has been the widespread illusion that in the preceding boom considerable excess of productive capacity was created. This view is ill founded in most cases.

There are some industries which grew too fast relative to industry as a whole, but by and large in manufacturing there has been a very modest rise in capacity during the last 7 years.

The best way to measure capacity is to take two periods when manufacturing was operating at capacity. May 1953 and December 1956 are two such periods. In May 1953, the index of factory output set an alltime high, seasonally adjusted. And again in December 1956 it set an alltime high. In each case if you look at the weekly hours, you will see that overtime was prevalent. In May of 1953 the average weekly hours in manufacturing were 40.7, and in December 1956, 41.0.

But in December 1956, when every effort was being made to produce all that could be produced, the index was only 7.2 percent above May 1953. Now a normal rate of growth in this country is somewhere around 3 to 3½ percent a year. But here you have a 3½-year period in which factory output went up 7.2 percent.

So I think that if business concerns were to look pretty carefully at their investment plans they might decide that now would be the time to increase the initiation of new projects and to start the construction of capacity which they will be very glad to have, come 1960.

And it will probably take until 1960 before that new capacity is ready to operate. In other words, now in the midst of recession is the time to start providing the capacity that will be needed in 1960.

What about the steps that the Government might take?

The outstanding issue in Government policy seems to be whether or not a tax cut would be desirable. This question must be considered in the light of circumstances. We have not cut taxes, but in the meantime various measures have been passed by Congress that will produce a substantial amount of spending next fall and next year.

It seems to me that perhaps without really facing up to this issue Congress has decided it, because if Congress were to use the device of the tax cut, the time to have done that would have been early in 1958. Furthermore, it would have been desirable, in connection with the tax cut, to have gone easy on increasing spending.

But Congress did nothing about taxes. Congress provided for various increases in expenditures, and now, I think, we are going to need all of the money which our present tax rates will yield.

I do not object to a deficit in the cash budget if circumstances are appropriate for it. I think, as I said a little while ago, that we shall need in the next year a deficit of somewhere around 5 or 6 billion in the cash budget, but I am not prepared to advocate making large additions to that deficit by making important tax cuts.

Senator ANDERSON. Now you are in a field that is very important to the Congress as far as your advice is concerned and I am glad to have that.

I assume from that since we have had to increase in actual debt by amendment, you do not believe in borrowing money to cut taxes?

Well, I had better not try to put words in your mouth, but you have said that the Congress has largely eliminated this possibility of a tax cut by failing to act early in 1958 and by instead of that increasing expenditures.

Mr. SLICHTER. I think that is true. Although I am not able to say exactly what these increased expenditures will add up to, it is fairly obvious that they will be substantial. Without attempting to make a precise estimate, I think the cash budget in fiscal 1959 will show a deficit of at least 5 or 6 billion dollars and probably more. I think that it will be necessary to raise the debt limit again. It does not seem to me that an increase of 5 billion in the debt limit is adequate, and a debt limit that is not adequate can be very wasteful in its effect upon Government procurement policies, as we found out last year.

Senator ANDERSON. I have an idea that the deficit may run above $8 billion, but in any event what you have said here is, I think, of importance and from my own standpoint it is very reassuring because I had come to the conclusion we could not do it.

Senator MARTIN. Might I ask a question along the same subject?

Senator ANDERSON. Yes.

Senator MARTIN. You have seen the budget estimate and the estimate of the tax collections for the fiscal year 1959.

Do you think we will be able to collect the amount of taxes anticipated in the budget message?

Mr. SLICHTER. No, I think the budget estimates were predicated upon assumptions with respect to the size of incomes that will be incorrect.

I do not think the yield of taxes may easily run $2 billion a year less than the January estimates. I am now speaking of the cash budget. I think it may easily run $2 billion a year less than was estimated last January. But estimating the yield is a job that requires the assembling of a vast amount of statistical data and one needs a statistical staff to do it, and I do not think that I would be fair to the committee if I indicated that I had very definite ideas as to what the drop in the yield would be but certainly——

Senator MARTIN. You have had access to an enormous amount of material and data and statistics in order to give us this very valuable paper that you are presenting this morning, and I feel it would be well to have your opinion. This committee will need information of that kind as we go along on our tax measures and things of that character.

Mr. SLICHTER. Well, if expenditures are $3 billion higher than estimated in January, and receipts are $2 billion less, you have got a spread of $4.4 billion—a deficit of $4.4 billion in the cash budget and I think the actual deficit will be more than that.

I think the administration and Congress would be wise to continue their efforts to speed up spending on useful projects, particularly spending that can be done during the next 12 months when the economy will have considerable unused productive capacity. And moderately large long-term increases in spending should be planned because we are a growing country.

Our population is rising, about three million a year. Our output is going up, about $14 billion a year, normally, and that kind of an economy needs more schools and roads and particularly recreation areas, and projects for the development of its resources and the protection of its resources. I wish we could move more rapidly than we have moved in recent years, to protect our communities against losses from floods, particularly in the industrial areas and——

Senator ANDERSON. I could not be more pleased than to have you mention recreational areas because I have a bill that has passed the Senate and is over in the House and I hope to see it revived there, that provides for a survey of what we may need in recreation areas 20 years from now. We will soon have to have a priority to get into Yellowstone Park.

Mr. SLICHTER. Well, the practice of taking vacations is growing, and more and more labor contracts are providing for vacations with pay. The figures on the number of people absent from work because of vacations with pay are to be found in the labor force reports each year for August and July, and other months, too, but they show a very rapid rise.

My memory for figures is too poor for me to quote them to you but you will be impressed, I am sure, with the rapid growth in the number of people taking vacations, and we lack recreation areas. We need an opportunity to get solitude, and as our population grows and we become more populous, the opportunity to get away from it all becomes important.

Senator MARTIN. Mr. Chairman, as we draw to completion this great interstate and national defense highway that we are talking about, it will be very easy for people to take long trips, and I think it will do the country a lot of good.

It will give the people of New England an opportunity to know the troubles confronting you down in New Mexico. I think it would help our country a lot if we would have that opportunity.

Senator ANDERSON. I am so happy to have him say we may need solitude because the battle to preserve some of our wilderness areas in the Southwest against the need of cattlemen to graze cattle there has been sort of a hard battle.

Some of us have a few scars from it. I am very happy to hear you say we do need solitude and recreation areas, not by the financial requirements, but it is a very important part of your testimony to some of us.

Senator MARTIN. Mr. Chairman, while we are commenting on things of that kind, we invite you to come to Pennsylvania where half of Pennsylvania is covered with second growth timber, and it is a beautiful State. We have got 5,000 miles of fine trout streams that we will be glad to have you come and try.

Senator ANDERSON. I just knew Pennsylvania would get into the chamber of commerce.

Mr. SLICHTER. Well, I am not going to give a commercial but I would like to say that opening up New England through the new road through Connecticut and through the Massachusetts Turnpike creates the need for a great increase in recreational areas in New England. The people are going to come, but where are the beaches for them to go to? The beach mileage that is under public control is very limited.

We are encouraging people to come but we are not providing them with an increase in the places for them to go.

Senator ANDERSON. If you are going to get through your paper we can only be thankful there was nobody here from California. [Laughter.]

Mr. SLICHTER. We are going to have a $45 billion increase in the gross national product in the next several years and part of that $45 billion increase should go for much needed public works of various sorts.

I think I might mention briefly two steps that deserve specific comment that the Government might take to mitigate the recession.

One step would be to provide the States with funds to pay extended unemployment benefits, but if that is done I think the same bill should incorporate higher standards for the States.

We started the unemployment compensation system with national legislation because no State wished to handicap itself by stepping out ahead of its competitors by imposing higher standards. Naturally the States hold back in imposing higher standards.

The result has been that the average weekly unemployment benefit has dropped from around 45 percent of the weekly pay of a factory worker in 1939 to around 34 percent now.

If the Federal Government simply gives money to the States without imposing higher standards, I fear that it will discourage the States from improving their system because the States will say, "Well, we get bailed out in 1958. We shall expect the Government to bail us out next time."

I was associate chairman of the committee to look at the social security system which the Finance Committee of the Senate established in the days when Senator Millikin was chairman of it, and we made some recommendations along this line then.

I think that the general principle that money should not be given without standards being improved is a sound one.

Then it seems to me that a temporary suspension of some of the excise taxes, particularly the excise tax on automobiles, might be wise. It would have little effect on the size of the budget deficit next year. It would increase the yield of the income tax, both the personal and the corporate income tax, so the net loss of revenue would be small.

It would stimulate demand just where the stimulation of demand would do the most immediate good. There is an exceptionally high unemployment rate in Michigan and in various communities throughout the Middle West which make automotive parts.

If you told people, "Well, if you buy your car before October 1 or before November 1, you escape half of the excise tax or you escape all of it," I think a fair amount of automobile buying would be stimulated. That would be borrowed in part from automobile buying next year, but would be much better to have that buying now, than next year, when the housing program, for example, will be helping the general situation.

The more of these 1958 cars that are sold, the more of them will be in the secondhand market in 1960 and 1961, when they will be helpful in holding down price increases.

I have been disturbed by the failure of the easy credit policy to effect long-term interest rates to any greater extent. A part of this failure of long-term interest rates to drop very much is optimism with respect to the long-run prospects of the economy. Part of it is due to the issuance of securities to pay short-term debts, and part of it is due to the large demand of cities and States in the security market. I have suggested here that if the long-term money market continues to be more or less isolated from the short-term the Federal Reserve might consider some direct purchases of long-term governments.

It has pursued the policy of operating at the short end of the market. But since this was written, the Reserve has come through with a new reduction in reserve requirements. Those are more important than the reduction in the rediscount rate, and it will be of interest to see to what extent the long-term rates reflect this third reduction in reserve requirements.

The important thing is to get a good supply of money seeking mortgages because the demand for housing is sensitive to the rate of interest. The rate of interest affects the size of the monthly payments, and the size of the monthly payments determines the decision of the would-be buyer whether or not to purchase.

Let me conclude with a few observations on the problem of inflation. An economy such as ours which has a great capacity, through large and expanding technological research, to increase the demand for goods, and which also possesses a powerful trade-union movement, should not be surprised at finding itself confronted with a more or less chronic problem of inflation.

The tendency for demand to outrun productive capacity can be controlled to a considerable extent by a policy of credit restraint, though that policy obviously poses many problems. But in our kind of economy, with our great capacity to increase the demand for goods, we shall need credit policy to be limiting the demand for goods a good part of the time. That does not necessarily mean that the policy of credit restraint has to be particularly drastic. It will vary in its degree of restraint, depending upon circumstances.

Far less tractable is the problem resulting from the tendency of trade unions to push up wages far faster than the increase in output per man-hour. In the period 1947 to 1956, the average hourly compensation of employees in non-agricultural industries increased 61.4 percent. In the same period the real product per employee-hour increased less than half as much, only 26.1 percent.

The excess of the increase in compensation over the increase in productivity averaged over 3 percent a year, and in all but 2 of the last 9 years compensation was increasing faster than productivity.

There is no quick and easy solution to the problem of wage push-inflation. I think the problem can be mitigated to an important extent by inventions and administrative improvements that increase the productivity of labor without raising the demand for capital goods.

The ordinary technological discovery increases the productivity of labor but it makes old capital obsolete. By making old capital obsolete it increases the demand for goods, it creates sellers' markets, and so that, along with the increase in productivity, there go increases in wages which may exceed the gain in productivity. For example, the invention and development of the diesel locomotive rendered obsolete our steam locomotive. It greatly increased the productivity of railroad labor, but it also increased the demand for goods and so it helped wages rise.

There is another kind of invention——

Senator MARTIN. If I could make a comment.

The dieselization of the locomotive also decreased considerably the amount of coal to be consumed and that left a lot of coal miners without employment. That is correct, is it not?

Mr. SLICHTER. That is true.

The kind of change that would raise productivity without tending to create sellers' markets might be illustrated by better scheduling of work, by better production schedules, by better selection of employees, by better training of employees. All of these are ways of increasing the productivity of labor without increasing the demand for capital goods.

I think these methods have important possibilities, but I do not think that they can be expected to make productivity rise as fast as wages are going up.

So we come face to face with the essential fact that we shall have wage-push inflation unless employers are strong enough to resist the demands of unions for wage increases that exceed gains in productivity. The current recession is making the problem of wage-push inflation slightly more tractable, I think, partly by increasing the opposition of employers to wage demands, and partly by helping the public see that there is such a thing as wage-push inflation.

The recession is stiffening the resistance of employers to excessive wage demand because it is teaching some employers the costliness of agreeing to substantial wage increases far in advance. I think it is safe to say that the steel industry and the railroad industry will long remember the wage increases for 1958 that they agreed to back in 1956.

Now, of course it took a strike to make the steel industry agree. Contracts of 2 or 3 years' duration are almost a necessity in modern industry, but the experiences of 1958 will warn employers to go easy in committing themselves to large future wage increases.

Even more important than the effect of the recession upon the resistance of employers will be its effect upon the attitude of the public toward wage increases. The recession is helping the public see more clearly than ever that rising wages are a principal cause of rising prices.

They are not the only cause, but the issue had been confused by the honest belief of many people that rising wages simply reflected a strong demand for goods. One heard again and again the description of inflation that always annoys me because it is so inaccurate, as "too many dollars chasing too small a supply of goods."

Wages have continued to rise throughout the recession in the face of falling demand for labor and goods. Thus the recession has given the public a clearer picture than ever of the responsibility of rising wages for rising prices.

The more plainly the public sees the relationship between wages and prices, the more carefully it will appraise the demands of unions. The public is obviously getting tired of the stiff annual rounds of wage increases that far exceed the contribution of workers to productivity. An atmosphere is being built up in which unions will hesitate to ask so much, and in which employers who take long and costly strikes in an attempt to hold wage increases down to increases in productivity will have considerable public support.

I do not think these changes promise an early disappearance of the problem of wage-push inflation, but they do give reason for believing that the tendency of wages to outrun productivity will be less in the future than it has during the last 10 years.

Senator ANDERSON. Senator Martin, any questions?

Senator MARTIN. Mr. Chairman, I will be very brief, because of the lateness of the hour.

We all appreciate very much this wonderful statement, Doctor. There are parts of it which I do not agree with, but it is a very able statement and will be mighty helpful to us in the work that we have to do.

You indicate in your paper that there is considerable lag between cause and effect in economic matters and that either boom or recession may be upon us before we have even suspected its approach, and then it is too late to avoid some of its effects.

This is my question: Do you consider, then, the current recession is a natural or inevitable consequence of excesses which developed from 1954 to 1957?

Mr. SLICHTER. I think it was the natural consequence of what happened in 1956 and 1957. Whether it was inevitable is another question, in the light of our imperfect knowledge, in the light of our imperfect indicators of what was going on in the economy, it was probably inevitable. We saw a lot of the figures, but we did not see the recession coming.

It was plain that in 1957 the economy was in a lull. I discussed this lull on several occasions in 1957. The question was, Would the lull be followed by a contraction or by expansion? I thought it would be followed by expansion. I was wrong.

Whether, with this experience behind us, on another time we would see a similar contraction coming is a question that we shall be unable to answer until the next time a recession comes. I was impressed, for example, in 1957, with the fact that retail sales down until July were making on a seasonally adjusted basis new alltime highs every month. I looked at the falling new orders of manufacturers and at the falling unfilled orders of manufacturers, and I thought and said that I expected the higher level of retail sales would bring a halt to the drop in new orders. I protested against what seemed to me to be the overdoing of credit restraint, but I did not think the credit restraint would bring about a recession. I do not think that overdoing credit restraint was the cause of the recession, though it undoubtedly aggravated our difficulties. But when you ask whether the recession was inevitable, you are really asking whether next time we are going to be bright enough to do, not only a better job of interpreting the data, but also a much better job of acting on the data.

Senator MARTIN. I think you stated during your testimony that you figured the retarding of credit growth by the Federal Board in 1956 and 1957 was justifiable.

Mr. SLICHTER. Well, certainly in 1956 and probably in early part of 1957 credit restraint was desirable. About the middle of 1957, a relaxation, not a shift to an easy credit policy but some relaxation, would have been desirable.

Senator MARTIN. Doctor, I was very much interested in your discussion of the rounds of wage increases where the productivity has not kept up with wage increases.

Is that a reason for inflation?

Mr. SLICHTER. It is one reason.

Senator MARTIN. And if we would continue that year after year inflation might get out of hand?

Mr. SLICHTER. I think we would have creeping inflation, but I do not agree with those who say that creeping inflation is bound to become galloping inflation. I do not think that the expectation of a slow rise in the price level will lead people to rush into spending money.

In the first place, in order to spend money one has to have money to spend. Most of us are limited to our incomes, and to such additional resources as we may get by credit. With the proper monetary policy, we shall be limited pretty much to spending the amount that we get in our incomes. Furthermore, if one expects an increase next year in the price level of 2 or 3 percent, and the year after of 2 and 3 percent, and the year after of 2 and 3 percent and so on more or less indefinitely, one is not going suddenly to duplicate what one already has. One is not going to buy another car or another house or another refrigerator.

The rushing into spending to get rid of money requires a very rapid deterioration in the currency to set it off. Hence, I do not think that we in the United States need fear a runaway inflation. But the problem of creeping inflation is going to be a difficult one to solve. As I explained in my statement, I think this recession will help us solve that problem, but I do not think that we can expect a complete and early solution of it.

Senator MARTIN. You do then consider a creeping inflation which might get clear out of control as very dangerous as far as the American economy is concerned?

Mr. SLICHTER. No, I do not think it is very dangerous. I think we are likely to have it, and I think it is an important problem, but I would not use that expression "very dangerous." I would describe it as unfortunate.

Senator MARTIN. Well, isn't the eroding of the dollar most unfair to people on fixed incomes and people with savings such as Government bonds, life insurance, and things of that kind?

Mr. SLICHTER. There is no doubt that it is unfair to those people, if they do not see it coming. Of course to the extent that they see it coming and get higher rates of interest they are compensated for it. I mean it is unfair to the person who does not see it coming.

Senator MARTIN. Well, a moment ago, and you are one of the foremost men of our country who would be able to anticipate recessions and the opposite, you said that it was most difficult to determine when those times might come.

Mr. SLICHTER. That is true.

Senator MARTIN. Then if you cannot do it, how can we ordinary Americans anticipate it? And what is it that we can do?

Mr. SLICHTER. There is no way of being sure about the long-term future, but you do not get rid of that uncertainty by getting rid of creeping inflation. That uncertainty exists in this world whether we have creeping inflation or whether we have a stable price level.

We cannot be any more sure that our price level will be stable, assuming that is what we want, and are striving to get, we cannot be any more sure of that than we can be sure of creeping inflation.

But on your essential point, I agree with you that creeping inflation imposes injustice upon people who save in certain ways, upon owners of life insurance policies, for example, if we can get rid of it, we should. But I do not agree that it is likely to become galloping inflation, that it is likely to threaten the stability of our economy. Creeping inflation is an unfortunate injustice that we ought to get rid of if we possibly can.

Senator MARTIN. Isn't it true that productivity has also been greatly increased by equipment, better engineering, better administration, and things of that character?

Mr. SLICHTER. That is true. And of course the pressure of these rising wages has helped increase productivity also.

Senator MARTIN. You, and so do I, believe in unions. They have a very important place, I feel, in our economy.

Yet is it not true that our industrial leaders and our labor leaders of the large industries could perform a most patriotic service in America if they would get together and agree on a more stable policy, that is that they would keep productivity in line with the increase in wages?

Mr. SLICHTER. I think the idea is gaining acceptance slowly, that by and large wage increases should not exceed the average increase in productivity in the economy as a whole. Some of the larger unions, with research staffs, are giving some thought to this matter.

Many of the smaller organizations, some of them very powerful, do not think in those broad national terms. Nevertheless, recognition of the fact that we cannot put up wages faster than the average increase in productivity for industry as a whole without pushing up the price level is slowly gaining currency.

Senator MARTIN. Doctor, isn't it true the real backbone of the American economy are the thousands and hundreds of thousands of small industries located all over the United States?

Mr. SLICHTER. I do not know that I would want to pick out the backbone of our economy.

I am glad we have got a lot or enterprises. I see no virtue in smallness as such because smallness means the enterprise has few customers and one always wonders why is it this enterprise has so few customers. No, I do not know what is the backbone of our economy. I think that——

Senator MARTIN. What I am leading up to; there is too much influence in the decision between those large industries and those large labor unions which extends over State lines. They have an effect on our smaller industries and our smaller unions, and there is no way for them to combat the larger ones.

Mr. SLICHTER. A small employer with only one plant may not be a match for a union with half a million or a million members. In those cases, one must remember that the influence of the national union is quite likely to be to restrain the local.

The local may be on the point of threatening the existence of the employer simply because it does not realize the employer's true condition, and it does not believe the employer when the employer protests that he cannot meet the demands of the local. In such cases the influence of the national is likely to be for moderation If one asks: "Are large national unions an influence for moderation or are they usually against it?" The answer is that by and large they are more frequently an influence for moderation than the contrary. And I should be sorry to see the large national unions disappear from the picture because I think they give a more sophisticated leadership than you could possibly get without them.

Senator MARTIN. Professor Slichter, we greatly appreciate your presence and we apologize for keeping you so long.

Mr. SLICHTER. It is very nice to have been here.

Senator ANDERSON. Dr. Slichter, we have enjoyed tremendously and I hope profited by this very fine statement of yours today.

Senator Kerr opened this hearing by quoting a very complimentary reference from Fortune magazine to your work. I can only say so far as I am concerned, everything that the magazine suggested has been justified by this testimony this morning, and I have profited tremendously by it personally. I hope that those who read the testimony will get as much out of it as those who have heard you present it.

On behalf of the chairman of the committee, Senator Byrd, who was unavoidably detained, I want to express the appreciation and deep gratitude of all of the members of the committee to you for this very fine statement.

Mr. SLICHTER. It has been a pleasure to be here.

Senator MARTIN. Mr. Chairman, as representing the minority, I want to concur in what the acting chairman has stated.

Senator ANDERSON. We will now adjourn until next Tuesday.

(Whereupon, at 1:10 p. m., the committee was adjourned, to reconvene at 10 a. m., Tuesday, April 22, 1958.)

INVESTIGATION OF THE FINANCIAL CONDITION OF THE UNITED STATES

TUESDAY, APRIL 22, 1958

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, Frear, Gore, Williams, Flanders, Malone, Carlson, Martin, Bennett, and Jenner.

Also present: Elizabeth B. Springer, chief clerk, and Samuel D. McIlwain, special counsel.

The CHAIRMAN. The committee will come to order.

The Chair announces that Charles C. Abbott, dean of the Graduate School of Business Administration of the University of Virginia, will appear as a witness in addition to those listed in previous announcements. Dean Abbott will appear immediately following Mr. Martin and Dr. Harris.

We expect Mr. Martin to be before the committee at least 2 days; Dr. Seymour Harris on Thursday, and then Dean Abbott.

Mr. Martin, we are very pleased to have you before the committee again.

A lot of water has gone over the dam since you were here, and the committee would like to know what has been done by the Federal Reserve System from the time that you were here last August.

Mr. MARTIN. August 19, sir.

The CHAIRMAN. August 19.

You may proceed, sir.

STATEMENT OF WILLIAM McCHESNEY MARTIN, JR., CHAIRMAN, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM; ACCOMPANIED BY RALPH A. YOUNG, DIRECTOR, DIVISION OF RESEARCH AND STATISTICS; AND WINFIELD W. RIEFLER, ASSISTANT TO THE CHAIRMAN

Mr. MARTIN. Since my appearance before this committee last August, the United States economy has passed from an inflationary to a recessionary phase of the business cycle.

For the third time since World War II the strong growth trend in this country has been interrupted by a downturn.

The troubles now confronting us are traceable in many respects to the excesses of the preceding 3-year boom with its creeping inflation overtones.

RECESSION AS AN EFFECT OF BOOM

Between the summer of 1954 and the summer of 1957 real output of of goods and services in the United States increased about 12 percent. But prices also rose. Consequently, the dollar value of total output, or gross national product, increased 22 percent. This gap of 10 percent between the real and monetary increase in total product roughly gages the magnitude of the inflation in that period.

The 3-year expansion of the economy represented at first recovery from the 1953–54 recession, sparked by active consumer buying of houses and automobiles. This surge of consumer buying, which was encouraged by the ready availability of mortgage funds and consumer installment credit on sharply eased terms, was followed by a wave of business spending for plant and equipment that transformed the 1954–55 upswing into a boom. The classic acceleration principle of business cycle history found confirmation once more. In the process, inflationary pressures were generated as aggregate demand came to press against productive capacity. The upward price movement so generated received further impetus from the mutual interaction of prices and costs.

Senator KERR. If I may interrupt, Mr. Martin——

Mr. MARTIN. Yes.

Senator KERR. I know that you would take pity on a fellow though who would really like to understand that sentence and explain it.

You know just so an ordinary fellow can understand it.

Mr. MARTIN. All right.

The CHAIRMAN. Read it over again.

Mr. MARTIN. The upward price movement so generated received further impetus from the mutual interaction of prices and costs.

Prices began to rise and the expectation was that they were going to continue to rise, and that you would be able to increase costs and pass it on to the consumer, provided a mutual interaction came about that spiraled.

That is the simplest—a simpler way of putting it.

It might have been wiser to have written it that way.

The CHAIRMAN. No, it is all right. I am glad to have the more advanced way of writing it.

Mr. MARTIN. I did not mean it as an advanced way.

The CHAIRMAN. Thank you very much.

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

Throughout our economic history, investment spending has tended to come in waves, closely associated with cyclical variations in overall economic activity. These periods of rapid growth in our capacity to produce have been followed by cutbacks in investment spending, usually with secondary effects on total incomes and output. One of the goals of stabilization policies is to attempt to mitigate the effects of such cycles without inhibiting underlying growth forces.

In the 1955-57 investment boom, inflation aggravated the tendency toward overexpansion as well as the subsequent decline. Inflation, as I have said, was the result of an excess of total demands at existing prices over what the economy was producing, and apparently able to produce under the existing organization and use of resources. But once prices started up and expectations of additional price and cost increases were engendered, spending was stimulated further. With prospective costs rising, business had every incentive to enlarge its productive capacity at today's rather than tomorrow's prices. And when investment plans are made on this basis, a certain amount of uneconomic productive capacity is likely to be created; that is to say, capacity which does not reflect a basic pattern of demands undistorted by expectations of rising prices.

MONETARY POLICY IN THE BOOM

In cyclical processes, monetary management has a responsibility to use such powers as it possesses over economic events to dampen excesses in economic activity. If this reponsibility is exercised wisely and effectively, it should help to foster a relatively steady and sustainable rate of economic growth and longer term price stability. Perfection in monetary management and economic stabilization, however diligently sought, is, in my judgment, unattainable. Nevertheless, over the years progress has been made and further progress will, I think, be made.

Last August monetary policy was in a restrictive posture, as it has been for 2 years. As I stressed before this committee at that time, the inflationary pressures that had developed in the boom had also given rise to the disturbing notion that creeping inflation had become an inevitable condition of modern economic life. This idea took nourishment from the steady upward movement in consumer prices in 1956-57 as well as from the substantial rise in all prices since prewar years. The creeping-inflation idea was, in turn, conspicuously reflected in the sharp rise in prices of common stocks, the most popular hedge against inflation. Thus in July 1957, for the first time in two decades, the average dividend yield on stocks was bid below the average yield on high-grade corporate bonds.

In that atmosphere, Federal Reserve discount rates were raised one-half percentage point in August in order to relate them more closely to market rates which had been rising for some time and in this way to maintain their effectiveness in restraining bank credit and monetary expansion. That action also served as an indication to the business and investment community that the Federal Reserve rejected the idea that creeping inflation was inevitable.

On the financial side, the 3-year expansion under conditions of monetary restraint had reduced markedly the liquidity of the business community and of the commercial banks. The money supply had increased but little after 1955. Its velocity of circulation, however, had quickened appreciably; that is, money holdings had been lowered in relation to the growing gross national product. Indebtedness of consumers and businesses had increased relative to incomes.

Inflationary sentiment was a factor not only in the domestic economy but in other industrial economies as well. Widespread expectations had developed in world markets that failure to arrest inflation in key countries, especially in Europe, would result in important changes in international currency values. Despite actions taken by various countries over the summer to strengthen their anti-inflation programs, speculative movements of funds continued to dominate exchange markets. The crisis was not resolved until late September, after the Bank of England raised its discount rate from 5 percent to 7 percent and the German Bundesbank, almost simultaneously, lowered its discount rate from 4½ percent to 4 percent, thereby lessening the incentive for short-term funds to move from sterling into deutschemarks. These actions made it clear that inflationary trends would be strongly resisted and that key foreign currency values would be maintained.

We are now aware that the economy was to reach a cyclical turning point in the fall. This is not to say that there were no earlier signs that the economy might be getting into an overextended position. This was shown by a falloff in new orders for machinery and equipment in the earlier months of 1957 and by the development of a margin of excess capacity in some key industries. In the spring, however, consumer buying took on renewed strength as business investment was being maintained, encouraging expectations of further economic expansion and of continued upward price pressures. Consumer buying, particularly of nondurable goods and services, rose through August. On balance, it looked as if an extension of rolling adjustments at a high level of activity would continue to be the prospect.

During the fall, expansive forces gave way and downturn set in. Business inventory holdings had been at a high level for a long period in which the price trend had been upward. Hence, they were vulnerable to the emergence either of eased conditions of supply or of relaxed market demands. This occurred as Government defense orders, which had been expanding in the spring, were cut back in the summer and fall to conform to the budget program and the ceiling on public debt. At the same time a decline in business spending for plant and equipment set in, in recognition that productive capacity had risen more rapidly than final demand and output.

MONETARY POLICY AND RECESSION

As evidences of downturn developed, the Federal Reserve System began to alter the course of its policies. In the latter part of October and early November, open market operations were used to relax somewhat pressures on commercial bank reserve positions. In mid-November, a one-half point reduction in discount rates signaled a decisive change in System policy. From this point on, restraints on bank credit expansion were progressively relaxed.

Through the first quarter of this year, as reserves were provided through open market operations and by two reductions in reserve requirements, member banks reduced their indebtedness at Reserve banks and accumulated some excess reserves. Between September and March, member bank borrowing at the Reserve banks declined from about $1 billion to less than $150 million, while excess reserves rose more than $100 million. Thus net reserve positions shifted by almost $1 billion. Discount rates were reduced in two further steps and at the end of the quarter stood at 2¼ percent, compared with 3½ percent in the autumn.

Just last week the System took additional action to ease credit conditions. Reserve requirements were reduced further, releasing about $450 million from required reserves. Discount rates were lowered an additional one-half percentage point, bringing them to 1¾ percent at 7 Federal Reserve banks.

The easing of bank reserve positions has been reflected in a substantial expansion in bank credit and an exceptionally sharp drop in interest rates. Over the 6 months ending in March, for example, the total of bank loans and investments has increased almost $5 billion. In the corresponding 6-month period a year ago, the growth of bank credit was less than $1 billion. The expansion of bank credit has been mainly in the form of Government security holdings, and the effect has been to enlarge holdings of cash balances and to increase the economy's overall liquidity. Aside from temporary spurts of bank loans to business in December and March, business loans outstanding at banks have tended to decline with economic activity. However, loans on securities which provide important support to the capital markets have risen.

As Federal Reserve policy has shifted from restraint to ease over the past 6 months, financial markets have reacted vigorously. Short-term interest rates fell more rapidly in the 3 months following the first reduction in Federal Reserve discount rates than in 6 months following the 1953 turning point. By mid-April, Treasury bill yields, an indicator of the availability of funds in the money market, had declined to about 1¼ percent, compared with more than 3½ percent in October.

Longer term market yields are down about three-fourths of a percentage point. This decline has met with remarkable demand response in the long-term security markets and the total volume of corporate, State, municipal, and foreign borrowing has reached record levels. In the first quarter of this year, State and local governments issued $2¼ billion of new securities. This was almost 25 percent more than in the same period of 1957 and represented a new record high for the quarter. Corporate business raised $3.1 billion in new capital through the securities markets. Although smaller than a year ago when business investment outlays were still rising, this volume of flotations exceeded that of any other first quarter on record. New issues of foreign and international borrowers amounted to an estimated $300 million, twice as much as in the first quarter of 1957.

It should be stressed that the Federal Reserve has been pursuing an active, not a static, policy and using all its instruments in the process, as indicated by the attached record of policy actions since last fall. That attachment is a part of this statement. Banks have been expanding their assets and deposits. Their reserve needs have increased, requiring that their reserve positions be strengthened. This has been done by means of open market purchases, lower discount rates, and reductions in reserve requirements.

Thus, monetary policy has contributed to an increase in the availability and a reduction in the cost of borrowed funds. This has permitted a sizable expansion in bank deposits. In this way monetary policy is helping to increase the liquidity of the economy, which is an essential financial prerequisite to recovery and renewed economic growth.

THE PROBLEM OF PUBLIC POLICY

No one can predict with certainty the course of the present recession. It is already deeper than the two which preceded it. Nevertheless, experience over the long history of the United States supports the belief that, except for occasional cyclical readjustments, our economy is one of continuing long-run growth and strength. Hence, governmental measures to deal with such cyclical readjusments ought to be shaped so as to be consistent also with the longer run trend.

This is not a prescription for inaction or immobility at times of recession. It is, rather, a recommendation for discretion and flexibility in selecting and implementing stabilization policies so that measures undertaken to deal with today's problem do not aggravate those of tomorrow. At the same time, public policy needs to keep alert to any tendency for downward movements to become cumulative.

A second observation relates to the use of resources. As I have said earlier, a part of our present problem stems from overexpansion or misdirection of investment in particular lines of industry. In some cases, excess capacity exists in part because producers have misjudged the market or the long-run rate of growth of demand for their products. To some degree, this is inevitable in a free market economy. It can be mitigated, however, to the extent the Government is able to stabilize aggregate demand around a steady growth curve and thus to provide a general economic climate that facilitates shifts in resource utilization as those are dictated by free markets.

THE HUMAN PROBLEM

In discussing economic problems, we should never forget that what we are really dealing with are human problems—human problems of a very important kind. In combating inflation and deflation, what we are really doing is combating human misery that springs from economic causes.

Every recession is serious: This one and all the others that preceded it. The best time to recognize that fact is before a recession starts, for the best way to prevent a recession is to forestall the inflation that precedes it. When the next economic turn comes, as assuredly it will, let us try harder to remember that—and act accordingly.

Today we are concerned, and properly so, with fostering the recovery everyone wants from a recession that nobody wants. That is fine. But let us also keep in mind that, vital as it is to achieve recovery, it is also vital to insure that it will be a recovery that lasts; a recovery that does not merely provide temporary jobs, but lasting jobs.

We must recognize that enduring prosperity is not a question simply of the dollar volume of spending. It is also a matter of equilibrium and balance of costs and prices within the economy. Lasting prosperity rests upon the efficient production and distribution of goods and services at prices that people are willing and able to pay. It has to be earned. It cannot be provided as a gift, by the Government or anyone else.

CONCLUDING OBSERVATIONS

By fostering conditions conducive to prosperity, the Government can help a lot. But it cannot do it all. That is why the Employment Act of 1946 pledges the Government's efforts to create and maintain—

> *conditions under which* there will be afforded useful employment opportunities, including self-employment, for those able, willing, and seeking to work. [Emphasis supplied.]

And it is why the same act says the Government's efforts to that end shall be applied—

> in a manner calculated to foster free competitive enterprise and the general welfare.

Monetary policy is undertaking, within its inherent limitations, to provide such a climate for recovery. It is not omnipotent, but I can assure that the system is approaching the problem of combating recession with just as much vigor as it exhibited in battling inflation. On both the up and the down side of the business cyles, the System is striving constantly to promote economic stability and growth.

(The attachment referred to above is as follows:)

Principal policy actions of Federal Reserve System, mid-October 1957 to mid-April 1958

Date	Action	Purpose of action
1957—mid-October–December.	System holdings of U. S. Government securities increased by $1 billion, including substantial amounts of securities held under repurchase agreement. Member bank borrowings declined from an average of about $1 billion to an average of less than $750 million.	To increase the availability of bank reserves for seasonal purposes and also to cushion adjustments and mitigate recessionary tendencies in the economy.
1957—November-December..	Reduced discount rates from 3½ to 3 percent at all Reserve banks.	To reduce the cost of borrowing from the Reserve banks and eliminate any undue restraint on bank borrowing in view of the decline in business activity and evidences of economic recession.
1958—January..............	Limited net reduction in holdings of U. S. Government securities to $900 million, more than half of which represented securities held under repurchase agreement at end of year. Member bank borrowings declined to an average of $450 million.	To ease reserve positions by absorbing only part of the reserves made available by the seasonal return flow of currency from circulation.
Do.....	Reduced margin requirements on loans for purchasing or carrying listed securities from 70 to 50 percent of market value of securities.	Stock prices and the volume of credit in the stock market had declined to levels near or below those prevailing at the time of the previous increase in requirements.
1958—January-February.....	Reduced discount rates from 3 to 2¾ percent at 11 Reserve banks.	To reduce further the cost of borrowing from the Reserve banks and increase further the availability of bank reserves in order to encourage monetary expansion conducive to resumed growth in economic activity.
1958—February................	Reduced reserve requirements on demand deposits from 20 to 19½ percent at central Reserve city banks; from 18 to 17½ percent at Reserve city banks; and from 12 to 11½ percent at country banks, thus freeing an estimated $500 million of reserves.	Do.
1958—March................	Reduced discount rates from 2¾ to 2¼ percent at 11 Reserve banks and from 3 to 2¼ percent at one Reserve bank.	Do.
Do....................	Reduced reserve requirements on demand deposits from 19½ to 19 percent at central Reserve city banks; from 17½ to 17 percent at Reserve city banks; and from 11½ to 11 percent at country banks, thus freeing an additional $500 million of reserves.	Do.
1958—February-mid-April...	Purchased about $450 million of U. S. Government securities. Member bank borrowings declined further to an average of about $180 million.	To supplement reserve requirement actions in further increasing the availability of bank reserves.
1958—April................	Reduced reserve requirements on demand deposits from 19 to 18 percent (in 2 stages) at central Reserve city banks and from 17 to 16½ percent at Reserve city banks, thus freeing a total of about $450 million of reserves.	To supplement previous actions to encourage monetary expansion and resumed growth in economic activity and to offset recent gold outflow.
Do....................	Reduced discount rates from 2¼ to 1¾ percent at 7 Reserve banks.	Do.

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

When we adjourned the hearings, recessed the hearings rather, of Mr. Martin last August, Senator Martin, Senator Williams, Senator Long, Senator Carlson, and Senator Malone had not had an opportunity to question—am I correct, Senator Malone, you did not question him?

Senator MALONE. I did not understand, Mr. Chairman.

The CHAIRMAN. The Chair is mistaken about that. I understood this was a list of those who had not previously questioned Mr. Martin.

Senator MALONE. Yes, I did question Mr. Martin at some length. It was necessary to hold rather late hearings.

The CHAIRMAN. The Chair will ask a few questions.

Senator MALONE. I did do that. I would like, however, an opportunity to question him again when my turn comes.

The CHAIRMAN. We will take it up in the regular order, when that comes.

Mr. Martin, there has been much talk and discussion pro and con about tax reduction as a means of aiding recovery and, of course, we all know that a tax reduction now must be on borrowed money because without a tax reduction there is a deficit of between 8 and 10 billion dollars in prospect for the next fisscal year and any tax reduction would increase that deficit.

I would like to ask you whether you think that a tax reduction would be helpful and whether you favor any tax reduction at this time.

Mr. MARTIN. Well, Senator, I approach the taxation problem with some diffidence because I realize the difficult decisions you gentlemen have to make and I just want to give you the best judgment I have on it.

The CHAIRMAN. I am speaking of a tax reduction in relation to business recovery.

Mr. MARTIN. I have some questions about a tax reduction as a cure for the present business recession.

I would be opposed to a tax reduction now on that basis. I think we cannot say that something is not being done in fiscal policy at the present time, when you recognize that the Secretary of the Treasury indicated a deficit of $3 billion for fiscal 1958, and our people tell me that about $10 billion is foreseeable for fiscal 1959, which is $13 billion.

Now under present conditions this is a risk that I think we can assume because of the recession, but I do not think we can say that nothing is being done of a compensatory nature through fiscal policy when a deficit of that size is looming on the horizon, and I also think it is too early to judge what the extent of the current downturn is, and I think we have to beware that the cures we employ do not turn out to be worse than the disease.

In the field of monetary policy, as I have outlined here, our actions have covered a period of 5 months roughly, which is not a very long time in perspective, and I believe they are just beginning to take hold at the present time, and I think they will have some usefulness.

Now in the general field of tax policy, if I may say a word about it, I have felt for a long time we have been placing too much reliance—monetary reliance—on both sides of the cycle, and not paying enough attention to fiscal policy and to a tax policy.

That is not said critically of anyone, but I think we have to recognize that when you are talking about these words inflation, prosperity, boom, decline, recession, leveling off, depression—that it is all a part of a process. It is related. It is not anything you can just isolate at a given time; and I am inclined to think that our tax system could stand a lot of reform, and that is quite irrespective of the situation we are in at the moment.

The CHAIRMAN. The Chair entirely agrees with that, it can stand a lot of reform. The question is, however, that a tax reduction will, of course, be added to the debt.

It would appear to me that the evils, a deficit of $15 billion next year, should we have a tax reduction would be terrible. Once a deficit of that size is started, it takes years to work out of deficit financing.

I have been in the Senate for 25 years and I know how difficult that is. I think that the evils of that and the inflation that will follow that must be considered in this present situation when and if the Congress should decide to reduce taxes. It may give temporary relief to certain parts of our economy but in the long run it may have very disastrous consequences.

Is that your opinion?

Mr. MARTIN. I would accept the risk of the current deficit that we are running, but I would not want at this time to undertake to accept the risk of a greater deficit than that by cutting taxes until the situation is considerably clearer than I think it is at the present time.

The CHAIRMAN. We are approaching, Mr. Chairman, a budget of $80 billion. It will not be $80 billion this next year but with the long-range spending programs being started now it is possible that we may reach an expenditure of $80 billion in the next 3 years. And with that we would be approaching a debt of $300 billion or more.

So it would appear that when we talk about tax reduction we should give consideration to what is going to happen a year or 2 years, or 3 years from now, and I gather that is your view.

Mr. MARTIN. I would subscribe to that view, sir.

The CHAIRMAN. You stated in your first paragraph that we passed from an inflationary to a recessionary phase since last August.

How do you account for the fact that the cost of living is still going up, and to that extent we are having an inflation on the one hand and a recession on the other?

Mr. MARTIN. Well, that is difficult to account for except that at the tail end of every boom there is a tendency for prices to be marked up to try to get out of it what you have put into it.

People do not like to make adjustments downward until the very last minute. It is the tendency of people to hang on.

Also, I might say that I question somewhat the reliability of the cost-of-living-index figures, not in the sense that I am questioning the compilation of them, but the great bulk of them—three-quarters of them are in food prices and services and I think services are the last items to move down in a period of this sort, and I would expect that there would be some decline in this cost-of-living index before too long.

I do not think it is a permanent operation, but I think it is a fact that the cost-of-living index was rising as a part of inflation last summer that was giving us such great concern.

The CHAIRMAN. How controlling is the increased cost of living with relation to inflation?

I have studied these statistics through the years and I find that there is a very close relation between increased living and loss in the purchasing power of the dollar.

Mr. MARTIN. I think it is very close, and I think the problem which we have been confronting is that inflation got ahead of us in 1956, 1957; when it gets ahead of you it is a very, very difficult operation to unravel the knots that it creates.

Part of the knots are in the price mechanism.

The CHAIRMAN. Now the cost of living in the past year has gone up more than 3½ on the 1939 index.

That means loss in the purchasing power of the dollar of nearly 4 cents on the 1947 index or nearly 2 cents by the 1939 index. Is that correct?

Mr. MARTIN. That would be about correct.

The CHAIRMAN. Yet at the same time we have a recession on our hands?

Mr. MARTIN. Yes, I think that is a temporary situation.

The CHAIRMAN. You think the cost of living will go down?

Mr. MARTIN. I think the cost of living will decline before long.

The CHAIRMAN. You speak of the boom from 1955 to 1957. You call that an investment boom.

Is it not true we have been on a boom since approximately 1955 until last year, sometime in the middle of last year?

Mr. MARTIN. That is correct.

The CHAIRMAN. And this present recession was perhaps occasioned by the leveling out process which has followed every boom we have had.

Do you think it has been more severe than some of the other recessions we have had? What was the last one?

Senator KERR. 1953 was the last one.

The CHAIRMAN. 1953 was the last one.

Mr. MARTIN. As I indicated in my statement, we think the decline has been larger than the 1953–54 recession or the 1948–49 situation.

The CHAIRMAN. Has it been in proportion to the boom that occurred in that period?

Mr. MARTIN. Very, very difficult to measure that. Your wartime period and your latent wartime controls make it very difficult to state.

The CHAIRMAN. Is it true that throughout the history of this country a boom has always been followed by a leveling out process?

Mr. MARTIN. That is correct, so much so that "boom and bust" has become the phrase that we have been trying to get away from.

The CHAIRMAN. What we have got to avoid is a bust.

Now, with respect to the high interest rate, you took your first action in October?

Mr. MARTIN. That was in the open market. Our first overt public action was a reduction in the discount rate effective November 15 of last year.

The CHAIRMAN. You said in your statement that a recession should be foreseen and steps taken to prevent it. Did you have any evidence that this would be a recession prior to the time that you took these actions?

Mr. MARTIN. I think we were quite apprehensive on the Board from the middle of 1956 up until the present time because we saw the measure of inflation there was in the economy and in spite——

The CHAIRMAN. Had these actions been taken earlier, say a year ago, or say last August or July, would that have had any effect in mitigating the recession?

Mr. MARTIN. You are talking about the easing actions?

The CHAIRMAN. Yes; the easing actions you took November 15.

Mr. MARTIN. In my judgment, no. I think that the real place where it got away from us was in 1956, and there it got away from not only the Federal Reserve but it got away from the Government on the expenditure side of the ledger at a time when we should have been building up a surplus, we had a very modest surplus, and we went ahead on an expansion program that just could not be sustained, and when you lose $10 billion of your gross national product in a markup on prices, with no additional goods and services——

The CHAIRMAN. Had you taken these easing actions in 1956, would that have been helpful?

Mr. MARTIN. If we had taken them in 1956, in my judgment the inflation would have been substantially greater than it was, and it would have meant that the recession would have been infinitely greater than it is at the present time.

The CHAIRMAN. In other words, prior to October and November any easing action by the Federal Reserve would, in your judgment, have been inflationary?

Mr. MARTIN. In my judgment, yes.

Now I want to say that in an area there, Senator, that the problem we were dealing with was that things looked shaky in some respects in February 1957. It looked shaky on the eve of the fall, of the raise in 1956, the inflation bubble looked shaky, but it is right at that point that you have your worst intake.

People say if you had eased money in July there might not have been any decline in business. Personally, I think that is just a cover for saying that inflation, if you perpetuate it, would never have a burst. I just do not think it.

The CHAIRMAN. You had to make a choice between increasing the inflation or meeting the recession?

Mr. MARTIN. That is right. The two cannot be separated. The best way to fight a recession is to fight the preceding inflation, and we were not successful.

The CHAIRMAN. You think that the easing action you took November 15, should not have been taken earlier?

I would not have criticized you if you made an error in it because looking back you can always see things clearer. But you think that was as early as it should have been taken?

Mr. MARTIN. I do not—I would not ever claim, as I tried not to in my statement, perfection in timing.

I would say it was as early—that is, we had sufficient evidence to justify our taking it, and also it was as early as we could have gotten all the elements in the System together to agree that it should be taken.

The CHAIRMAN. You mentioned some action you took in October?

Mr. MARTIN. In October we began to ease pressure on bank reserves through open market purchases.

The CHAIRMAN. Then did you anticipate that the recession in October would result as seriously as it has?

Mr. MARTIN. We did not know.

The CHAIRMAN. You did not know? But you felt then that a recession was coming?

Mr. MARTIN. We thought then it was likely it was coming because in September we were waiting to see whether the fall upturn would occur, and the fall upturn began to look shaky in the latter part of September, and in the early part of October there was a sudden dropping off in the demand for bank credit, very dramatic over a 5-week period. It was——

The CHAIRMAN. Could that be attributed to the high interest rates, or not?

Mr. MARTIN. In my judgment; no. I think money was always available during this period at a cost, and I do not believe that it was the high interest rates that was the controlling factor.

The CHAIRMAN. Would you say that these interest rates were considerably higher than normal? Approximately when did the high interest rates start?

Mr. MARTIN. I do not know what is norma lin interest rates, but our discount rate stood at 1½ percent in May of 1954, roughly. That was the low point in that period, and we had a long-term rate. What would you guess, was the long-term rate in 1954—about 3 percent, just under 3 percent?

Now in the course of the next few—from that period——

The CHAIRMAN. Now take 1955. What was the long-term rate?

Mr. MARTIN. 1955—the long-term rate began to go up modestly, about an eighth or a quarter of 1 percent in the early part of 1955. We raised the discount rate November 18, 1955. We had quite a tussle about it, that is why I remember it so clearly, and in retrospect, I wish we had moved a little more rapidly and a little more aggressively early in 1955, but that is all hindsight.

The CHAIRMAN. You think 1954 was fairly normal although it is very difficult to say what is normal?

Mr. MARTIN. I think that money rates in 1954 were a little bit on the easy side.

The CHAIRMAN. Easy side?

Now, then, 1955, the rates were increased. In 1956?

Mr. MARTIN. In 1956 they continued to increase.

The CHAIRMAN. And 1957?

Mr. MARTIN. In 1957 they continued to increase.

The CHAIRMAN. They started going down when?

Mr. MARTIN. They really started their big decline immediately after the decline in the discount rate.

The CHAIRMAN. You do not think that periods of 2 or 3 years of high interest rates contributed to this present situation?

Mr. MARTIN. No; I do not.

The CHAIRMAN. Recession?

Mr. MARTIN. In my judgment I think it may have been added a little to costs; I do not say that it was not a cost factor.

But I think the problem was you had a demand for money that was, as I put it at the hearings last summer, tantamount to a California gold rush.

Demand for money just kept rolling on and on and we have to make a distinction between borrowed money. Borrowed money can be the worst slavery that people can get into, and we had an enormous expansion of borrowing that I think was misconceived in its nature.

You had short-term bank credits being used for long-term capital purposes because they did not want to pay the rate of return that was required to finance it in the bond market.

We had an inadequacy in savings, so the pressure was on the banking system to create additional funds, additional credit in lieu of savings.

Now, permanent plant and equipment expension that is worth anything has got to come out of savings.

It must now come out of bank credit debt.

The CHAIRMAN. Do you think banks have followed the lower trend in interest rates as rapidly as they should?

I see by the day's paper that the Guaranty Trust and other big banks have cut the prime rate from 4 to 3½ percent. It has occurred to me they have not reduced interest rates for business purposes as rapidly as they should in view of the actions that have been taken and the low interest rates that the Government is paying.

Mr. MARTIN. We have never tried to run the banks.

The CHAIRMAN. I know that. I do not mean that you should.

Is it true that they have just started to reduce the interest rates?

Mr. MARTIN. Well, there was a previous reduction in the prime rate from 4½ to 4 percent.

The CHAIRMAN. When was that?

Mr. MARTIN. That was about 30 days ago. Let me correct that; it was in November 1957.

The CHAIRMAN. In other words, that was 6, about 5 or 6 months after the Federal Reserve took the first easing action?

Mr. MARTIN. Oh, no, very shortly after. We eased November 15, and it was very shortly after that. I do not have it precisely.

The CHAIRMAN. I thought you said 30 days ago?

Mr. MARTIN. Oh, no, I was corrected by Mr. Riefler.

The CHAIRMAN. In other words, 30 days after you took your first easing action there was a reduction of ½ to 1 percent in the prime interest rate?

Mr. MARTIN. That is about right.

The CHAIRMAN. How long after that was the second?

Mr. MARTIN. About 3 months.

The CHAIRMAN. It is true there has not been any reduction except the two that you mentioned?

Mr. MARTIN. In the prime rate, that is right. Of course interest rates have trended down during that period.

The CHAIRMAN. Do you believe that there are funds available in the banks for sound loans?

The statement has been made quite often that borrowers with sound security have been unable to borrow money for their business operations, especially small businesses.

Are there sufficiently liquid funds in the banks to make reasonable loans?

Mr. MARTIN. In my judgment, yes, sir. I think that the availability of funds is quite clear at the present time, and I believe the liquidity of the banking system which has undergone a dramatic shift over the last 3 or 4 months gives ample evidence of this fact.

The banks have been tending to buy securities to increase the investment side of their operations rather than the loan side because the demand for loans has not been there.

The CHAIRMAN. And you think any businessman, as he was able to do under what I would call normal conditions, can obtain loans now so far as the funds are concerned?

Mr. MARTIN. I believe so.

The CHAIRMAN. What has happened to the nontaxable bond market, the issues made by States and towns?

Mr. MARTIN. In the first quarter of this year, the State and municipal security flotation was the largest of any quarter in our history.

The CHAIRMAN. What about the interest rates?

Mr. MARTIN. And the interest rates are down about—they are down very sharply.

The CHAIRMAN. Can you give me a figure on that?

Mr. MARTIN. Around 2.60, from a high of about 3¾. 3.40—3.40 to 2.60.

The CHAIRMAN. In what period?

Mr. MARTIN. In a period of about 4 months.

The CHAIRMAN. Then, long-time corporate bonds?

Mr. MARTIN. Long-time corporate bonds are down about one-half of 1 percent. The demand response to this has been very dramatic and I would say encouraging in terms of finance, because the first quarter of this year shows a slightly lower level of corporate capital flotations than the first quarter of last year but it is still the largest quarter in history, except for last year, and the overall total of corporate, municipal, State finance, is at the record for the first quarter of this year.

So there has been no inability to finance.

The CHAIRMAN. Is there any resistance to these bonds when they are offered on a 30-year basis?

Several of the larger companies have sold their bonds on a 30-year basis and pay at an average of about 3¾.

Mr. MARTIN. Some of them have.

The CHAIRMAN. Are investors resisting long-term bonds now?

Mr. MARTIN. They——

The CHAIRMAN. I know Mr. Humphrey testified here last August that he could not sell long-term Federal bonds at that time.

Senator KERR. At any rate?

The CHAIRMAN. At any reasonable rate.

Mr. MARTIN. Well, the Treasury has been successful in selling some long-term bonds recently, and long-term corporate issues for the most part have gone very well.

The CHAIRMAN. In very minor amounts I think.

Mr. MARTIN. That is right.

The CHAIRMAN. What puzzles me is, if a company like the American Can Co. can sell a 30-year bond, why can't the Federal Government.

Mr. MARTIN. I think the Federal Government can if it wants to pay the rate.

The CHAIRMAN. Pay the interest rate?

But what I am trying to get at, does the investing public resist the long-term bonds, either corporations or of the Government?

Mr. MARTIN. Not at a rate.

The CHAIRMAN. Do you think 3¾ was too much—I just cite the American Can Co.; I happened to have read about it in the paper.

Was that too much for the American Can Co. to pay for a 30-year bond?

Mr. MARTIN. Not at the——

The CHAIRMAN. I think A. T. & T. issued a long-term bond at a little less than that.

Mr. MARTIN. I do not think it was too much at the time they paid it.

The CHAIRMAN. There is somewhat of a change of attitude then since last August?

Mr. MARTIN. Oh, very much so. Very much so.

The CHAIRMAN. Well, isn't that an indication of the confidence of the people in the future of our business conditions?

In other words, if a man is willing to buy a 30-year bond, it would indicate that he had confidence in the future of our economic situation, would it not?

Mr. MARTIN. Well, I think that at a rate, I don't know whether you can just put a confidence factor on the term.

The CHAIRMAN. You think it is entirely the question of rates?

Mr. MARTIN. Rates.

The CHAIRMAN. Could the Federal Government sell a long-term Federal bond at a lower rate today than it did last August?

Mr. MARTIN. Yes, indeed, and has done so.

The CHAIRMAN. And you still think that the high interest rates for the 2 or 3 years preceding last October, was not substantial factor in accelerating the recession?

Mr. MARTIN. No, I do not think so at all. I think that the recession which we presently have would be considerably worse than it is if it had not been for that. I think we should have taken other steps, let along interest rates to have controlled the inflation. But to me——

The CHAIRMAN. To what extent do you think the over-expansion of plant facilities which began in 1955—I suppose it really began right after World War II—was responsible for the current recession in building up inventories and manufacturing products for which there was no immediate sale?

Mr. MARTIN. I think it is a major factor.

The CHAIRMAN. I thought so.

Mr. MARTIN. Yes.

The CHAIRMAN. There was enormous expansion as you know, in plant facilities all through that era and part of it was expedited by the accelerated depreciation provision which the Senate Finance Committee cut off last year.

Mr. Humphrey, as you will remember, testified that the Government had lost $3 billion in revenue by reason of the accelerated depreciation; it resulted in building plants which, in my opinion, should not have been built, in oversupplying and in building up enormous inventories. Is that a correct analysis?

Mr. MARTIN. I think that was one of the factors. I think you have temporary over-capacity that has been created in a number of lines by this boom and it will take a little while before we will get the demand to pick up.

The CHAIRMAN. When we read in the papers about the steel production, it is steel production on present capacity. It is not steel production as compared with actual production in past years and that is quite a difference.

Mr. MARTIN. That is right.

The CHAIRMAN. I think we are 50 percent of the present plant capacity, but that does not mean steel production is down 50 percent.

Mr. MARTIN. Right.

The CHAIRMAN. That is right, is it not?

To what extent do you think excessive inventories have been responsible for the present recession?

Mr. MARTIN. I think that has been another of the factors. Inventories began to accumulate and they were evidently greater—as we can see by the extent of the liquidation—than we thought they were. I do not think our inventory figures are as good as they might be, but by and large they look like they were reasonable in relation to their current sales, but with increased capacity on top of that——

The CHAIRMAN. That goes back to this plant expansion during that period?

Mr. MARTIN. That is right.

The CHAIRMAN. To what extent do you think the excessive debt, private, corporate, and public debt, are responsible for the current recession?

We have increased all debt from $600 billion to $800 billion in a period of 4 years.

Mr. MARTIN. Well, I think we did—we used borrowed money too much for the expansion. That was another one of the factors which has contributed to our present problem.

Consumer installment credit and real-estate debt have just zoomed upward in almost a steady line from 1952.

The CHAIRMAN. And the increased interest is a substantial element, too?

Mr. MARTIN. That is right.

The CHAIRMAN. Every business corporation attempts to pass that along to the purchasers who purchase their goods.

I am going to ask a question now that I know is very difficult to answer. The question is: How far along are we in this leveling out we have been talking about? I realize that there are a great many factors involved in that. We have a very bad situation in the automobiles. We have the same thing in the steels. The railroads have had a decline which is not necessarily due to this present recession but has been going on for some time.

My question is directed at the economy as a whole; it is not confined to the bad spots.

What do you see today that did not exist 3 or 4 months ago that would indicate that we are climbing out maybe gradually or leveling off in the present recession?

Mr. MARTIN. Well, I think I would have to say that the decline in business is continuing but is continuing at a less rapid pace than it was, let's say, 30 to 60 days ago; and it has tended to slow up.

We are just entering the spring period, however, and you have to weigh the influence of seasonal factors. Just as soon as the sunshine comes out, why, we feel a little bit better.

Now you travel around the country today and you will find some areas that have not been affected by the recession at all, and in some areas there is very little knowledge of it except what they read in the newspapers.

While recent figures have shown some slowing down of decline, I personally have a feeling there may be some spring rally in business. But just how you gage its importance or measure that against the longer economic swing I certainly would not want to say.

The CHAIRMAN. In other words, you see more favorable conditions now than you did, say in January or February perhaps?

Mr. MARTIN. Well, take the inventory situation as one. You have had a persistent inventory liquidation, which measured against the utilization of resources is bound to indicate that at some point you will have to do some reordering or else close up entirely, and I do not think there is any likelihood of business closing up entirely.

The CHAIRMAN. In other words there is nothing in this situation that is comparable to the extremity of the depression of the thirties so far as you can see?

Mr. MARTIN. Not at the present time.

The CHAIRMAN. There are no basic conditions?

Mr. MARTIN. No basic conditions; and I do not have the slightest hesitation in expressing my optimism about the longer run.

The CHAIRMAN. Is recovery a question of time?

Mr. MARTIN. Right.

The CHAIRMAN. I am going to ask another question. I know you are not an expert on the stock market. But how do you account for the fact that stocks have been going up lately in the face of very discouraging reports of earnings of corporations in the first quarter of this year?

Mr. MARTIN. Well, I have tried not to comment on stock prices, Senator, through the years. I think there are so many factors that come in there.

After all, stocks are discounting what they see in the future. There are some people who buy them as inflation hedges. There are some people who sell them short because they see an opportunity to make a big profit.

You had an enormous short interest develop in the market during this period of gloom, and then the shorts have got nervous and have been covering. I think over a period of time the stock market is a fairly good barometer. I am not one of those people——

The CHAIRMAN. That is what I wanted: Your opinion on as to whether the stock market over a period of time is a good barometer for what the conditions that may occur later on.

Mr. MARTIN. If you will take it over a long period of time, yes, but not the short swings.

The CHAIRMAN. Mr. Martin, I certainly thank you for a very frank, interesting, and able statement.

The other Senators will want to question you.

Senator Kerr would like to start tomorrow morning.

Senator KERR. I would like to feel that the chairman and I both had a bright and early start. [Laughter.]

The CHAIRMAN. Senator Frear, would you care to ask some questions?

Senator FREAR. I only have a couple of questions.

I won't take much time.

There was considerable talk, Mr. Chairman, several years ago regarding price controls on goods and services as standby legislation. The Banking and Currency Committee of the Senate had it up on 1 or 2 occasions and I believe you were one of the witnesses at the time.

It was decided that no standby controls should be legislated at that time.

Do you think that was a wise or an unwise move as we view it in retrospect?

Mr. MARTIN. Well, I do not really like standby controls at any time because I think that if a situation should develop, action could be taken quickly enough either by the Executive or the Congress to take care of the problem, and, as I remember it, we spent most of our time at that period debating under what conditions the standby controls would be invoked.

Senator FREAR. Yes; I think we were trying to legislate some part of the administration's authority.

Of course, you know what one of our former Presidents, Teddy Roosevelt, said, "Speak with a low voice but carry a big stick," or words to that effect.

Do you think that legislation on the books would have had any effect of carrying a big stick and having an effect of putting it into effect?

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

Senator FREAR. You don't think that would hold a hammer over the heads at all if this kind of legislation had been enacted?

Mr. MARTIN. I think—no, I think it would have made our problem more difficult in the sense we would always be debating whether we should or should not invoke it and that would cause runups and rundowns on the basis of what we did or did not do.

Senator FREAR. Back in 1953 and 1954, when we were voting some tax reductions in this committee, if I recall correctly, the then Secretary of the Treasury, Mr. Humphrey, stated that he thought that the greatest reduction in taxes should go to the corporations, and he gave as his reason that they needed the money for the expansion of facilities to produce more products.

Now then, is it or is it not true that plant expansion since 1955 has increased inventories considerably?

Mr. MARTIN. I do not think there is any question of it, sir.

Senator FREAR. And I think your testimony earlier said that, of course inventory, large inventories was a factor in the present economic situation?

Mr. MARTIN. Certainly the liquidation of inventories which were obviously built up from plant and equipment expansion beyond the need of current demand was a real factor.

Senator FREAR. Then again in retrospect do you think we acted wisely or unwisely when we granted large tax decreases to corporations?

Mr. MARTIN. I think that is very hard to say in retrospect because you have to weigh—I think it is perfectly obvious that anything that increased plant and equipment expansion in the late 1955–56 period just added to the inflationary fuel, especially if it was done out of borrowed money.

Now there is sound plant expansion where you gage the market correctly, and there is unsound plant expansion.

Senator FREAR. Well, of course, I don't know as all of our industries have engaged in it unwisely.

I think there is some plant expansion that was made that was necessary and they are still utilizing it for capacity.

Mr. MARTIN. That is right.

Senator FREAR. And I believe I was one of the ones who supported part of the Secretary's theory at that time, so I am not trying to be critical but trying to get some information of what we have done in the past that might help guide us in the future.

The present situation however of overproduction did come in large part in the overall picture, from increased plant expansion or facilities.

Mr. MARTIN. It came from the plant and equipment boom.

Senator FREAR. Technology and other things assisting a bit but by and large the expansion of plant facilities has accounted for the present large inventories?

Mr. MARTIN. Well, I would not say that the inventories have been so large as the plant and equipment expansion has been an excess of demand. That has been one of the factors, the inventories.

But your plant and equipment expansion was generated in large measure by the inflation.

Senator FREAR. Can I take it from that you think there is pent-up demand that can exert itself later on?

Mr. MARTIN. I think there definitely is at different price differentials.

Senator FREAR. Sufficient to take care of the plant expansion that has been made available?

Mr. MARTIN. I do for the longer run, yes.

Senator FREAR. Then you view it as quite temporary?

I don't mean 30 or 60 days, but in the matter of a few short months, that the demand for goods can become so great as to relieve our inventory situation and put the plant expansion back into full operation?

Mr. MARTIN. I think the demands of our people for goods and services at prices which they are willing and able to pay, is still pretty much unlimited.

I think this is a year of opportunity for the development of a product, of products that people want and at prices that they want.

Senator FREAR. New mousetraps?

Mr. MARTIN. What?

Senator FREAR. New mousetraps? [Laughter.]

Senator KERR. I wonder if you could repeat that last statement that you made about prices that people want.

(Statement read.)

Senator KERR. Thank you.

Senator FREAR. I am not trying to lay a basis of questioning for the senior Senator from Oklahoma. [Laughter.]

He is pretty apt at all times.

I think, Mr. Chairman, Chairman Martin, that we have now opened this, and I would prefer the Senator from Oklahoma, following this line of questioning because he can do it much more adequately than I can, and develop it to a fuller degree and I only intended to take a minute or two anyhow and I meant that as a compliment to both you and the Senator from Oklahoma, sir.

Just one final question then that has been brought to my attention: If we can use a tax reduction now as compared to 1953 and 1954 for plant expansion would you favor that?

Mr. MARTIN. Well, I have already stated my general position on taxes. I think the problem on taxes is that you do need to give incentive for modernization and for—in the depreciation area and that sort of thing, and in order to get prices that people can pay and develop better products all the time.

That is what I was talking about when I talked about tax reform. But if you are talking about it as a cure for the present recession, I would not be in favor at this time of accepting the risk of increasing the deficit because we are already doing a great deal in the way of compensatory fiscal policy when you are running a deficit of $3 billion in the current year plus $10 billion for the next year—you are already engaged in compensatory fiscal operations at considerable magnitude.

Now to add on to that an additional X billion dollars, whatever the intentions are, is a risk that I say that at the moment I would not want to assume.

However, I recognize the problem that you gentlemen have and that is the problem of how and when. The interpretation of the problem is a different story.

Senator FREAR. Well, in your opinion as I understand it, you feel there is a demand by the American people sufficient to occupy the plant facilities that were made available by any tax reduction in 1954.

Mr. MARTIN. Well, I cannot relate it to the tax reduction in 1954, but I say that, in my judgment, whatever overcapacity there is today is temporary overcapacity as against the needs and requirements of the American people that I foresee in the sixties.

Senator FREAR. Then it may not be a tax reduction. It may be just an attempted change in the thinking of the buying public. If they can buy it at the price they want to pay as you stated a while ago, maybe the price is 1 percent less than it is now and it may be even 5 percent higher than it is now, but it is the feeling of the people that is going to determine whether this surplus inventory is used or left idle for a period of time longer.

Mr. MARTIN. In certain items; yes.

Senator FREAR. Do we use the tax reduction as a psychological measure?

Mr. MARTIN. I have already indicated I would question it as a psychological measure at the present time because I think the psychology of it might be bad. If the people suddenly found that the deficit that we already have is doubled, and I doubt if many people understand the magnitude of these deficits at the present time, the psychology might work in just the reverse way from what was wanted.

Senator FREAR. Of course, I think it is rather hard to judge what effect it may have if certain things were done.

Somebody is going to have to find out though in the future, not one way or the other. But if a tax reduction were given to the individuals and they did find a price level to their liking, and the pent-up demand was met, then the tax reduction would not be as serious as you have indicated it might be today.

Mr. MARTIN. Well, that is a matter of judgment, of course; and if it created demand on such a scale, why it is possible. But the point I am trying to make is that to say that nothing is being done today when, in a period of roughly 6 months, you have had the shift that has already occurred in the money and credit area, and we are now facing a compensatory fiscal change from the modest budget figures of a year ago this time to a prospective deficit of, let's take a rough figure of $15 billion dollars——

Senator GORE. Would you yield there?

Senator FREAR. With the Chairman's permission.

I don't object to it.

Senator GORE. I wonder why you describe that as a compensatory system.

Mr. MARTIN. Because it involves deficit financing. It means your expenditures have been stepped up to the extent of unbalancing your budget on that basis. I am not one who says that under no circumstances should you have deficit financing; but I think that the impact of deficit financing has some limit, and I think you have to gage the importance of it against the current situation.

I would merely want to make the overall point I am making primarily with respect to monetary policy.

I had a gentleman come in to see me last week and tell me that monetary policy has failed completely, that it has not done anything.

Senator KERR. Just one?

Mr. MARTIN. Just one? [Laughter.]

Mr. MARTIN. All right, Senator, I am sure there are others.

Senator KERR. That is off the record.

Mr. MARTIN. I would merely say, and I say this to you good naturedly, Senator, that in 5 months' time there has been an amazing money and credit change, and 5 months' time is a very small period in the perspective that we will be writing about 2 years from now. That is the point I am making.

Senator KERR. I appreciate the optimism inherent in the statement that we will be writing about this 2 years from now. [Laughter.]

Mr. MARTIN. All right; maybe we won't but others will.

Senator FREAR. I think he likes that better.

May I just say then without holding the witness any longer though, that I gather correctly that in your opinion that the demand for goods is sufficient to take care of any surplus inventory that we have and still put our expanded plant expansion back into operation when it is exercised, when this demand is exercised?

Mr. MARTIN. I do.

Senator FREAR. Thank you.

The CHAIRMAN. Senator Martin?

Senator MARTIN. Mr. Chairman, I apologize for being late for the meeting this morning but I had an unexpected matter come up and

I have not had the time or opportunity of reading the statement so I would like to defer my questions until later.

The CHAIRMAN. Senator Gore?

Senator GORE. No questions.

The CHAIRMAN. Senator Williams?

Senator WILLIAMS. Mr. Chairman, Senator Flanders did not get a chance to ask any questions the last time and I think I will pass on to him.

Senator FLANDERS. I am glad of the opportunity, Mr. Martin, to question you at this time, because it is about the only time I have to do it. I extend my thanks to my various colleagues, those who have passed in this way at this time to me.

I just want to say there is one of the elements of the tax cut remedy which so far as I have been able to listen has not been touched on. That is the assumption that the tax remedy would, to the extent that taxes were decreased, that it would immediately appear in an increase in purchases. The assumption is that that increase in purchase might start to snowball in a mild sort of way into an expansion of production and distribution.

It would seem to me that that would be the only justification for tax reduction at this time. I would like your comment on that phase of it.

Mr. MARTIN. Well, as I expressed earlier, Senator, I question tax reduction as a cure for the recession. My thinking goes to the view that that recession is clearly the result of a preceding inflation; that the patient, to put it in those terms, developed an infection, the infection of inflation; that the patient now has to have some period of convalescence; that there are some things, some goods that have been created in the course of this infection that the public does not want at the moment at the prices they are being offered, and it is not a matter of money that is involved. It is a matter of their confidence, their psychology, their like or dislike of the product.

Now, I do not believe, if any analysis of this is correct, that an infection and virus of this type is going to be cured by, I have used the phrase before, a hypodermic in the patient, or asking the patient to forego the period of convalescence that is required.

I do not want anybody to take a loss if it can be avoided at any time. But this is a loss economy as well as a profit economy, and at times we have to take some losses and we have to have a period of convalescence.

Senator FLANDERS. Well, now, Mr. Martin, I would like to get you off of this medical simile.

Mr. MARTIN. All right, sir.

Senator FLANDERS. And ask you a direct question: Would a decrease in taxes be reflected in increased volume of business?

Mr. MARTIN. Well, I think it depends on the time.

I assume that there are certain—that is why I cannot get completely away from my medical.

Senator FLANDERS. I am trying to get you off.

Mr. MARTIN. I do not think—we will leave the medical out; but let's take it as a time basis.

Over a period of time something may come that will galvanize people to want to buy things; and under those circumstances, if it is precisely timed right, a tax reduction which is a reduction in the price of some items, if you apply it to excises, now, something of that kind, might stimulate them.

I question it at the present time.

Senator FLANDERS. What would the decrease in taxes go into, more savings?

Mr. MARTIN. It could go into more——

Senator FLANDERS. It has got to go somewhere.

Mr. MARTIN. It could go into more savings or into a repayment of debt.

Senator FLANDERS. Yes, savings or repayment of debt or purchasing; there are three channels.

Do you know of any other?

Mr. MARTIN. I think those three are general.

Senator FLANDERS. About cover it?

Mr. MARTIN. Yes.

Senator FLANDERS. Well, my point of view is that the only justification for the tax reduction would be if it resulted in increased purchasing, resulting in increased production and resulting in a change of tone of our whole business total.

And I must say that that seems a bit dubious to me. But I just wanted to make sure that that possibility was firmly stated on the record.

I think that is the justification. The question is as to whether it is a measured and justifiable risk.

Mr. MARTIN. That is right.

Senator FLANDERS. My own self-questioning about the thing has been this: If the excise tax on automobiles were eliminated, say, and a certain percentage of it passed to me by the automobile dealer, would I turn in my old car for a new one?

I asked myself that and after looking at the new cars I am inclined to say, "No."

Senator JENNER. Senator Flanders, could I interrupt there in regard to tax reduction?

Isn't there also a fourth proposition that a tax reduction might let the people spend the money instead of the Government?

Senator FLANDERS. That is a point, of course. Still, they would either spend or reduce debts or they would save, those three things.

Senator JENNER. It would be a transfer of spending from the Government to the people.

Senator FLANDERS. I want to come to another point.

In various preceding hearings we have used the terms "inflation" and "deflation" and "recession" to which it would seem appropriate to add the antithesis of "recession", "expansion"; that is "expansion and recession," "inflation and deflation."

Is there any other measure of inflation and deflation than the price level—the general price level?

How do you measure it otherwise?

Mr. MARTIN. Well, I think that is very difficult, Senator. You measure it in excesses, of course.

That is why I have always had great difficulty with these words. I have not felt that it made any difference whether it was wage inflation or price inflation or cost inflation, all of which are measured in prices or credit inflation. What you were really talking about was something that bordered on the excess that comes from imprudence or improvidence, if you want to talk about it in a moral sense, or unsustainability in an economic sense.

Senator FLANDERS. Well, now, does Henry Jones in Kokomo care, or should he be concerned with, anything except prices in this connection of inflation and deflation?

Mr. MARTIN. Well, I think that is his primary interest, and I think the price mechanism does work. But I think it sometimes takes quite a time for it to work.

Senator FLANDERS. But the human effect would seem to be in the price level, the general price level.

Now that is the human effect. You can analyze, can you not, the reasons for that human effect by going back to innumerable springs and sources but isn't the human effect finally the thing?

Mr. MARTIN. I think that is right.

Senator FLANDERS. Now we do have price levels both in consumer goods and services and in wholesale goods. They bear some relation to each other.

Mr. MARTIN. That is right.

Senator FLANDERS. I was interested to note that you were either a pessimist or an optimist—I was unable to decide which—in your certain measure of confidence that the consumer price level might decrease.

Does that make you an optimist or a pessimist?

Mr. MARTIN. Well, I would say at the moment it may make me an optimist.

Senator FLANDERS. An optimist?

All right.

I wish I could share that optimism because if I could I think I would be an optimist, too. But looking on consumer prices from the beginning of 1952 to the present time, and we have been through a recession in that period. They have on the whole never decreased.

Do you really think they are going down?

Do you really think it is going down?

Mr. MARTIN. Yes, I am inclined to think so, Senator.

I think that you have to realize that the measurement of these prices is very difficult. I am not criticizing in any way the people that compile them. But take the quality factor in prices. We have no way of measuring quality at the moment. For example, one of my associates says if you go to a garage these days a mechanic has to be twice as skilled as he was a few years ago and the quality of his services, I think, is probably measured somewhat in the increase in price. I think there are a lot of elements in this price structure that are very difficult to measure and that we are all caught together in a mesh.

There are many products where if you modernized even in this day of wonderful machinery, if you modernized the equipment—and that is where this problem of depreciation comes in—and could write it off properly, you would find that you could produce your product cheaper and make a better profit on it.

That has been the history of machinery development, as you know far better than I do.

Senator FLANDERS. I am glad you brought that up because I want to come to it presently.

I might ask you whether you think the wholesale price index is more readily reckoned on a rational basis than the consumer price index?

Mr. MARTIN. Can I ask Mr. Young to comment on that?

Senator FLANDERS. I would be glad to hear from Mr. Young.

He has the same first name as I do, and there are not many of them in the world. [Laughter.]

Mr. YOUNG. Well, you get many of the same problems with both types of indexes, such as difficulties arising from changes in quality of the things that are priced. Your wholesale price index is just commodities as against consumer price index which includes rents and services.

Senator FLANDERS. However, it would not seem to represent such shifts in construction, in quality, in invention and improvement as does the——

Mr. YOUNG. The final product index?

Senator FLANDERS. Yes.

Mr. YOUNG. Would be more affected by that.

Senator FLANDERS. I note that throughout 1952, on the whole, the wholesale price index did decrease, and then it hung along level to the middle of 1955 and then started up again.

Mr. YOUNG. It was the first reaction from the sharp Korean upswing.

Senator FLANDERS. Yes.

Next I want to come to this question of excessive plant expansion construction. I would like to make, and I judge from what you just said that you are prepared to follow me, a distinction between investments in plant and equipment for expansion and for improvement of processes.

It seems to me that it is very important to make that distinction for two reasons: the first reason would seem to me to be what I think you just indicated, that the second type of investment, for improvement of efficiency in production, is something that is in order at any time, if you can finance it, and if you see a sufficient volume of business ahead of you.

Mr. MARTIN. Yes.

Senator FLANDERS. So it would seem as though recovery of that kind of investment in plant and equipment would be in order now wherever it can be undertaken.

I think that is a rather important thing and let's not write off plant investment as a whole without discriminating between the two types of plant investment. I take it you would agree.

Mr. MARTIN. I agree completely.

Senator FLANDERS. That leads to another question, and that I do not find adverted to directly, indirectly or by remote inference in your paper, and that is the wage-price spiral.

First, what is the relationship between the wage-price spiral and the demand and supply ratio?

We can go back to that old Yale professor's money formula of 40 years ago, what was it—price equals money over goods or something or other.

What was that? You know who he was and I do, too.

Mr. MARTIN. I know him very well, but I cannot recall his formula. Irving Fisher.

Senator FLANDERS. Yes—Irving Fisher, that is the name.

Now, that formula I would think was also axiomatic. How does the wage-price spiral fit into it? Or maybe you think the wage-price spiral does not?

Mr. MARTIN. I think it exists and it is operating right at the moment. That is one of the factors in the price level, with escalator clauses and other things. Even though the demand for products has slipped with the cost-of-living index going up, there are a good many people who are getting an increase in wages just automatically.

Now there the spiral is just turning like that.

Senator FLANDERS. Is that independent of the Fisher formula?

Mr. MARTIN. I would say it was independent of the Fisher formula. Mr. Riefler would like to make a comment. He is an expert in this.

Senator FLANDERS. Mr. Riefler?

Mr. RIEFLER. Well, the Fisher formula is simply MV equals PT; P is prices, and that would include the whole spiral, both the wages and the prices going up.

Senator FLANDERS. If the escalator clauses and other activities of the relations between management and labor keep running the cost up and running the price up, how does that affect the 3 factors there, the 3 factors which you just gave? How does it affect the money supply? How does it affect the supply of goods?

Is it not a direct effect on prices independent of the old formula, and if it affects the other factors of the formula besides price, is it not a determinant of a sort that is not recognized in our consideration of inflation as directly in relationship between money supply and things to be bought?

I do not know, Mr. Chairman, that this is fruitful for discussion, but I have been a little bit perplexed by the relationships between the wage-price spiral and the money-goods relationship.

It seems as if there were two things that focused on prices, and that we have to take both of those two things into accunt. By the way, the reason for my lack of optimism about the lowered prices just is that wage-price spiral.

I think we are caught.

But I will not go much further with this. I would like to know whether we have these two factors focusing on prices and whether in some way they can be expressed each in terms of the other.

Mr. MARTIN. I think you have both of them, don't you?

Mr. YOUNG. Yes, they interact, these different factors are interacting on one another and prices can get out of line and, when they do, your T or Q, your quantity, is going to go down.

Prices can be an independent causal factor in that sense.

Senator FLANDERS. I just wanted to make sure that whenever we speak of inflation it was proper to be considering the wage-price spiral.

Mr. MARTIN. Oh, no question of that.

Senator FLANDERS. We can't state it in purely monetary terms.

Mr. MARTIN. That is what we tried to spell out in the paper last August.

Senator FLANDERS. Yes.

Mr. MARTIN. And I made a little reference to it today and the point that Senator Kerr picked up on the "mutual interaction."

Senator FLANDERS. Let's see.

Mr. Chairman, the principal point I had hoped to make, I judge that our witness agrees with. That is that expenditures for improvement in efficiency of production are in order when expenditures for expansion are not.

Mr. MARTIN. That is right.

Senator FLANDERS. And that, it seems to me, is one of the hopeful possibilities in the present situation. It was my desire to nail that thought down. That is all I have, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Flanders.

Senator JENNER. Mr. Chairman, could I ask one question?

How much have we dropped the reserve requirement in the last 5 months?

Mr. MARTIN. In the case of the central Reserve city banks, which are in New York and Chicago, the drop has been from 20 to 18 percent.

In the case of the Reserve city banks, which are most of the large city banks elsewhere, we have dropped from 18 to 16½ percent.

Senator JENNER. Around 2 percent generally as an average?

Mr. MARTIN. Around 2 percent, yes.

Senator JENNER. How much additional money does that create?

Mr. MARTIN. Well, a total reduction of—what is it, a billion and a half—about a billion and a half; that would be a potential expansion of $9 billion, assuming that they loaned the money.

Senator JENNER. Used it up?

Mr. MARTIN. Assuming they used it up.

Senator JENNER. Now, if we have plenty of money in savings and so forth, which I believe you testified to here earlier, to take care of credit demand, what was the necessity for creating another $9 billion potential?

Mr. MARTIN. Well, that is a good question, Senator.

Merely to make it possible for the banks to invest in securities and make possible the financing in the first quarter of this year that has occurred in corporate, State, and municipal securities, because it is very questionable whether it would have been financed otherwise; and also to put the banks in a more liquid position and to prepare them as a prerequisite for the recovery that we are confident will come, for making additional loans when the time comes.

Senator JENNER. Well, then, if that be true, and savings are at an alltime high, and I think it does have an effect upon the whole system, should we anticipate further decreases in reserve requirements, if we have already created a $9 billion additional?

We have $300 billion, I think approximately in savings, the highest ever known in the history of our country.

Is there any reason for our country to believe that the Federal Reserve System may further decrease?

Mr. MARTIN. I would not want to comment on future action, except that I have repeatedly stated over the last few years that I think reserve requirements generally have been too high for the development and growth that I think is ahead for the country. That has nothing to do with the current recession. But I think that we got them too high over a period of time.

You will recall that up to 1936 roughly, 1935, 13, 10 and 7 percent were the reserve requirements. Then we had a special situation with the terrific inflow of gold that occurred in the thirties, and the Board was given permission to double the reserve requirements in large measure to take up that slack.

Senator JENNER. Well, I was just thinking along these terms. You have made it possible for $9 billion more to be put into the bloodstream of credit in this country and we down here in Washington every day, I won't say every day, but we are increasing Federal expenditures, probably before this session ends around $4 billion, $3½ billion for the Commodity Credit Corporation, the lending authority for the Export-Import Bank another $2 billion.

Stepping up the highway program, $1,800 million, housing another $1½ billion and so forth, and so on.

I just wonder if what you said earlier, that you have got to look at the results of what is going to happen in a year or two now if we are not all just getting a little too liberal with money, spending.

Mr. MARTIN. I am sure there are some people who think the Reserve System has acted too liberally in this matter now. There are also people who think we have been too slow and done too little.

Senator JENNER. One other question and I am finished: Senator Flanders referred to it. What effect is the rigidity that has been built into our economy by the prices of labor having on this overall situation at the present time?

Mr. MARTIN. It is having an unfortunate effect, I think. The more rigidities we place in the price mechanism, the more difficult it is to make our adjustments.

Senator JENNER. When you say if this country will produce something at a price the public is willing to buy, you are covering the great human element of this country that unless they are satisfied with the price and that the price cannot be reduced because of the rigidity of labor and wages we are not likely to see the public come out and spend this $300 billion until they are ready, are we?

Mr. MARTIN. I think there is a right in that.

Senator JENNER. Thank you, Mr. Chairman.

Senator CARLSON. Mr. Chairman, I need to ask a question before you recess in order to answer one of my constituents.

The CHAIRMAN. Yes, sir.

Senator CARLSON. In your statement of course we knew in advance you had eased the credit conditions last week by reducing the rediscount rates an additional one-half interest point. I notice you say this was accepted by 7 Federal Reserve banks. Would you name those?

Mr. MARTIN. New York, Chicago, Boston, Atlanta, Philadelphia, St. Louis, Minneapolis, and I think the others probably will come along when they have their meetings, Senator.

I cannot forecast what they do—we do not order them to.

Senator CARLSON. The reason I inquired is I received a wire yesterday complaining bitterly and I assumed it affected our particular area, that this constituent of mine says that what are we going to do about it when the banks in our area will not follow the regular trend of the Federal Reserve and reduce the requirements by this one-half percentage point and that is the reason I asked you.

Now this should have been taken care of in my opinion by the St. Louis or the St. Paul bank.

Mr. MARTIN. The Kansas City Reserve Bank would be in your area.

Senator CARLSON. That is the reason I was inquiring.

Now, what am I going to wire this man that we can do about that situation and what is the reason they did not reduce it in Kansas City?

Mr. MARTIN. Well, I do not know exactly when the Kansas City Board meets, but it may be that they will decide that the Kansas City district is doing so well they ought not to reduce the rate—in which event we would not order them to reduce the rate. On the other hand, they may decide—we have had discussions on this in the open market committee—to fall in line; but they have not had a meeting. If they have not acted, I am quite sure they have not had a meeting.

Senator CARLSON. In other words, these banks act as an autonomy on their own. They operate and raise or lower these requirements as individual banks see fit; is that right?

Mr. MARTIN. Each one of these banks has its own boards of directors and, while there is coordination here in Washington, we try to get them to exert as much independence and intelligence as they can; we are not necessarily always right here.

We do have an open market meeting every 3 weeks at which the president of the Kansas City bank will be a participant so he will know what the general thinking is.

Senator CARLSON. Well, I have great confidence in the head of all these reserve banks and especially in Kansas City and I just wanted to check to see what this problem was because I was not certain of it.

I do not want to detain the committee, Mr. Chairman.

Senator Flanders and I noticed every member of this committee has been concerned about what seems to be, I do not like to use the words "buyers' strike," but a buyers' resistance or a buyers' selectivity at the present time which seems to be one of our problems and Senator Flanders went into some details as to what the people might use some of this money for if we had a tax reduction.

I noticed in last Sunday's release by Dr. Gallup, who has made a study of this, contains some interesting information on this very matter.

Dr. Gallup has been wrong, I know on one occasion when he was painfully wrong, so far as I was concerned, but it is an interesting study, and I am going to ask, Mr. Chairman, that we can put this in the record at least.

The CHAIRMAN. Without objection.

(The document is as follows:)

THE GALLUP POLL—TAX REBATE, SPENDING ARE LINKED

By George Gallup, director, American Institute of Public Opinion

PRINCETON, N. J., April 19.—As politicians and economists argue the relative merits of tax cuts and increased Government spending, one question remains which only the consumers can answer—what would they do with a tax rebate if they got it?

The institute gave 162 experienced reporters the assignment to ring doorbells, to get at the grassroots sentiment in all sections of the country. They asked th question:

"If the Government gave you back one-fifth of the money you pay in income tax, what would you do with the money?"

From a Mountain Creek, Ala., miner who said he would buy whisky with it to a Pulaski, Wis., farmer who would purchase a new manure spreader, the answers Gallup poll reporters got from voters fall into these general categories:

	Percent
Would you buy something which otherwise would not buy	36
Would pay debts	22
Would save it	18
Would use it for normal living costs	11
Would invest it	7
Don't know	6

The categories above give, in general terms, the way voters answered. Here is a sample of some of the specific things people would do:

"Put a new roof on my home * * * live it up * * * buy something I don't need * * * buy me a rabbit dog * * * go to Europe * * * have my teeth fixed * * * take a trip to Hawaii * * * buy more hogs * * * go on a shopping spree * * * eat—I'd like some steak for a change."

A 48-year-old civil engineer from Carlsbad, Calif., lamented:

"Oh, my wife will probably find a way to spend it."

COOL TO TAX CUTTING

To get voter reaction to the Government's position in the recession, Gallup poll next asked these two questions of voters from coast to coast:

"Do you think conditions will get better naturally with time, or do you think the Government will have to take action?"

The views of all voters:

	Percent
It will get better with time	35
Government will have to take action	54
No opinion	11

"If the Government does take action to improve the business situation in the country, which of these two plans would you prefer—an income tax reduction for all taxpayers and businesses, or Government spending for public works?"

The vote:

	Percent
Tax cut	41
Public works	46
No opinion	13

Analysis of the question of Government action reveals that although all groups feel the Government will have to step in, the greatest sympathy for letting time take its course is found in the Midwest, among college-trained people, and among business and professional people.

(Copyright, 1958, American Institute of Public Opinion)

Senator CARLSON. I want to comment for a moment on it because I am sure the chairman did see it or someone called it to his attention.

Thirty-six percent of the people who were interviewed said they would buy something if they had this tax reduction that they would otherwise not buy.

Twenty-two percent would use this reduction to pay debts. Eighteen percent would save it, 11 percent would use it for normal living costs, 7 percent would invest.

When you analyze those figures between those who would buy something they would not otherwise buy and those who would use it for normal living costs, and those that would pay debts, would save it, and would invest it, it comes to exactly 47 percent of those 2 groups, then if you take the 6 percent who did not know, take 3 percent and divide that it would be exactly 55 as to the opinions he secured from the people.

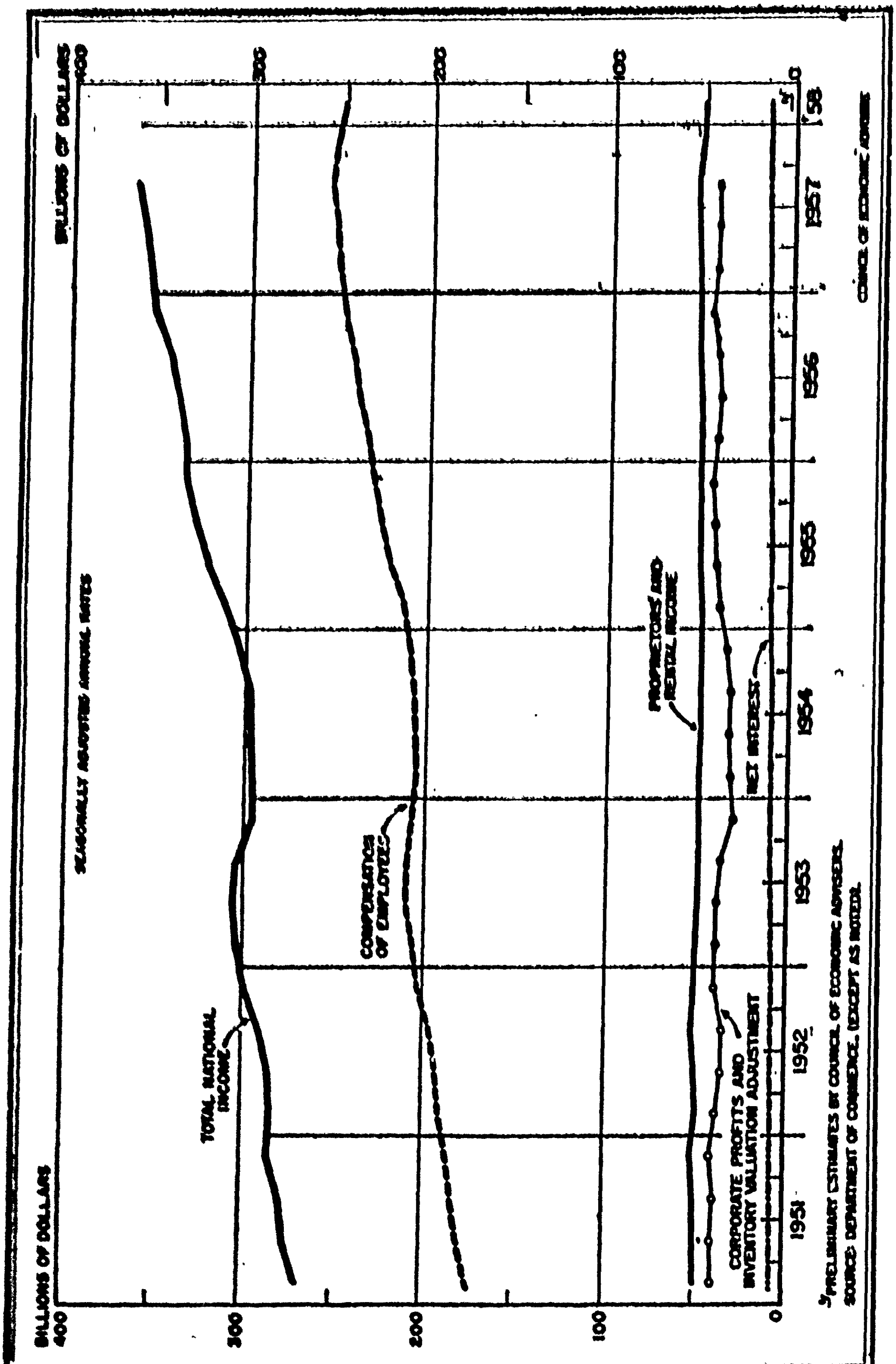
Who would be benefited by tax reductions?

I thought it was an interesting study, and I will ask, Mr. Chairman, that this chart be made a part of the record.

The CHAIRMAN. Without objection.
(The table is as follows:)

NATIONAL INCOME

Compensation of employees was $4.9 billion (seasonally adjusted annual rate) lower in the first quarter of 1958 than in the fourth quarter of 1957.



[Billions of dollars]

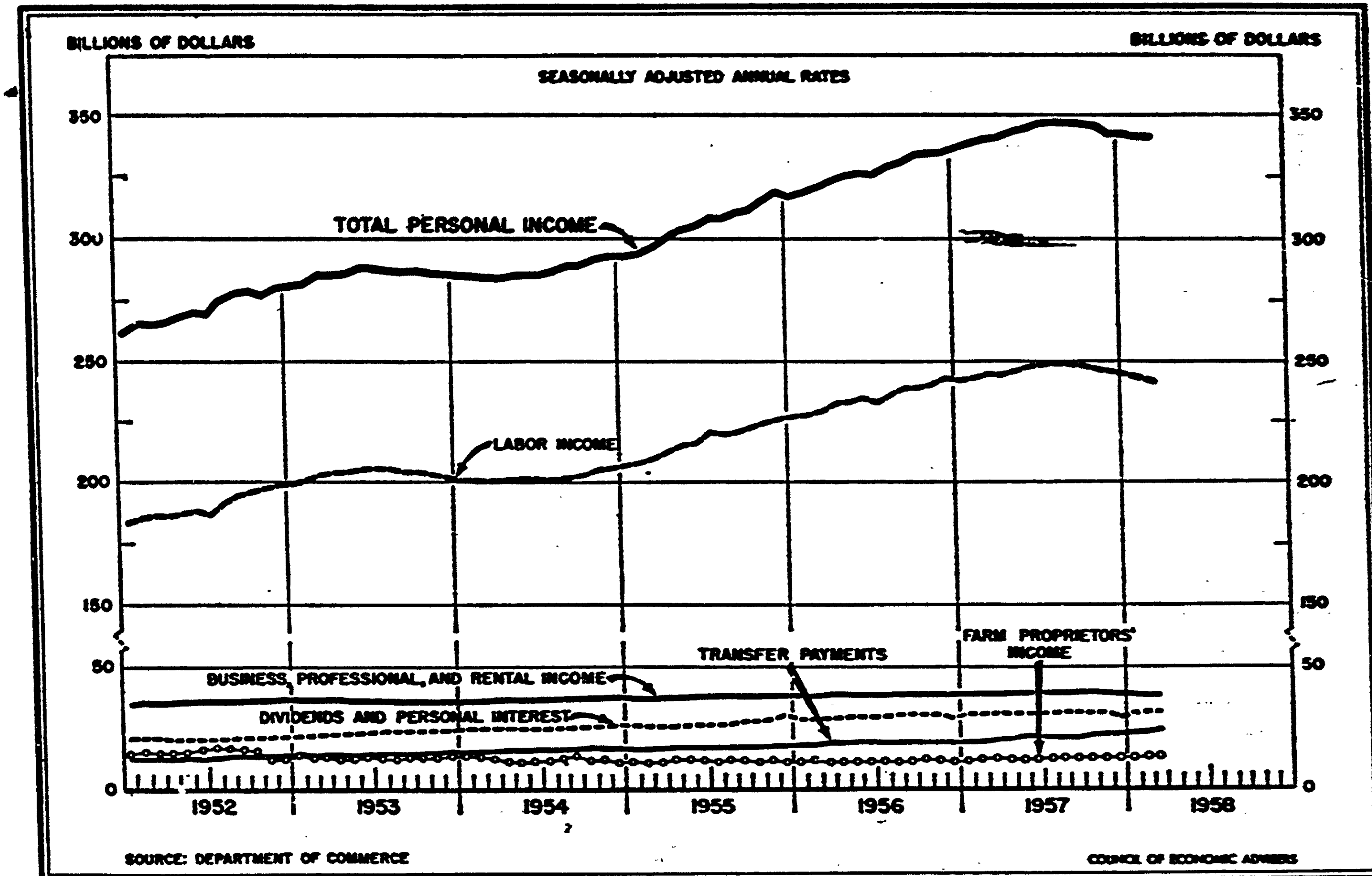
Period	Total national income	Compensation of employees [1]	Proprietors' income: Farm	Proprietors' income: Business and professional	Rental income of persons	Net interest	Corporate profits and inventory valuation adjustment: Total	Corporate profits and inventory valuation adjustment: Profits before taxes	Corporate profits and inventory valuation adjustment: Inventory valuation adjustment
1939	72.8	48.1	4.3	7.3	2.7	4.0	5.7	6.4	−0.7
1948	221.6	140.9	15.7	21.6	7.2	4.5	30.6	32.8	−2.2
1949	216.2	140.9	12.7	21.4	7.9	5.2	28.1	26.2	1.9
1951	277.0	180.4	16.0	24.8	9.1	6.5	39.9	41.2	−1.3
1952	290.2	195.1	15.1	25.7	9.9	7.4	36.9	35.9	1.0
1953	302.1	208.1	13.3	25.9	10.2	8.7	36.0	37.0	−1.0
1954	299.0	206.8	12.7	25.9	10.6	9.6	33.1	33.6	−.3
1955	324.1	223.1	11.9	27.3	10.2	10.9	40.7	42.5	−1.7
1956	343.6	241.4	11.6	28.0	10.3	11.9	40.4	45.0	−2.6
1957	358.0	254.4	12.1	28.7	10.4	12.6	[2] 39.5	[2] 41.0	[2] −1.5
	Seasonally adjusted annual rates								
1956—3d quarter	344.8	242.7	11.8	28.2	10.4	12.0	39.5	40.5	−1.0
4th quarter	353.5	247.9	12.0	28.5	10.4	12.3	42.4	45.6	−3.2
1957—1st quarter	355.0	251.1	12.0	28.4	10.4	12.5	41.2	43.9	−2.7
2d quarter	356.8	254.0	12.1	28.7	10.4	12.7	40.7	42.0	−1.3
3d quarter	362.0	257.0	12.2	29.1	10.4	13.0	40.9	41.8	−.9
4th quarter	(3)	255.5	12.2	28.6	10.4	13.3	(3)	(3)	(3)
1958—1st quarter [2]	(3)	250.4	12.6	27.9	10.3	13.4	(3)	(3)	(3)

[1] Includes employer contributions for social insurance (See also p. 4.)
[2] Preliminary estimates by Council of Economic Advisers; rounded to nearest $500,000,000.
[3] Not available.

NOTE.—Detail will not necessarily add to totals because of rounding.
Source: Department of Commerce (except as noted).

SOURCES OF PERSONAL INCOME

Personal income in March was at a seasonally adjusted annual rate of $341.4 billion, slightly lower than in February. The $1.2 billion decrease in wages and salaries was partially offset by increases in farm income and transfer payments. Other types of income were unchanged.


BILLIONS OF DOLLARS
BILLIONS OF DOLLARS
SEASONALLY ADJUSTED ANNUAL RATES
350
300
250
200
150
50
0
TOTAL PERSONAL INCOME
LABOR INCOME
TRANSFER PAYMENTS
FARM PROPRIETORS' INCOME
BUSINESS, PROFESSIONAL, AND RENTAL INCOME
DIVIDENDS AND PERSONAL INTEREST
1952
1953
1954
1955
1956
1957
1958
SOURCE: DEPARTMENT OF COMMERCE
COUNCIL OF ECONOMIC ADVISERS

(Billions of dollars)

Period	Total personal income	Labor income (wage and salary disbursements and other labor income) [1]	Proprietors' income: Farm	Proprietors' income: Business and professional	Rental income of persons	Dividends	Personal interest income	Transfer payments	Less personal contributions for social insurance	Nonagricultural personal income [2]
1939	72.9	45.6	4.3	7.3	2.7	3.8	5.8	3.0	0.6	67.1
1949	206.8	137.4	12.7	21.4	7.9	7.5	9.8	12.4	2.2	190.8
1951	255.3	175.6	16.0	24.8	9.1	9.1	11.6	12.6	3.4	235.7
1952	271.8	190.3	15.1	25.7	9.9	9.0	12.3	13.2	3.8	253.1
1953	286.0	203.4	13.3	25.9	10.2	9.3	13.7	14.3	3.9	269.2
1954	287.4	201.7	12.7	25.9	10.6	9.9	15.0	16.2	4.6	271.3
1955	305.9	217.3	11.9	27.3	10.2	11.0	16.1	17.4	5.2	290.6
1956	326.9	234.8	11.6	28.0	10.3	11.9	17.6	18.5	5.7	311.7
1957	343.4	246.7	12.1	28.7	10.4	12.1	18.8	21.2	6.8	327.5
	Seasonally adjusted annual rates									
1957—March	340.2	245.0	12.2	28.6	10.4	12.4	18.5	20.0	6.8	324.5
April	341.1	244.9	12.1	28.6	10.4	12.5	18.6	20.8	6.7	325.3
May	343.2	246.1	12.0	28.7	10.4	12.5	18.6	21.6	6.8	327.5
June	345.1	248.0	12.0	28.8	10.4	12.5	18.7	21.5	6.8	329.3
July	346.3	248.8	12.1	29.1	10.4	12.5	18.9	21.3	6.9	330.5
August	347.3	249.7	12.2	29.1	10.4	12.6	19.0	21.2	6.9	331.3
September	347.2	249.5	12.2	29.0	10.4	12.5	19.1	21.2	6.8	331.3
October	346.8	248.1	12.2	29.1	10.4	12.5	19.2	22.1	6.8	331.0
November	346.2	247.5	12.2	28.6	10.4	12.4	19.3	22.6	6.8	330.3
December	343.6	246.8	12.2	28.3	10.4	10.2	19.5	22.0	6.8	327.6
1958—January	343.6	244.9	12.2	28.1	10.3	12.2	19.5	23.3	6.8	327.6
February	341.7	242.2	12.9	27.8	10.3	12.2	19.6	23.5	6.8	325.2
March [3]	341.4	241.0	13.2	27.8	10.3	12.2	19.6	24.1	6.8	324.6

[1] Compensation of employees (see p. 3) excluding employer contributions for social insurance and the excess of wage accruals over disbursements.

[2] Personal income exclusive of net income of unincorporated farm enterprises, farm wages, agricultural net interest, and net dividends paid by agricultural corporations.

[3] Preliminary estimates.

NOTE.—Detail will not necessarily add to totals because of rounding.
Source: Department of Commerce.

Senator CARLSON. If I have a future time I will get into some of these savings. I will not detain the committee. I think the chairman made a very outstanding statement this morning and I appreciate it very much.

The CHAIRMAN. Mr. Martin, there is just one other thing I want to insert in the record which has, it seems to me, considerable significance.

In the first quarter of 1957 the gross national product was $429 billion plus.

The first quarter of 1958 it was $424 billion plus—approximately $5 billion less.

Yet the personal consumption expenditures in the first quarter of 1957 was $276 billion plus, and the first quarter of 1958 they were $281 billion plus.

In other words, gross national product was $5 billion less but personal consumption was up $5 billion. It seems to me these figures are a very good index of the general business situation.

In addition I want to make it clear that in my views on the excessive plant development which occurred in a short period, I believe that temporarily has had an adverse effect. But I think within a reasonable time, and probably a short time, that the additional plant will be caught up with. Is that your opinion?

Mr. MARTIN. That is my opinion; yes, sir.

The CHAIRMAN. Thank you very much, Mr. Martin. We will see you at 10 o'clock tomorrow morning.

Mr. MARTIN. Thank you, sir.

(Whereupon, at 12:10 p. m., the committee was adjourned, to reconvene at 10 a. m. Wednesday, April 23, 1958.)

INVESTIGATION OF THE FINANCIAL CONDITION OF THE UNITED STATES

WEDNESDAY, APRIL 23, 1958

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 (chairman), Kerr, Frear, Long, Gore, Martin, Williams, Flanders, Carlson, Bennett, Anderson, Malone, and Jenner.

Also present: Elizabeth B. Springer, chief clerk, and Samuel D. McIlwain, special counsel.

The CHAIRMAN. The committee will come to order.

The Chair recognizes Senator Kerr.

Senator KERR. Thank you, Mr. Chairman.

Mr. Martin, first I want to say that I have as high regard for your integrity and sincerity as that of any man I know in Government, and my regard for your ability is very high, and although it is a fact I may disagree with you as to policy, that is in no way indicative of lack either of complete confidence in your integrity or lack of respect for your ability.

I think that you probably are in position to do more than any other one man in the Nation to determine the tempo of our economic operation, either expansion or contraction, and therefore I think that probably you have responsibilities beyond any other single individual in the Government that I know of, aside from the President.

I think you have a good deal of responsibility there, because you have access to him and those who surround him, either to him when he is making his decisions or others when they are making them for him, and you have to determine those decisions either by active participation or by failure to participate.

Quite early in the history of this Republic a very eminent authority, Chief Justice John Marshall, in the case of *McCulloch* versus *Maryland*, made this statement:

> The power to tax the (bank) by the States may be exercised so as to destroy it, is too obvious to be denied; that the power to tax involves the power to destroy is not to be denied.

Do you agree with that statement?

STATEMENT OF WILLIAM McCHESNEY MARTIN, JR., ACCOMPANIED BY RALPH A. YOUNG, WINFIELD W. RIEFLER, AND ARTHUR MARGET—Resumed

Mr. MARTIN. I do.

Senator KERR. I wonder if you would explain to the committee in your own words as to what you believe is involved in the exercise of the power to tax.

What is there about that power that causes John Marshall, then the Chief Justice of the United States, and countless others since then and you and I today, to feel that the power to tax includes the power to destroy?

Mr. MARTIN. Well, because if you carry taxation far enough it can become confiscation.

Senator KERR. Would this be a simple and accurate statement: That the power to tax is the power to take from a citizen by due process of law that which he has which has value?

Mr. MARTIN. That is correct.

Senator KERR. Yet, in order to implement a tax there has to be a law, does there not?

Mr. MARTIN. There does.

Senator KERR. And in our form of government that comes about by action of representatives of the people, elected by the people?

Mr. MARTIN. Correct.

Senator KERR. Now, taxation is not the only operation of taking from people that which they have that is of value, is it?

Mr. MARTIN. It is not.

Senator KERR. For practical purposes, Mr. Martin, how much difference is there between taking from people those things of value which they have and the taking the value from things which the people own or have?

Mr. MARTIN. I think there is very little difference, and that is why depreciation of the currency is such a vital point and why it was so actively considered at the time that John Marshall was making those comments.

Senator KERR. Well, now, is currency the only thing that people have that is of value?

Mr. MARTIN. No; I do not say it is the only thing they have that is of value, but as a measure of value——

Senator KERR. Does it in fact have any intrinsic value whatever?

Mr. MARTIN. Currency? When it is related to something; yes.

Senator KERR. I do not mean by relation. I mean does currency by itself have any intrinsic value?

Mr. MARTIN. Are you talking about a dollar bill now?

Senator KERR. Yes. You cannot eat it, you cannot wear it, you cannot use it as a roof over your head, can you?

Mr. MARTIN. No; but nobody would consider it of any value if you did not attach it to something that—and that is what money is, really.

Senator KERR. I do not think I would disagree with you there. But I think its value is extrinsic rather than intrinsic.

Mr. MARTIN. Well, the basic component of money, if you define money as a medium of exchange——

Senator KERR. What else is it? What else is it unless it is metallic?

Mr. MARTIN. Well, it is a store of value, but it——

Senator KERR. It is a store or a standard?

Mr. MARTIN. Both. If it is what we want it to be, it is both and the basic component in money is confidence.

That is where——

Senator KERR. You say the basic component in money or the basic component which gives it its value is confidence?

Mr. MARTIN. Well, the two are related, but I think the latter is correct, your latter statement is correct.

Senator KERR. I think that the real determination of its value is what you can buy with it.

Mr. MARTIN. That is quite right.

Senator KERR. But whether its value is extrinsic or intrinsic or both, or valuable otherwise, it is not the only thing that people have that is of value?

Mr. MARTIN. I agree with that, but——

Senator KERR. How much currency do we have?

Mr. MARTIN. At the present time—roughly $30 billion in circulation. That includes coins.

Senator KERR. That is in circulation and out of circulation, is it not?

Mr. MARTIN. Yes; that is right.

Senator KERR. That includes all that is in the banks, all in lockboxes and——

Mr. MARTIN. Well, no; there is more than—what is the figure, Ralph? Have you got it?

Mr. YOUNG. Currency outside of banks—in circulation with the public—would be in the neighborhood of $28 billion.

Senator KERR. How much is inside the banks?

Mr. YOUNG. About $2 billion.

Senator MARTIN. Well, doesn't 28 and 2 make 30?

Mr. MARTIN. That is correct; we were correct the first time.

Mr. YOUNG. There is deposit currency.

Mr. MARTIN. I am not talking about checks, but there is the check.

Senator KERR. I am talking about the total amount of printed currency that is outside of the vaults of those that issue it.

Mr. MARTIN. $30 billion is correct.

Senator KERR. Approximately $30 billion.

Mr. MARTIN. That is right.

Senator KERR. What is the total value of the economic assets of the Nation and the people in the Nation?

Mr. MARTIN. Could you get a figure on that?

Mr. YOUNG. I do not know whether there would be a figure on that. It would run into the hundreds of billions of dollars, of course.

Senator KERR. Would not it run into the trillions of dollars?

Mr. MARTIN. Well, I suppose with real estate——

Senator KERR. I am talking about everything.

Mr. YOUNG. It would run way up.

Senator KERR. How much is the total public and private debt?

Mr. MARTIN. About $600 billion.

Mr. YOUNG. Around $600 billion.

Senator KERR. Why, it was over $600 billion on December 31 of 1956.

You have got the figures there, have you not?

Mr. YOUNG. Not on that.

Senator KERR. Haven't you got a staff here that is going to be able to inform me on the answers?

Mr. MARTIN. We will be glad to inform you on the figures.

Mr. YOUNG. We will be glad to get you the figures.

I do not have the total wealth.

Senator KERR. I do not think it is the total wealth, it is an item of wealth. Because the creditors regard it as an asset, don't they?

Mr. MARTIN. I think they do.

Mr. YOUNG. The debts; yes.

Senator KERR. Isn't there something like $800 billion dollars of it?

Mr. YOUNG. It would be $700 or $800 billion—in that neighborhood.

Senator KERR. Well, that is nearly a trillion.

Mr. YOUNG. Yes.

Senator KERR. Doesn't the Federal Reserve in its analysis of the economy make an estimate of the total wealth of the Nation or make estimates which could be referred to and from which could be ascertained reasonable estimate of the wealth of the Nation?

Mr. YOUNG. At the present time there is no estimate of the total wealth of the Nation that is made by any Government agency.

We have been working toward that, but we have not gotten such an estimate that is relatively current at the present time.

Senator KERR. Well, how near do you have it?

Mr. YOUNG. Well, there are past estimates that have been made by various experts in the field.

Senator KERR. I am talking about the Federal Reserve. I regard you as the most authentic source of economic information available to the country.

Mr. YOUNG. We have never made any estimates of the total wealth of the country ourselves.

Senator KERR. How much of an undertaken would that be?

Mr. MARTIN. I think it would be quite an undertaking. It is a difficult measurement to make and I think we will be glad to explore it.

Senator KERR. Well, it is certainly well over a trillion dollars, is it not?

Mr. YOUNG. It is a lot of money.

It is a very big figure.

Senator KERR. Would you say it is well over a trillion dollars?

Mr. MARTIN. I would guess you would be correct in that, but I do not know.

Senator KERR. That figure does not stun you?

Mr. MARTIN. It does not stun me at all; no.

Senator KERR. The Nation that is producing $440 billion of gross annual product, and has been doing that for several years, unless there has been a lot of depreciation or waste it is going to be somewhere in that neighborhood, would it not?

Mr. MARTIN. It would be very large.

Senator KERR. Can we assume that you, as Chairman of the Board of Governors of the Federal Reserve Board, would get out on the limb far enough to say that, in your judgment, there is well over a trillion dollars total economic assets in this country? And make it on the basis of something—other than a guess.

Mr. MARTIN. I would not want to put my prestige as Chairman of the Federal Reserve Board on any specific figure that I was uninformed on, as I am at the moment with respect to what is involved in total wealth computation.

Senator KERR. What figure would you put your prestige on?

Now, remember this, that your prestige can suffer by ultraconservatism in the judgment of some, including the questioner, as much as it could by excessive optimism.

Mr. MARTIN. Well, I am aware of that. I will withdraw the prestige factor. [Laughter.]

Senator KERR. You cannot disassociate yourself from it. I would not have you do it if you would.

Mr. MARTIN. That is right. I will say frankly that I don't know what the total wealth of the country is. I have not thought of it in those terms.

Senator KERR. Well, then, let me go back to the question that started all this verbal meandering.

Would you say that currency is any considerable percent of the total things of value that people have?

Mr. MARTIN. Well, in you take currency, if you take money as pocket money which is currency——

Senator KERR. I am talking about currency.

Have you got any in your pocket?

Mr. MARTIN. I have some in my pocket.

Senator KERR. Here is some. What do you call that?

Mr. MARTIN. I call that currency.

Seantor KERR. How much is there of it in existence?

Mr. MARTIN. Well, it is about $30 billion.

Senator KERR. All right.

Would you say that that was a considerable percent of the total things of value that people in this country own?

Mr. MARTIN. No; I won't say that was a very large percent of the total things. But there is, in addition, deposit money that is interchangeable with that.

Senator KERR. Well, you mean to those that can get there in time if they all decided they want it.

Mr. MARTIN. Well, I think it is a little bit more certain than that. I think that our deposit currency and our pocket——

Senator KERR. I am not talking about credit, I am not talking about credit in the bank. I am talking about currency.

Mr. MARTIN. Currency.

Senator KERR. What I am trying to do is to find ground from which we can go forward, that we can agree on for this record, and that is that currency is but one of the items of things that have value which people own.

Mr. MARTIN. That is correct.

Senator KERR. And that at least insofar as people are concerned, other things that they have of value mean just as much to them as money.

Mr. MARTIN. Well, that is unquestionably so.

But we are using the money as a convenience, as a medium of exchange.

Senator KERR. But not exclusively?

Mr. MARTIN. Well, you can have barter of all of these items, but in a——

Senator KERR. You can even trade checks for them?

Mr. MARTIN. Yes, indeed.

Senator KERR. But if they do not have value you cannot trade them for currency much.

Mr. MARTIN. Well, that is where——

Senator KERR. Can you?

Mr. MARTIN. No; but that is where the relationship factor comes into the thing.

Senator KERR. But the very existence of the relationship compels you to the conclusion that the value of the other assets they have is of significance to them?

Mr. MARTIN. That is correct.

Senator KERR. Now, therefore, I get back to the question that I started with: Isn't it just as important to people that the value of other things they have than money be maintained as it is that the value of their money be maintained?

Mr. MARTIN. Well, I think it is, but I do not believe you can separate them. That is why I stress this relationship.

Senator KERR. I know you cannot separate it, and that is the reason that the answer to that question has to be "Yes."

Mr. MARTIN. On that——

Senator KERR. If you cannot separate them, then you cannot say that the value of one is of more significance to them than the value of the other, if they are directly related.

Mr. MARTIN. Well, they are directly related, but the relationship is such that you measure them in terms of one or the other.

Senator KERR. All right.

Take either one you want to now.

Just take either one you want to and stay with it for 5 minutes. Which one are you going to have as the standard, the thing or the money?

Mr. MARTIN. Well, I think that you have to look at money as a convenience that modern society has developed.

Senator KERR. I agree with that. However, it is not so modern that I do not suppose there has ever been a time since man either received the impact of the breath of life and changed from clay to a human being or when he crawled out of the trees or whichever way he got there, that he did not have something that was regarded by him as money.

Mr. MARTIN. And we could return to barter tomorrow.

Senator KERR. Has he?

Then it is not such a modern thing; is it?

Mr. MARTIN. In its refinements, it is relatively modern.

It certainly goes back——

Senator KERR. We have it in this modern era, but we inherited it from antiquity, didn't we?

Mr. MARTIN. We did, indeed.

Senator KERR. Did Marshall say that the power to tax involved the power to destroy?

I do not find anything in there about that power being limited to money.

Mr. MARTIN. Well, I have not reviewed that.

Senator KERR. You do not so understand it, do you: If you take a man's property by process of law but without compensating him for it, it is just as deadly to him whether you take his money or his farm or his goats or his sheep or his asses; is it not?

Mr. MARTIN. That is correct.

Senator KERR. So the power to take from people involves the power to destroy whether you are taking currency or anything else of value.

Mr. MARTIN. I think that is right.

Senator KERR. All right. That is where I would like to have gotten to when we started.

Which has taken the most of value from people in this country, taxation, inflation, or deflation?

Mr. MARTIN. Over a period of time, that is a pretty difficult question.

Senator KERR. I would agree with you that taxation has.

Mr. MARTIN. Taxation—now inflation and deflation, you cannot separate.

Senator KERR. Let's don't get into that for just a minute.

As between the three, do you agree that taxation has taken more than either of the other two?

Mr. MARTIN. No, I cannot say that I would agree to that, because your taxation has to be measured in something.

Now whether you measure it in property or you measure it in money there has to be—if there is a depreciation of the currency occurring or the currency is becoming of more value, that is a relationship that has to be dealt with.

Senator KERR. When money becomes of less value that is a depreciation of currency, is it not?

Mr. MARTIN. That is right.

Senator KERR. When money becomes of more value that is a depreciation of other assets, isn't it?

Mr. MARTIN. There is depreciation, that is correct.

Senator KERR. So that any shift in the relative value results in depreciation in value of one or the other?

Mr. MARTIN. That is correct.

Senator KERR. Now then, for purposes of this hearing, it has gotten to be pretty well accepted that we use the term "inflation" to refer to depreciation in the value of the currency, and deflation to refer to depreciation in the value of things other than money?

Mr. MARTIN. Well, that I would question. That is where you get into——

Senator KERR. You might question whether or not that is the accurate designation or use of the term.

Are you telling me that you are questioning whether in the process of this hearing it seems pretty well that that is the way the two terms have been used?

Mr. MARTIN. Well, I have not attended all the sessions of the hearings, but it seems to me that inflation and deflation—we are seeking here reasonable stability and maximum production, employment, and purchasing power, as the Employment Act instructs us to seek.

Senator KERR. As what?

Mr. MARTIN. As the Employment Act instructs us to endeavor to achieve.

Senator KERR. I am glad you made that statement, because that is going to be one of the things I am going to question you about.

But for the moment, what terms do you want to use generally as between you and me, when I am asking about processes as follows:

One, depreciation or the decrease of the purchasing power of the dollar.

Two, depreciation or decrease in the value of things.

Shall I just use all of those words when I am referring to one of those processes or can we do it in a simpler, briefer language?

Mr. MARTIN. No, I think you have to use them all, as this process is a continuing process.

Senator KERR. I understand. But the sunshine is a continuing process and you still call it sunshine.

Mr. MARTIN. If you can develop some phraseology that we can use——

Senator KERR. How do you define deflation?

Mr. MARTIN. Well, I do not try to define inflation in precise terms any more than I define deflation in precise terms.

Senator KERR. Well, define is a precise term, is it not?

Mr. MARTIN. Well, that is the big problem we are dealing with in this area. It is the words you use; we talk about prosperity, boom.

Senator KERR. We are talking about inflation and deflation.

Mr. MARTIN. And depression. If it were that simple we would not have our problem.

Senator KERR. The problem is one thing and the designation of it is another thing, Mr. Martin.

Mr. MARTIN. Well, I have been struggling with it for a good many years and my associates have too, and we find terminology is the most difficult thing we have to deal with.

Senator KERR. I want to tell you that the problem is the most difficult thing the people have to deal with.

A rose by any other name actually would smell as sweet unless a fellow's imagination controlled his smelling apparatus.

Mr. MARTIN. I don't think——

Senator KERR. For instance, I will read you a statement by Marriner Eccles in 1936:

> It is just as important to bankers that deflation be prevented as it is that inflation be prevented.

Now maybe he was uninformed, maybe he did not know the meaning of those two terms, but to me that terminology has a perfectly simple meaning.

Mr. MARTIN. Well, and I translate the terminology that he is using there in terms of the Employment Act and on the basis of those three phases, maximum production——

Senator KERR. The act had not even been passed when he made that statement.

Mr. MARTIN. No, but I think the Employment Act is a better statement of what we are trying to achieve.

Senator KERR. It may be a better statement of what we are trying to achieve but what I am trying to do is get to some kind of common ground when you and I talk or when I talk we understand what we are talking about and are willing to talk about it on that basis.

Mr. MARTIN. I want to say, just as Mr. Eccles said there, I want neither inflation nor deflation.

Senator KERR. What are you talking about?

Mr. MARTIN. I am talking about stable growth in the economy.

Senator KERR. What does deflation mean then, Mr. Martin?

Mr. MARTIN. Deflation means——

Senator KERR. When you use the term "deflation," what do you mean?

Mr. MARTIN. It means unstable contraction.

Senator KERR. What do you generally describe, how do you generally describe a situation where the value of things is decreasing in relation to the value of money?

Mr. MARTIN. Well, if you put that in technical terms that——

Senator KERR. Do I have to talk in technical terms for you to understand me?

Mr. MARTIN. Well——

Senator KERR. I tell you if you have to talk in technical terms to answer my questions you might just as well talk Choctaw.

Mr. MARTIN. Well, what phraseology could I use?

I do not want the value of money to be increasing at the expense of employment.

Senator KERR. Well, that is a process, Mr. Martin. I am talking about a definition of a condition. You have been using the word "inflation" here for months, for years, and you have, under questioning stated that you referred to the process in which the dollar loses a part of its purchasing power.

Mr. MARTIN. That is correct.

Senator KERR. Well, what is the opposite to that?

Mr. MARTIN. Where the dollar gets additional value——

Senator KERR. Where it gets greater purchasing power.

What do you call that?

If inflation is the process of its value or its purchasing power becoming less, what is the term to define the opposite, the reverse?

Mr. MARTIN. If you isolate it from the process, again.

We have made it very clear in these discussions that in talking about monetary policy as restraining inflation, we have not attempted to use monetary policy as a positive tool to promote deflation, to increase the value of money in relation to——

Senator KERR. Wait, don't use that term unless we have agreed—I do not see what it can mean otherwise, and that is the opposite of inflation.

Mr. MARTIN. All right. Let's agree to these terms in the abstract.

Senator KERR. All right. Let's just agree to them without putting that other word on it.

Mr. MARTIN. Well, I insist it is in the abstract.

Senator KERR. Well, it may be but let's do not make that a condition precedent there to our agreeing.

Mr. MARTIN. All right. We won't make it a precedent, but I want to reserve the right to make some comments on it.

Senator KERR. I know you reserve that right.

I have watched you here, sir, and I recognize not only that you have the right but that you reserve it and make comments.

Mr. MARTIN. All right.

Senator KERR. Then for the purposes of our discussion can we generally use the term "inflation" as meaning diminishing of the purchasing power of the dollar and the term "deflation" as an increasing of the purchasing power of the dollar?

Mr. MARTIN. Right.

Senator KERR. Then if deflation increases the purchasing power of the dollar, it depreciates the value of things that you purchase with the dollar, does it not?

Mr. MARTIN. That is correct.

Senator KERR. Now then with that understanding, which do you regard as the more costly or detrimental or damaging, inflation or deflation?

Mr. MARTIN. I consider deflation the most damaging, and have at all times.

Senator KERR. I do, too.

Mr. MARTIN. But I think the battle against deflation begins with the battle against inflation in the growth economy.

Senator KERR. I am convinced that you do believe that.

Mr. MARTIN. That is correct.

Senator KERR. But whether you believe that or not, or whether that is accurate or not, does not reduce the damage of deflation when it sets in or is applied or results.

Mr. MARTIN. I think that we ought to do everything in our power to resist deflation and the deflationary spiral.

Senator KERR. Well, I do, too, Mr. Martin.

Let me ask you this now: Is not the power to bring on deflation the power to destroy?

Mr. MARTIN. Yes, I think so, if you put it in the sense of positive—yes, I will answer it that way.

Senator KERR. Now, we are in a recession, are we not?

Mr. MARTIN. We are.

Senator KERR. It was brought on in part by tight money and monetary control policies, was it not?

Mr. MARTIN. No, that I do not subscribe to.

Senator KERR. Well, now, that is what Mr. Humphrey told us, that is what Mr. Burgess told us; that is what Mr. Eccles told us.

Mr. MARTIN. I am sorry—but I don't believe that tight money brought on this recession, and I do not really think, again we are getting into terms—I don't think it was tight money, I think it was loose money that was the precursor of the present situation that we are in.

Senator KERR. You know you and I do fine except when you pull one of those "precursors" on me and then you just lose me.

Mr. MARTIN. Well, I am sorry. Let's say that the advance that this operation—it is very difficult for me to follow the arguments of the opponents of tight money, so-called tight money, and I do not concede that it was tight in the sense that they are talking about it.

The argument that with the inflation that was developing from 1955, 1956, 1957, the rise in prices, the cost in living, but still using the terms you and I have agreed on—with what was occurring during that period, it is awfully hard for me to believe that anyone thinks that easy money would have had an effect that would not have created more inflation, more price rises, more disparities than we presently have.

Senator KERR. Let me ask you this: What is the meaning of this language in your statement here that—where is the part of your statement that refers to or describes the amount of reserves that were on hand and the transition from—I believe it is at the bottom of page 5:

As evidence of downturn developed the Federal Reserve System began to alter the course of its policies. In the latter part of October and early November, open-market operations were used to relax somewhat pressures on commercial bank reserve positions. In mid-November, a one-half point reduction in discount rates signaled a decisive change in System policy. From that point on, restraints on bank credit expansion were progressively relaxed.

Now what do you call restraints on bank credit expansion, if it is not accurately described as tight money?

Mr. MARTIN. Well, this money stream and the reason that it was tight, came about——

Senator KERR. You said it was not tight?

Mr. MARTIN. Well, that is where we are dealing in terms——

Senator KERR. If it was not tight, why are you talking about the reason it was tight?

Mr. MARTIN. Let me try to put it to you this way: Tightness is a relative term.

Senator KERR. You are not going to just put it to me at all.

Just tell me what the situation is.

Mr. MARTIN. The situation was that starting in 1955——

Senator KERR. No, no, Mr. Martin; let's not do that.

Let's kind of go along together here. I used the term "tight money."

Mr. MARTIN. All right.

Senator KERR. You used the term—you say "restraints on bank credit expansion."

I will say this to you, that is what I am referring to when I use the term "tight money," restraints on bank credit expansion.

Mr. MARTIN. Well; these restraints that we are talking about here, the reason they——

Senator KERR. I am not talking about the reason for them. I am talking about what they are or what they add up to.

Don't restraints on bank credit expansion add up to the situation that is usually called "tight money"?

Mr. MARTIN. I think that is a phrase that is——

Senator KERR. Used by the more or less uninformed and inarticulate but they are doing the best they can.

Mr. MARTIN. That is right.

Senator KERR. All right.

Now, then, what do you call it?

Mr. MARTIN. I say that a situation in which the demand for——

Senator KERR. No, no, a situation in which there are restraints on bank credit expansion.

How would you describe that?

Mr. MARTIN. The restraints on bank credit expansion were that they were not getting all the reserves that they could utilize against the demand except——

Senator KERR. Restraints mean "restrictive."

Isn't that restrictive?

Restraints are restrictive, are they not?

Mr. MARTIN. Well, if there was no restraint at all——

Senator KERR. If there had not have been, you would not have said they would be relaxed if there had not been any, would you?

Mr. MARTIN. But I am trying to put it in focus, Senator, that the demand—this is a condition we are dealing with——

Senator KERR. That is right; and I referred to the condition as tight money.

Mr. MARTIN. All right. Let it stand on that basis.

Senator KERR. Then if you want to use some other term you tell me what it is, and I will accommodate myself to it.

Mr. MARTIN. I do not know a better term for it.

Senator KERR. Let's just use it.

Mr. MARTIN. Let's just use "tight money" then.

Senator KERR. All right.

Mr. MARTIN. The tight money was a condition——

Senator KERR. Who brought that condition about?

Mr. MARTIN. The borrowers brought that condition about. That was a condition which was brought about——

Senator KERR. If the borrowers brought that condition about how was it that you changed it when you progressively relaxed the restraints?

Mr. MARTIN. Well, the demand had already begun to fade.

Senator KERR. You mean that there was no longer a pressure there that you relaxed the restraints?

Mr. MARTIN. Our relaxing came after that pressure had——

Senator KERR. What did you relax?

Mr. MARTIN. We relaxed the volume of reserves.

Senator KERR. No, you relaxed the restraints you said in this statement.

Mr. MARTIN. Well, what other word——

Senator KERR. The volume of reserves was not a restraint?

Mr. MARTIN. Yes, that is what the restraint is, if the bank has more reserves or less reserves it can——

Senator KERR. But you used the term here "restraints on bank credit expansion were progressively relaxed."

Mr. MARTIN. That is correct.

Senator KERR. Well, hadn't you imposed those restraints?

Mr. MARTIN. We had imposed those restraints against this condition.

Senator KERR. Regardless of what it was against or not you imposed them, and if you want me to, I will define them. I will outline them here.

Mr. MARTIN. Let's state——

Senator KERR. The restraints that you are talking about were reserve requirements, consisted of the rediscount rate fixed by the Federal Reserve Bank?

Mr. MARTIN. That is right. Or operations in the open market.

Senator KERR. And the condition that resulted from your open market operations?

Mr. MARTIN. That is correct.

Senator KERR. All right.

Then, the Federal Reserve Board had imposed restraints on the supply of money.

Mr. MARTIN. Yes. Now——

Senator KERR. Hadn't they?

Mr. MARTIN. They had in the sense——

Senator KERR. Well, had they or not?

Mr. MARTIN. They had.

Senator KERR. All right. Let's just leave it right there.

Mr. MARTIN. All right. We will leave it right there.

Senator KERR. They had done that for 2 years and a half, had they not?

Mr. MARTIN. Not in a steady line but more or less; yes.

Senator KERR. All right.

And on the more side rather than on the less.

Mr. MARTIN. Yes.

Senator KERR. What was the purpose of it?

Mr. MARTIN. The purpose of it was to prevent, to do what we could to keep under control this demand that was just burgeoning on all sides.

Mr. KERR. Now that was not what you did at all.

You told this committee you did it to keep inflation from getting out of hand.

Mr. MARTIN. That is what I mean by inflation.

Senator KERR. You said inflation was the depreciating value of the dollar.

Mr. MARTIN. It was depreciating during that period. There was not an adequate level of savings——

Senator KERR. Then you imposed these restraints to keep the cost of living from going up?

Mr. MARTIN. That is one of the reasons; yes, indeed.

Senator KERR. What other reasons?

Mr. MARTIN. Well, that is the reason. I won't say one of the reasons. That was the reason.

Senator KERR. And that had the effect of slowing down the economy, did it not?

Mr. MARTIN. Well, not very much.

All during that time——

Senator KERR. Had not the production of steel gone down from nearly a hundred percent to 47 percent?

Mr. MARTIN. That is recently.

Senator KERR. It has been in the course of going down for a year.

Mr. MARTIN. Well, the inflation——

Senator KERR. Let's stay with this. It has been going down for nearly a year.

Mr. MARTIN. When did steel start declining, Ralph, is that right?

Mr. YOUNG. I think the decline was mostly from August on.

Senator KERR. Give us the figures. What was it in July?

Mr. YOUNG. Steel production?

Senator KERR. Yes.

Mr. YOUNG. In millions of tons——

Senator KERR. No, in percentage of capacity.

Mr. YOUNG. I do not have percentage of capacity here.

Senator KERR. Then in millions of tons.

Mr. YOUNG. In millions of tons it was at a peak for the year in February.

Senator KERR. In February?

Mr. YOUNG. It was 2.5 million.

Senator KERR. February was what, 2.5 million?

Mr. YOUNG. Yes.

Senator KERR. March, what page of the Economic Indicator is that on?

Mr. YOUNG. That is on page 18.

Thousands of tons—2.4 million in March, approximately. And then it slipped off gradually in October and from October it went down.

Senator KERR. What was it in March?

Mr. YOUNG. In March it was 2.4.

Senator KERR. 2.4. What was it in April?

Mr. YOUNG. I am rounding these figures off; 2.2.

Senator KERR. What was it in May?

Mr. YOUNG. 2.2.

Senator KERR. June?

Mr. YOUNG. 2.2.

Senator KERR. July?

Mr. YOUNG. 2.

Senator KERR. August?

Mr. YOUNG. 2.1.

Senator KERR. September?

Mr. YOUNG. 2.

Senator KERR. October?

Mr. YOUNG. October, 2.1.

Senator KERR. November?

Mr. YOUNG. November, 2.

Senator KERR. December?

Mr. YOUNG. December, 1.7.

Senator KERR. January?

Mr. YOUNG. 1.5.

Senator KERR. February?

Mr. YOUNG. February, 1.4.

Senator KERR. March?

Mr. YOUNG. March, 1.4.

Senator KERR. March, 1.4. Would you not call that a picture of rather steady decline for the last year?

Mr. MARTIN. I think that is correct, but I do not think it was certain, however, that that decline was in the nature of a recession until the latter part of the summer.

Senator KERR. Well, it is a fact, now, Mr. Martin, and we are going to stay with this until we either prove it or fail, that the restraints on bank credit expansion were calculated to slow down the tempo of the economy.

Mr. MARTIN. That is correct.

Senator KERR. All right.

Mr. MARTIN. That is correct. No question about that.

Senator KERR. And it succeeded?

Mr. MARTIN. No, I do not think it succeeded——

Senator KERR. That is what it was done for and that is what happened.

Mr. MARTIN. It had some influence on it. But don't attribute everything to monetary policy.

Senator KERR. I did not, Mr. Martin. I did not say it was brought on solely—I did not say that the recession was brought on solely by restraints on credit expansion. I said tight money was in part responsible for the recession.

Mr. MARTIN. Well, I do not agree with that.

Senator KERR. Well, you have just said it.

Mr. MARTIN. Well, I am sorry——

Senator KERR. You just said it. You just said they were imposed to slow down the tempo of the economy.

Mr. MARTIN. I think that is right.

Senator KERR. And you said the tempo of the economy slowed down?

Mr. MARTIN. But not as a result of tight money. The tempo of the economy slowed down because the inflationary excesses——

Senator KERR. If you imposed the restraints, Mr. Martin, to slow it down, and if you kept them there and the slowdown occurred—now are you telling this committee that the restraints played no part in slowing it down?

Mr. MARTIN. I don't say it played no part, but I go back to my statement——

Senator KERR. I am not saying that it was solely responsible at all. I am only trying to establish the basis here that it was a contributing factor.

Mr. MARTIN. It was an element in the slowdown that ultimately came, but the real criticism, if there—and I think there is some vulnerability here of the usefulness of monetary policy in this period—is that we were not more aggressive and did not make more of an effort to slow it down in 1955 and early 1956 when this got out of hand.

Senator KERR. Well, now, we are not talking about 1955 or 1956 now.

We are talking about 1957.

We will go back.

Mr. MARTIN. I agree with you that we are talking about 1957, but I do not think you can isolate it in terms of 1955 and 1956 in considering monetary policy.

Senator KERR. You just cannot talk about both of them at the same time; you may have both of them in mind and we may go backward and forward but we just have to have one of them in mind at a time, don't we?

Mr. MARTIN. Yes.

Senator KERR. All right. Let's do that.

Have we established a meeting of the minds here that the restraints on bank credit expansion were either imposed or kept to help slow down the tempo of the economy to prevent inflation?

Mr. MARTIN. That is correct.

Senator KERR. And that they succeeded?

Mr. MARTIN. Their success was a very limited success, indeed.

Senator KERR. But they did what you had in mind for them to do, didn't they?

Mr. MARTIN. They helped in slowing down the inflation.

Senator KERR. Evidently they succeeded, Mr. Martin, or you would not have relaxed them?

Mr. MARTIN. They had—yes, they succeeded—not they, alone, succeeded.

Senator KERR. I don't say they alone. They succeeded in doing what you had in mind for them to do?

Mr. MARTIN. The usefulness of monetary policy as a restraining factor was over, in our judgment, by mid-October.

Senator KERR. That means they had succeeded in accomplishing the mission you had in mind for them?

Mr. MARTIN. They had done all that they could in the way of restraining inflation at that time.

Senator KERR. And a part of what they could do was to slow down the tempo of the economy?

Mr. MARTIN. Which they had been trying to do for a number of years.

Senator KERR. And which they had done in 1957.

Mr. MARTIN. That is right.

Senator KERR. That is correct?

Mr. MARTIN. In—I am not going to withdraw from that. It is correct.

Senator KERR. All right.

So in mid-November you started the relaxation process?

Mr. MARTIN. Mid-October, really.

Senator KERR. Well, now, you said here at the bottom of page 5——

Mr. MARTIN. Well, the first overt public action was November 15, but we had started to relax in our open market operations in the middle of October. That is not a very important point——

Senator KERR. It is an important point.

Then the open market operations which is one of the three main weapons you have——

Mr. MARTIN. That is right.

Senator KERR. Started in the latter part of October and early part of November?

Mr. MARTIN. That is correct.

Senator KERR. Now the purpose of that, Mr. Martin, was to stabilize or help stabilize the value of the dollar, was it not?

Mr. MARTIN. That is correct.

Senator KERR. What legal authority or mandate do you have specifically to stabilize the value of the dollar?

Mr. MARTIN. I don't think we have anything in specific terms to stabilize the value of the dollar, but the Federal Reserve Act certainly specifies that we should make every effort to have stability and growth.

Senator KERR. All right.

Now suppose you point that language out to me right quick here, will you?

Mr. MARTIN. I have not got the Federal Reserve Act.

Senator KERR. I know you would not make a statement here unless you had a basis for it.

Mr. MARTIN. I will get it.

Senator KERR. Is any of your legal staff here?

Mr. MARTIN. I did not bring a lawyer.

Senator KERR. Never go out in public without one. [Laughter.]

You referred a while ago to the Full Employment Act as having been in part addressed to the Federal Reserve Bank.

Mr. MARTIN. I agree with that.

I quoted from the Full Employment Act.

Senator KERR. I know that, and I am awfully glad you did. I am going to quote some of it to you:

> The Congress hereby declares 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 able, willing and seeking to work and to promote maximum production and purchasing power.

Mr. MARTIN. That is correct.

Senator KERR. Do you regard that as being addressed in part to the Federal Reserve System?

Mr. MARTIN. I do.

Senator KERR. Then it is a positive legal mandate, don't you think?

Mr. MARTIN. I accept it as such.

Senator KERR. Would you say that that mandate is addressed to all or to whom it may concern, including the Federal Reserve bank to maintain stable employment?

Mr. MARTIN. I do indeed.

Senator KERR. You cannot point to any specific language that says to the Federal Reserve bank "maintain the stable value of the dollar" though, can you?

Mr. MARTIN. I think the two are related; but, no, I cannot find anything. I will get the Federal Reserve Act to you which uses the term "stable dollar." It is not in the act as such, but it——

Senator KERR. All right.

Now I want to ask you this question:

Which do you regard as the more important, stabilized value of the dollar or stabilized maximum employment?

Mr. MARTIN. Maximum employment every time. No question about it.

Senator KERR. Well, do you think we have that today?

Mr. MARTIN. No, I do not think we have it today.

But when we talk about employment, and the mandate of the Employment Act, we intended jobs that could be sustained, not jobs that are temporary in nature.

Senator KERR. Where is that in the language of the act, sir?

Mr. MARTIN. I assumed——

Senator KERR. Aren't all jobs temporary?

Mr. MARTIN. No.

Senator KERR. Why, Mr. Martin, even your job is temporary when it started and getting more so every day. [Laughter.]

I want to tell you that is true of every member of this committee. [Laughter.]

We are here on a temporary basis.

Mr. MARTIN. I cannot quarrel with you on that, sir.

Senator KERR. And it is getting more so every day.

Mr. MARTIN. But the stability——

Senator KERR. What do you mean then that the stability you are talking about has to exclude anything of a temporary nature as meeting the requirement?

Mr. MARTIN. Well, I do not think any purpose would be served, as I read the Employment Act, by creating out of borrowed money an expansion program that would not be self-sustaining.

Senator KERR. I do not either.

Mr. MARTIN. And would not pay for itself and would collapse.

Senator KERR. Just the fact it is created out of borrowed money does not mean it won't be sustaining.

Mr. MARTIN. No; I use borrowed money just to emphasize——

Senator KERR. Do you regard the American Telephone & Telegraph Co. as a financially sound institution?

Mr. MARTIN. I do, and I know the size of their debt roughly, too.

Senator KERR. What is that?

Mr. MARTIN. It is about $2 billion, I think.

Senator KERR. Now, Mr. Martin, would you be surprised to know it was in excess of $5 billion?

Mr. MARTIN. Well, no; I would not be surprised. I said I knew it, and I apologize if I misquoted it. But it is a large amount.

Senator KERR. I will tell you what so that neither of us will be humiliated in the eyes of posterity by having on record here by having used too large or small a figure, suppose you ask one of these boys to get for us approximately the accurate overall debt of the American Telephone & Telegraph Co., and its affiliate.

Mr. MARTIN. We will ask Ralph to get it for us.

Mr. YOUNG. The total debt of the A. T. & T. at the end of 1957 was $2.4 billion and for the entire Bell Telephone System it was $5.7 billion.

Senator KERR. Now regardless of what it is, you have seen their announcement in the paper that they are going to expand this year about $2.25 billion, have you not?

Mr. MARTIN. I have.

Senator KERR. How much of that is going to be with borrowed money?

Mr. MARTIN. A large portion of it, I assume.

Senator KERR. Pretty close to a billion dollars?

Mr. MARTIN. Yes.

Senator KERR. Do you regard that as an unstable operation?

Mr. MARTIN. No; I think the amount of borrowed money has to be related to the capacity to repay, and I believe that the American Telephone Co. has pretty well evaluated its situation and probably will be able to borrow and be able to pay.

Senator KERR. Do you look forward to the time when the American Telephone & Telegraph and its affiliates will owe less money than it does today?

Mr. MARTIN. That I don't know.

Senator KERR. Do you think the necessity for it is exclusively consistent with soundness and solvency?

Mr. MARTIN. You mean the increase?

Senator KERR. No, no. The certainty of repayment. Or the certainty of reduction of overall indebtedness of that organization.

Mr. MARTIN. Well, not if the relationship to growth is properly measured. But if they make a mistake in that relationship——

Senator KERR. Which do you think is the more apt to endure and be able to pay the interest and refinance its obligations—American Telephone & Telegraph or the United States Government?

Mr. MARTIN. I think the United States Government.

Senator KERR. You think it is?

Well, then you know we have gone a long ways here in this stabilized maximum employment, because you injected the thought that you did not believe in it if it was temporary.

Let's get back to that and see just how much difference there is between our viewpoints as to the importance of maintaining stabilized maximum employment from the standpoint of how permanent the employment has to be in order for it to be wholesome and acceptable.

Mr. MARTIN. Well, in terms of American Telephone that we have just been talking about, we are talking about sustainable growth, and employment which is in excess of sustainable growth usually has to be adjusted in periods just as those we are going through at the moment by unemployment.

Senator KERR. By unemployment? Then you think the unemployment we have at this time is a wholesome thing?

Mr. MARTIN. I do not ever want to be in the position of saying that it is wholesome in the sense that I want any man to be unemployed.

But I do not think that you can expect to have everybody employed at all times.

Senator KERR. What number do you think, in terms of unemployment, can exist and be consistent with the objective in this law which you say is addressed in part to the Federal Reserve System?

Mr. MARTIN. I don't know what the figure ought to be on that, Senator.

Senator KERR. If you don't know, who does?

Mr. MARTIN. I think we will have to——

Senator KERR. How long have you been in this job?

Mr. MARTIN. I have been in the job 7 years.

Senator KERR. How long is it going to take you to find out?

Mr. MARTIN. I am not sure I will ever find out. I am doing the best I can, and I have a lot to learn every day; I realize that.

Senator KERR. You mean you have been in this job for 7 years and you do not know what your objective is in terms of total unemployment to meet the requirements of this full employment act?

Mr. MARTIN. My objective is very clear. How you attain it is not so clear, but my objective——

Senator KERR. What is your objective in terms of numbers of unemployed?

Mr. MARTIN. I have no numbers of unemployed, but I want the men——

Senator KERR. If that is true, Mr. Martin, you would feel that you had met the mandate of this law with 10 million unemployed?

Mr. MARTIN. I think that a figure of unemployed is not the——

Senator KERR. Is immaterial?

Mr. MARTIN. No. I am concerned whenever 2 people, 1 person, is unemployed.

Senator KERR. Well, let's get back to this law.

This law is a positive thing. It fixes an obligation on somebody.

Mr. MARTIN. I pointed out in my last appearance before this committee that I have interpreted this law as I believe the law was intended to be. But I did point out at that time that it might be desirable to make explicit in the law instead of implicit in maximum purchasing power, as I read it, the responsibility for long-run price stability.

Senator KERR. That is one of the things.

It says to "promote maximum employment, production, and purchasing power." Yes.

Mr. MARTIN. And those three merge together.

Senator KERR. Now then, I am trying to find out from you what degree of unemployment or what figure of unemployment, in your judgment, would be inconsistent with this objective.

Mr. MARTIN. And I tell you I don't know.

Senator KERR. Well, make some estimate.

Mr. MARTIN. I cannot make an estimate on that——

On that kind of thing. I am disturbed about the level of unemployment today.

Senator KERR. If you cannot make an estimate and you do not know, it would seem I can assume you would not know if 10 million unemployed created a situation inconsistent with it.

Mr. MARTIN. The inconsistencey here, Senator, is that what we are up against is the mistakes which were made 2 or 3 years ago——

Senator KERR. But, Mr. Martin, we are talking about this law, and you said the Federal Reserve Board had some responsibility under it.

Mr. MARTIN. I am accepting that responsibility.

Senator KERR. How can you accept it if you do not know what it means.

Mr. MARTIN. Well, if——

Senator KERR. If you cannot relate its mandate to you in terms of some figures, how are you accepting it.

Mr. MARTIN. I do not know what figure I am going to—there is no figure written in the law.

Senator KERR. No; there is not, but there are words to promote maximum employment. Do you think we would have maximum employment if there was 10 million unemployed?

Mr. MARTIN. No; I would not think we had maximum employment with 10 million unemployed. I do not think we have maximum employment at the present level of unemployment. That is why we are pursuing as vigorous an antirecession policy in the Federal Reserve as we are pursuing at the moment.

Senator KERR. I am glad you said "as vigorously as we are pursuing." I thought you were going to say as vigorous as you can, and then I was going to disagree with you.

Mr. MARTIN. I was saying we were doing it as vigorously——

Senator KERR. As you are doing it.

Mr. MARTIN. That is right.

Senator KERR. I think that is right. I want to tell you, I think it is a profound, accurate, and unchallengeable statement. You are pursuing it as vigorously as you are pursuing it.

Mr. MARTIN. Nobody can quarrel with that.

Senator KERR. Not with its accuracy.

Mr. MARTIN. That is right.

Senator KERR. Then you think the present number of unemployed is too many?

Mr. MARTIN. I do.

Senator KERR. By how much?

Mr. MARTIN. I don't know by how much.

Senator KERR. Then how do you know it is too many?

Mr. MARTIN. Well, I have a feeling, and there are a good many points in these unemployment statistics which are not clear, but I have a feeling that frictional unemployment——

Senator KERR. Frictional?

Mr. MARTIN. Well, the minimum unemployment in this country would be defined as closer to 2 or 3 million, and I would say we probably had full employment in 1955 and 1956. I do not remember the levels at that time.

Senator KERR. I think that is a leading statement. Did you just arrive at that conclusion? Did that just suddenly dawn on you here in your conversation with me?

Mr. MARTIN. No.

Senator KERR. If it did, I may have made some contribution to your understanding of your responsibility.

Mr. MARTIN. Well, I still would not want to stand on that figure.

Senator KERR. I do not want you to make statements here which you do not want to stand on.

Mr. MARTIN. All right, Senator.

Senator KERR. Because that is not consistent with the dignity and prestige of your position. You know what the fact is. If you had to go back home and run for office, you would not make statements that you would not want to stand on.

Mr. MARTIN. I am very much afraid I would not be elected; that I agree with you.

Senator KERR. You wouldn't right now. [Laughter.]

Mr. MARTIN. I doubt if I would under any conditions.

Senator KERR. Well, I have seen the time when you would have done pretty good, but not now. [Laughter.]

Well now, you have made a statement here that is quite significant, and I wonder if I could persuade you to stand on it, that employment to the extent that not more than 2 to 3 million are unemployed reasonably, in your judgment, meets the mandate to promote maximum employment.

Mr. MARTIN. I will stand on this: That in the period 1955 and 1956—we had a growing labor force all the time, of course——

Senator KERR. Yes.

Mr. MARTIN. But in the period 1955 to 1956, it is my conviction that we had full employment.

Senator KERR. All right.

Mr. MARTIN. And I would go one step further.

Senator KERR. Don't go just a bit further until we see what it was in 1955 and 1956.

Mr. MARTIN. I just want to qualify it by one thing. I was inclined to think it was over full employment.

Senator KERR. How much?

Mr. MARTIN. That is pretty hard to measure, but I would say by a substantial amount.

Senator KERR. Well, how much would you say? You said a while ago you thought that in 1955 and 1956 we had what you would describe as reasonable full employment. Now you say that in your judgment we had overemployment.

Which statement shall we accept as a basis to proceed on here?

Mr. MARTIN. Well, you had better proceed on the basis that I have a conviction that the tendency was overemployment there. I was satisfied——

Senator KERR. If it was, Mr. Martin, tell me by how much.

Mr. MARTIN. It would just be sheer guesswork.

Senator KERR. No, no. You can do better than guess. You can make a reasonable estimate.

Mr. MARTIN. Well, let's say a million people.

Senator KERR. In 1955, unemployment was 2.0 million. What about 1954.

Mr. MARTIN. Well, in 1954 we had, from this figure, if I have got it right, 3.5.

Senator KERR. 3.578.

Mr. MARTIN. Right.

Senator KERR. The Federal Reserve took measures to correct that situation, and you told some committee in the Congress that it was consistent with the obligation you had under the Full Employment Act.

Mr. MARTIN. I think the actions were taken——

Senator KERR. We are talking now about 1954?

Mr. MARTIN. 1954, that is right.

Senator KERR. You must have felt that 3.57 was too high a figure for unemployment.

Mr. MARTIN. It was not unemployment alone. We were talking about the economy, you see. You cannot just——

Senator KERR. Is there any better indication of the condition of the economy than the number of employed and unemployed?

Mr. MARTIN. It is one of the very good indicators.

Senator KERR. Very good indicators.

Mr. MARTIN. But let me make clear my point here that I do not think we ought to be slaves of these statistics.

Senator KERR. I do not, either, but they are the best we have got.

Mr. MARTIN. I agree with you.

Senator KERR. Let us either use them or get better ones.

Mr. MARTIN. We are trying to get better ones.

Senator KERR. You haven't up to now. You hadn't any better ones for 1954.

Mr. MARTIN. No; we had not.

Senator KERR. And those were the figures before you in 1954.

Mr. MARTIN. That is right.

Senator KERR. And in 1954, you moved to relax restraints on bank credit expansion, did you not?

Mr. MARTIN. We started moving in 1953, and we continued——

Senator KERR. Well, in 1954 you were in the posture of moving to relax restraints on bank credit expansion?

Mr. MARTIN. Yes; through almost all of 1954.

Senator KERR. All of 1954.

Mr. MARTIN. Toward the end of 1954——

Senator KERR. I am sure you have told committees of Congress, but if I am mistaken you tell me, and if the assumption is incorrect, you tell me. I am sure one of the considerations you had in mind in thus moving was the number of unemployed.

Mr. MARTIN. That certainly was one of the considerations; yes.

Senator KERR. Then, that being the case you would feel that the number of unemployed, consistent with the full employment mandate we have been talking about would be somewhere between 3 million and 3½ million.

Mr. MARTIN. I am just making a rough guess on it. I just don't know. But I would say that in 1954, you go down to 2.9, and in 1955——

Senator KERR. In 1954, you go down to 2.9—wait a minute. I do not have the monthly figures here. You say you started to move in 1953, Mr. Martin. What was the figure in 1953?

Mr. MARTIN. Well, 1953—you see, there is where you are in trouble on the way these figures roll up. In 1952—what was it?—1.9 million was the average; 1953 was 1.8 million.

Senator KERR. 1,870,000.

Mr. MARTIN. Yes.

Senator KERR. You started to move, you said, in 1953.

Mr. MARTIN. We did. Now, the inventory recession in 1953–54 was a direct result, to my mind, of the binge that occurred in the post-Korean period.

Senator KERR. Well now, aside from that, we are now talking about the relationship of unemployment to the provisions of the Full Employment Act.

Mr. MARTIN. Well——

Senator KERR. And you are not going to tell me that the figures for 1953 and 1954 are entirely unrelated to the policies of the Federal Reserve at those times?

Mr. MARTIN. No; I wouldn't say they are entirely unrelated. But I would say——

Senator KERR. You have told me you had a high regard for your responsibility in connection with carrying out the mandate of the Full Employment Act.

Mr. MARTIN. I have, indeed.

Senator KERR. And the figures here show that in 1953, there were 1,870,000 unemployed.

Mr. MARTIN. That is right.

Senator KERR. And you have told me that you started moving in 1953, late that year, to relax the restraint on bank credit expansion.

Mr. MARTIN. We did, because we had an inventory situation that had developed from the 1951–52 period which was going to endanger employment quite apart from these figures, further endanger it.

Senator KERR. How can it be quite apart from these figures, because if it endangered employment, that means that further unemployment would occur, would it not?

Mr. MARTIN. Well, the point I am making is——

Senator KERR. I say if you are going to endanger employment, you are speaking in terms of danger of increased unemployment, are you not?

Mr. MARTIN. You are speaking of a future unemployment?

Senator KERR. I am speaking about what you are. I am just using your words.

Mr. MARTIN. I am taking it there, and I am saying that in the 1951-52 period where we had active inflation, 1950-51——

Senator KERR. Wait a minute. 1952-51 you had active inflation?

Mr. MARTIN. Well, I am going back to the time——

Senator KERR. Where is the statement of the Federal Reserve bank I put in the record here last year in which you said through 1952 you had a stabilized condition.

Mr. MARTIN. All right. I will go back to my figures.

Senator KERR. Have you got the report for 1952, the Federal Reserve bank report?

Mr. MARTIN. 1952, we had gotten——

Senator KERR. I say, do you have that report there?

Mr. MARTIN. Not in front of me; no, sir.

Senator KERR. Well——

Mr. MARTIN. You are quite correct, the Treasury-Federal Reserve accord——

Senator KERR. Your report for 1952 showed the wholesale price index had declined.

Mr. MARTIN. You are correct.

Senator KERR. You said in your report we had achieved a degree of economic stability in 1952.

Mr. MARTIN. That is right.

Senator KERR. Why are you saying now you were moving in 1953 to overcome the inflationary situation of 1952?

Mr. MARTIN. It got out of hand here. Do you want to comment on this?

Senator KERR. You are the one who made the statement.

Mr. MARTIN. Well, I stand on the statement.

Senator KERR. You can't stand on both of them, because they are in contradiction to each other.

Mr. MARTIN. Mr. Riefler, I have gotten confused under the questioning. Will you bail me out on this? [Laughter.]

Senator KERR. Who are you?

Mr. MARTIN. This is Mr. Riefler.

Senator KERR. I'll tell you, if you can bail him out of that one, I want to get acquainted with you. [Laughter.]

Mr. RIEFLER. During the——

Senator KERR. Let us identify you.

Mr. RIEFLER. I am Winfield Riefler.

Senator KERR. What is your position?

Mr. RIEFLER. Assistant to the Chairman.

Senator KERR. You are the Assistant to the Chairman?

Mr. RIEFLER. That is right.

Senator KERR. That is wonderful. [Laughter.]

Now proceed.

Mr. RIEFLER. During the Korean period——

Senator KERR. No, we are talking about—he made the statement here that his actions in 1953—read what he said there about the inflationary thing going on in 1951 and 1952, that he was doing something in 1953:

(The statement referred to was read by the reporter.)

Senator KERR. He wants you to bail him out.

Mr. RIEFLER. I thought he wanted to correct himself. He was not saying in 1951–52 we were having active inflation.

Senator KERR. You can say that is what he wanted?

Mr. RIEFLER. That is right.

Senator KERR. I tell you if you can read men's minds, I want you out of this room.

Mr. RIEFLER. He was going to say that when you interrupted him.

Mr. MARTIN. That is what I was going to say.

Senator KERR. What were you trying to say?

Mr. MARTIN. I wanted to say I got ahead of myself in 1951–52. My memory is not good. The Treasury-Federal Reserve accord was in 1951.

Senator KERR. The Treasury-Federal Reserve accord?

Mr. MARTIN. That was the time we decided to unpeg the Government securities market.

Senator KERR. I think the latter statement is correct and the former is incorrect. I think the act that you referred to was a decision by the Federal Reserve Board of which the Treasury was advised.

Mr. MARTIN. In 1951.

Senator KERR. The unpegging of the bond market.

Mr. MARTIN. It was an agreement that was worked out with the Treasury.

Senator KERR. It was worked out after you told them what you were going to do. They accepted it after you advised them that was your policy.

Mr. MARTIN. Well, now, let's be fair on that. I was in the Treasury at the time.

Senator KERR. I know you were.

Mr. MARTIN. I had something to do with that.

Senator KERR. I know you were.

Mr. MARTIN. It was a negotiated operation. The cards may have been heavily stacked with the Federal at the time.

Senator KERR. Well, they were heavily enough stacked that they advised the Treasury what they were going to do.

Mr. MARTIN. Oh, no. Oh, no. It was a negotiation right straight through.

Senator KERR. You are going to have to substantiate that if you stand on it. I am going to ask you to bring in here the evidence of an agreement.

Mr. MARTIN. Of the Treasury and Federal Reserve accord?

Senator KERR. Yes, sir.

Mr. MARTIN. It has been spread on the minutes.

Senator KERR. It has been talked about and referred to and described. If you are telling this committee that this was a negotiated agreement between the two, I am going to ask you to put it in this record.

Mr. MARTIN. I will put into the record the very best——

Senator KERR. If it is in existence, you don't have to strain yourself. All you have to do is bring it down here and put it in.

Mr. MARTIN. Well, the accord was worked out. I will be glad to get it.

Senator KERR. If it was worked out, it ought to be in existence somewhere.

Mr. MARTIN. It has been brought before any number of committees of the Congress.

Senator KERR. Who signed it?

Mr. MARTIN. It was not formally signed in that sense. John Snyder was Secretary of the Treasury.

Senator KERR. And in the hospital at the time.

Mr. MARTIN. That is correct.

Senator KERR. Who signed it for John?

Mr. MARTIN. I don't think there was any signing of it, but I discussed it——

Senator KERR. How could it exist if it was not executed?

Mr. MARTIN. We have it in our minutes, do we not?

Senator KERR. I am not talking about what you have got in your minutes.

That is what I am saying, that that is the source of it. It was an action by the Federal Reserve Board. An accord or a negotiated agreement has some form or substance, Mr. Martin.

Mr. MARTIN. This had form and substance, Senator.

Senator KERR. Well, you said it was never signed by anybody.

Mr. MARTIN. I don't think that you need a formal document to be signed by the Treasury and the Federal Reserve in a matter of this sort.

Senator KERR. If there is an agreement between the two of them—is there anything in the minutes of the Treasury?

Mr. MARTIN. I do not know what is in the minutes of the Treasury.

Senator KERR. You were there. You were running the Treasury at the time. You were assistant to John Snyder, and he was in the hospital. That is correct, is it not?

Mr. MARTIN. That is right.

Senator KERR. What evidence can you put into the record as to the agreement of the Treasury to this thing?

Mr. MARTIN. Well, I don't know what evidence you could put in. Every point of the negotiation——

Senator KERR. You were there. You were running the Treasury at the time.

Mr. MARTIN. No, I was not running the Treasury.

Senator KERR. You were acting in the absence of the Secretary.

Mr. MARTIN. And I consulted the Secretary on everything that was done.

Senator KERR. All right.

Now, where is the record of what you did?

Mr. MARTIN. Well, I don't have—I don't know that the Treasury has any formal records. I will be glad to give you what we have at the Federal Reserve.

Senator KERR. There are none in existence, Mr. Martin, and nobody knows that better than you.

Mr. MARTIN. Well, I don't believe that there was any formal document that was signed.

Senator KERR. Well, you are sure that there wasn't.

Mr. MARTIN. Well, no, I am not sure—there certainly were documents that were entered into——

Senator KERR. If there was a formal document of this accord signed, you produce it, or admit that there is none.

Mr. MARTIN. Well, I can't produce anything that was signed; no.

Senator KERR. No. Nor can you produce anything from the minutes of the Treasury where they made a proposal or where they agreed to a proposal, can you?

Mr. MARTIN. I don't know, when you talk about "made a proposal" and "agreed to it." This was a——

Senator KERR. What is an accord? You said there was a negotiated agreement.

Mr. MARTIN. The issuance of the accord was approved by the officials of the Treasury.

Senator KERR. Where is the act that they took approving it?

Mr. MARTIN. Well, I don't know what records are down there.

Senator KERR. You were there.

Mr. MARTIN. There was a joint press release.

Senator KERR. Well, the joint press release was a statement of what had happened.

Mr. MARTIN. Well, it purported——

Senator KERR. The only official action taken by anybody, Mr. Martin—and if I am not correct, you correct me by putting something else in this record—was the action of the Federal Reserve Board, and the only evidence of it appears in their minutes.

Isn't that correct?

Mr. MARTIN. I don't know what the Treasury records show.

Senator KERR. Well, you don't know of any other thing, do you?

Mr. MARTIN. I will review that for you.

Senator KERR. I say, you don't have any knowledge at this minute of any other thing, do you?

Mr. MARTIN. I have no knowledge of what the records in the Treasury are, but the Treasury certainly had a clear understanding——

Senator KERR. Sure. Anybody that could read could clearly understand what the Federal Reserve Board had said they were going to do.

Mr. MARTIN. But that is what the Federal Reserve Board carried out, what it agreed to do.

Senator KERR. But the record of what they agreed to do, you say was in their minutes.

Mr. MARTIN. Well, that is the only record——

Senator KERR. Did the minutes recite that due to an agreement negotiated between the Treasury and the Federal Reserve Board, this was going to be the Federal Reserve Board's policy?

Mr. MARTIN. No.

Senator KERR. It just said the Federal Reserve Board is not going to support Government bond prices any further. That is what it said, did it not?

Mr. MARTIN. No, it didn't say that.

Senator KERR. What did it say?

Mr. MARTIN. I haven't got it.

Senator KERR. You said you put it in the record many times. Has one of your assistants got it here?

Mr. MARTIN. No. But we will get it for you and give it to you.

Mr. YOUNG. Well, the two organizations jointly agreed to minimize monetization of the public debt. That, in substance, was the press release.

Senator KERR. I am not talking about the press release. I am talking about the official action of the Federal Reserve Board and the Treasury. And you said it was disclosed in the minutes of the Federal Reserve Board.

Didn't you make that statement awhile ago?

Mr. MARTIN. No.

Senator KERR. You made that statement.

Mr. MARTIN. I said there are references to it in the minutes of the Board. But this was a negotiated agreement, and it is——

Senator KERR. Mr. Martin, if there was a negotiated agreement, produce it.

Mr. MARTIN. Well, I will produce——

Senator KERR. The Treasury Department of this Government and the Federal Reserve Department of this Government cannot negotiate an agreement that has any substance unless it is in existence.

Mr. MARTIN. Well, the working relationships, Senator, between the Treasury and the Federal Reserve are not carried on by formal agreements.

We discuss regularly with the Treasury what our policy is, what we propose——

Senator KERR. But you have no responsibility for their policy.

Mr. MARTIN. Well, we give them advice.

Senator KERR. I understand but you do not appoint them?

Mr. MARTIN. No.

Senator KERR. You don't give them any directives?

Mr. MARTIN. No.

Senator KERR. They do not give you any?

Mr. MARTIN. Well, they give us their views?

Senator KERR. Sure. But you make your decisions, don't you?

Mr. MARTIN. We do.

Senator KERR. And they make their decisions?

Mr. MARTIN. That is right.

Senator KERR. Now, you have said there is a negotiated agreement between these 2 units of Government which have the dignity and the power and the position of individual identities and if there is a negotiated agreement between them, Mr. Martin, of any significance, it has to be in writing and there has to be a record of it and I want you to put it in this record.

Mr. MARTIN. Well, I will do the best I can to——

Senator KERR. Well, you either can or cannot.

Mr. MARTIN. Well, on this record. But now, I moved over from the Treasury to the Federal Reserve.

Senator KERR. Well, then, nobody should be in better position to know what is in the files of either than you.

Mr. MARTIN. I will do the best I can to get you up a memorandum on that.

Senator KERR. I do not want a memorandum; I want a copy of that agreement.

Mr. MARTIN. Well, there is no agreement in that sense.

Senator KERR. That is exactly right, and any informed person knows there is no agreement.

Mr. MARTIN. I don't think there should be an agreement——

Senator KERR. I don't either, I don't either, and, therefore, why talk about one?

Mr. MARTIN. Then I misunderstood the purport——

Senator KERR. It is a fiction, it is a nonexistent fiction, that is what it is.

Let's get back to what we were talking about when you interjected the statement here about a negotiated agreement which does not exist.

You said you were going to correct your statement about the inflation of 1952.

Mr. MARTIN. Well, what I was saying was that I said 1952; I should say 1950–51.

Senator KERR. Well, do you mean to tell me then that you were moving in 1953 to correct the inflationary situation in 1951?

Mr. MARTIN. Senator, that is the difficulty of this problem. The heritage of all wars is inflation.

Senator KERR. But Mr. Martin, you said in your report at the end of 1952 that the stability had been achieved.

Mr. MARTIN. It had temporarily been achieved.

Senator KERR. You did not say temporarily.

Mr. MARTIN. Well, we should have been more modest in our statement.

Senator KERR. Well, there are times when I agree with that but all I can do is, just as an ordinary member of this committee, is to read what your report says.

It means what it says, does it not?

Mr. MARTIN. We do the best we can with it. And we do not claim perfection for it.

Senator KERR. Well, you have at times.

Mr. MARTIN. I have never claimed perfection for any of our reports.

Senator KERR. Well, you said that you had achieved stability and that is perfection in this—where is the sheet in this economic indicator showing the cost of living month to month in 1952 and the wholesale price index, and so forth?

Mr. MARTIN. Mr. Young?

Mr. YOUNG. The consumer price index is given on page 23.

Senator KERR. What?

Mr. YOUNG. Consumer prices page 23, and wholesale prices page 24, for 1950 and 1951.

Senator KERR. All right.

Now in 1952 the wholesale prices of all commodities had a substantial decline, did it not?

Mr. YOUNG. In 1952?

Senator KERR. The wholesale price index of all commodities had a substantial decline?

Mr. YOUNG. In 1951, Senator——

Senator KERR. No; I am talking about 1952.

Mr. YOUNG. In 1951 there was a decline. In 1952 it was approximately stable.

Senator KERR. I might just announce to you, Mr. Martin, that the March consumer price index has just been given out by the Labor Department and that is 123.3 for March compared to 122.5 for February, which is up 8 points.

Going back to your action in 1953, according to the record that I have, and according to your own statement in your 1952 report, price levels declined in 1952, wholesale price levels of all commodities took a rather sharp decline in 1952.

Have you got something to the contrary?

Mr. YOUNG. No; there was a decline in wholesale prices in 1952.

Senator KERR. And showed, I would say, practically no increase in 1953 and 1954.

And in your statement before this committee last year you stated it, and had a chart up there showing that 1952, 1953, 1954, and 1955 was the longest period of sustained stability in the peacetime history of this country.

Isn't that about what you said here a year ago?

Mr. MARTIN. I think so, I think that is correct.

Senator KERR. How can you now say you were moving in 1953 here to overcome inflationary conditions?

Mr. MARTIN. Well, in 1953, the points I am making is that we had an inventory adjustment which was producing a decline in business that we felt warranted our taking what action we could to minimize its snowballing effect, and we pursued——

Senator KERR. What do you mean its "snowballing effect"?

Mr. MARTIN. Liquidation of inventories that——

Senator KERR. Then you were moving to reduce the unemployment?

Mr. MARTIN. I don't think we were initally moving to reduce the unemployment because it was not an unemployment problem. It was a liquidation of inventories; no unemployment had been produced by the liquidation of inventories.

One of the reasons to distinguish between this recession and that recession is in the capital goods field and in the inventory field.

Senator KERR. You mean to say we had a recession but no unemployment?

Mr. MARTIN. Oh, no, I would not say we had no unemployment. Unemployment began to go up later, but in its early stages it was clearly an inventory adjustment.

Senator KERR. Well, now, which one of those figures do you want us to take as the normal of unemployment consistent with the mandate of the Full Employment or Maximum Employment Act?

Mr. MARTIN. I do not want you to take any of those figures as—unless the Congress wants to write into the Employment Act——

Senator KERR. But they have not, Mr. Martin, and you are operating under a law which has a mandate in it without specifics, and you have said 2 or 3 different things.

Mr. MARTIN. That is exactly the problem that we are dealing with.

Senator KERR. Well, let's get it down to some basis that we can halfway agree on. Is it 2 million, 2½ million, 3 million or 3½ million as a reasonable basis?

Mr. MARTIN. Well, I just do not know, and I wish—I am not trying to avoid or evade here, but I just don't know what it ought to be.

Senator KERR. You said awhile ago that you thought 3 million was overemployment.

Mr. MARTIN. I certainly do in terms of the conditions that prevailed at that time.

Senator KERR. Well, what about the conditions that prevail today?

Mr. MARTIN. The conditions that prevail today are still unfolding. We do not know——

Senator KERR. Well, Mr. Martin, unemployment figures are more than just so many dots on an economic chart, are they not?

Mr. MARTIN. I have indicated that repeatedly, and nobody has more concern about unemployment than I have.

Senator KERR. All I am trying to do is to get you to define the condition concerned.

Mr. MARTIN. I say that the nature of this problem is such that you cannot specifically say this number of unemployed you can tolerate and this number of unemployed you cannot. I think that if——

Senator KERR. I am not talking about what you can tolerate, and what you cannot.

I am talking about what is reasonably consistent with the provisions of the full employment act.

Mr. MARTIN. That is the problem; if the Congress will take the Employment Act——

Senator KERR. But they have not, Mr. Martin, and you say you recognize a duty under it and to recognize a duty you have to reduce it to terms of unemployment.

Mr. MARTIN. You have to reduce it to the overall situation.

Senator KERR. Of which unemployment is a part?

Mr. MARTIN. It is one of the factors which has to be borne in mind every week and every month as we assess this developing picture.

Senator KERR. All right.

Now just tell us what figure you think that you would be willing to stand on as being somewhere near normal for unemployment under the Full Employment Act.

Mr. MARTIN. Well I cannot give you that figure, Senator. I wish I could.

Senator KERR. Give me the confines of it.

Is it between 2 and 3 million or between 3 and 4 million, or between 4 and 5 million?

Mr. MARTIN. Well we have a growing labor force and that has a factor——

Senator KERR. But for 1957–58?

Mr. MARTIN. For 1957 and 1958, I honestly don't know. I say it depends on the length of unemployment. It depends on the type of unemployment. It depends on the adjustments.

Senator KERR. Well if a fellow is out of a job, Mr. Martin, do you think he is interested in a philosophical definition of the kind of unemployment he is suffering from?

Mr. MARTIN. Well I am talking from the standpoint of those of us who want to get him back to work.

Senator KERR. But if you don't know whether his unemployment is of the kind that you are interested in, how do you know whether he wants to get him back to work or not?

Mr. MARTIN. Well I am interested in all unemployed. It is not a case of the type or the kind.

Senator KERR. Then if you are; how many?

How many does it take to get you interested?

Mr. MARTIN. One is all that it takes to get me interested as an individual.

Now in trying to evaluate this—one of the difficulties with the Employment Act which the Congress certainly faced in writing it, was how to define these terms.

Senator KERR. Mr. Martin, you say there is a positive legislative mandate in the Employment Act?

Mr. MARTIN. I do, indeed.

Senator KERR. And you say there is no legislative mandate about a stabilized dollar?

Mr. MARTIN. I say if you are asking for a phrase that says "stabilized dollar," no.

If you are talking about the history of the Federal Reserve Act, I think it is quite clear that it——

Senator KERR. You think it is inherent in the language of the act?

Mr. MARTIN. I do, indeed.

Senator KERR. But you think it is specific in the language of the Employment Act?

Mr. MARTIN. No, I think——

Seantor KERR. There are the words "maximum employment."

Mr. MARTIN. Also maximum purchasing power.

Senator KERR. How can you have maximum purchasing power without maximum employment?

Mr. MARTIN. Well, do you want to describe full employment as being that level of employment which is consistent with maximum purchasing power?

Senator KERR. I would say this, Mr. Martin, and I know what you are referring to there, I am doing what this assistant of yours did here, I am reading your mind.

You are referring to the value of the dollar received for the fellow to pay him for his employment, that is what you are talking about?

Mr. MARTIN. Right.

Senator KERR. What is the value of the dollar he gets if he is not employed?

Mr. MARTIN. I fully appreciate that problem.

Senator KERR. I say what is the value of the dollar he gets if he is unemployed?

Mr. MARTIN. I don't get it; he does not have a dollar.

Senator KERR. He does not have it?

Mr. MARTIN. He has received no dollar.

Senator KERR. As between the two of them which do you think is the better, the one that he does not have or the one that he has that does not have as much purchasing power as the one he had last year?

Mr. MARTIN. We have to relate this to the business machine. I would rather give him a dollar than employ him if it harms the machinery in such a way that later we will have more people unemployed than presently.

Senator KERR. That is what I am trying to find out.

What do you think is more important, a stabilized dollar or stabilized employment?

Mr. MARTIN. I think the dollar should never be our master. It should be our servant; but I do not believe you can get away from the fact that the business machine depends upon a dollar that has integrity and value, saving and investment, and all of the factors that go into this machinery, the lubricating——

Senator KERR. How about employment that has integrity and value?

Mr. MARTIN. That comes from this. That is a part of this.

Senator KERR. You mean it stems from a stabilized dollar?

Mr. MARTIN. It is in part coming from a stabilized dollar.

Now under specific circumstances, take this matter of a balanced budget——

Senator KERR. We are not talking about a balanced budget.

Let's don't get into that.

Which is the most important in your responsibility as Chairman of the Board of Governors of the Federal Reserve Bank, to maintain the stable value of the dollar or to help maintain stable employment?

Mr. MARTIN. There is no question; to help maintain stable employment is the more important.

Senator KERR. Yet have you?

Mr. MARTIN. But I do not believe you can separate that.

Senator KERR. You said maintaining the value of the dollar helped result in 6 million unemployed.

Mr. MARTIN. I don't believe that. You see that is where we disagreed.

Senator KERR. Oh, no, you disagreed with that awhile ago but we went back and came up a step at a time, and you admitted the restraints on credit expansion were to slow down the economy?

Mr. MARTIN. That is right.

Senator KERR. Well, now, a slowdown in the economy results in unemployment.

Mr. MARTIN. I don't believe that it results in unemployment.

Senator KERR. You do not?

Mr. MARTIN. I think if we had run at a much slower pace than we were running in 1955 and 1956 we would have had more employment than we have today.

Senator KERR. That is something you and I can speculate about that neither one of us can prove.

We are confronted today with a reality, not a theory.

Mr. MARTIN. That is where this matter of judgment comes in; and I say that the Federal Reserve Board, in exercising its judgment, is convinced that its policies in 1955 and 1956, if they deserve apology, deserve apology in the sense that they were not restraining enough at that early stage, rather than the reverse.

Senator KERR. But Mr. Martin, you have reversed those policies, you have abandoned them?

Mr. MARTIN. That is exactly right.

Senator KERR. And the result of it has been you still have a depreciating value of the dollar.

Just now confronted with the information I gave you that in the last 30 days the value of the purchasing power of the dollar has gone down 8 points, and I believe if you will look at that you will see that is as great as has occurred in any month.

Let's look and see if more than that much has occurred in any month.

Mr. MARTIN. I will accept it as great as in any month, but I will make the observation that it is because of the preceding imbalance, disequilibrium that occurred that we are still having——

Senator KERR. But Mr. Martin, you have reversed those restraints?

Mr. MARTIN. Well, how long have we reversed those restraints, Senator?

Senator KERR. Well, you said you began in October but the record of your meeting does not show that.

The record of your meeting here shows that you did it in November.

Mr. MARTIN. Let Mr. Riefler look at that. We just wrote that.

Senator KERR (reading):

> The committee concluded, after reviewing the data, that there was no immediate occasion to reverse its policy of restraint on credit expansion or to make a change in the policy directive.

There it is, that is the minutes or something of your October 22 meeting.

Mr. RIEFLER. Then—go on.

Senator KERR (reading):

> While it was clear that the committee at this juncture did not wish to make any move that would signal a change in policy, it wished to supply seasonal needs reasonably freely. It did not wish to increase restraint from what it had been.

There it is.

Mr. RIEFLER. Go on.

Senator KERR (reading):

> The committee concluded, after reviewing the data, that there was no immediate occasion to reverse its policy of restraint on credit expansion—

There it is right there.

Mr. RIEFLER. Yes, sir. But there is the way the policy starts, a change in policy starts.

Senator KERR (reading):

> Thus, in reviewing the directive without change, the committee agreed that although general policy was not to be changed appreciably, it should tend on the easier side from where it had been in recent weeks.

Well, in other words, you just had a tendency because you just stated the committee concluded, after reviewing the data, and—

> The committee renewed its policy directive with the same wording that had been adopted at the meeting on March 5 and at each meeting since, namely, that open market operations were to be with a view, among other things, "to restraining inflationary developments in the interest of sustainable economic growth wh[illegible] recognizing uncertainties in the business outlook, the financial markets, and the [illegible]ternational situation."

Senator GORE. What was the vote there?

Have you got the vote?

Senator KERR. Unanimous.

Votes against this action, none.

Senator GORE. If you will look at the following minutes you will find where they did change the policy.

Senator KERR. That was in November 12. The directive of the open market committee was changed at this meeting of November 12, and that is when the change was made, according to your own record right there.

Mr. MARTIN. I do not think you read the record correctly, Senator.

Senator KERR. You mean to tell me I may have misread that record?

Mr. MARTIN. So far as policy development is concerned, the meeting of October 22 clearly tended toward easier money.

Senator KERR. It clearly tended toward it after you concluded there was no immediate occasion to reverse and after you started off by adopting the same wording.

You say the same wording that had been adopted at the meeting on March 5 and at each meeting since.

Mr. MARTIN. There are shades of change within—we do not change the words of every—at every meeting; but we have a go-around of our entire 12 presidents and the Board of Governors and we come out with some pretty clear indications of what the accounts should do.

Senator KERR. I want to tell you there are no words there that indicate a clear change.

Mr. MARTIN. Well, it was intended to. Mr. Riefler pointed out the words we put in; we spent a good deal of time on it.

Senator KERR. Thus in renewing the directive without change——

Mr. MARTIN. We did not want to make the overt change.

Senator KERR. Thus in renewing the objective without change, the committee agreed that although general policy was not to be changed appreciably——

Mr. MARTIN. Well, isn't "appreciably" an important word?

Senator KERR. Well, is it?

Mr. MARTIN. I think it is, because I think all policies begin with a shade of change.

Now whether you continue or not, it depends on whether it becomes a policy.

Senator KERR. You know a fellow sat right where you are sitting one day and he says, "This posture is in the outer edge of the rim of the periphery."

Mr. MARTIN. Do you think we can use him? [Laughter.]

Senator KERR. Well, he got almost as fine a distinction there as you have but he is the only fellow that ever did it. His name was Stassen—he sat right there where you did, he talked about the outer edge of the rim of the periphery.

Will you tell this committee that if you think that stable employment is of more value or more importance than the stable dollar, why it is that you took action that helped bring about 6 million—five million some hundred thousand unemployed?

Mr. MARTIN. Well, I just definitely deny that our action brought about or helped bring about the present number of unemployed.

Senator KERR. Mr. Martin, you have sat there and admitted that it helped bring it about.

Mr. MARTIN. No.

Senator KERR. You imposed it to slow down the tempo of the economy?

Mr. MARTIN. That is correct, but not to create unemployment.

Senator KERR. You slowed down the tempo of the economy.

It results in unemployment but you did not aim for it to, is that what you are saying?

Mr. MARTIN. If we had not slowed down——

Senator KERR. I am not talking about what would have happened if you had not—Mr. Martin, you are speculating.

Mr. MARTIN. You are speculating, too.

Senator KERR. No, I am not. There is no speculation about there being 5.7 million unemployed, is there? Is that an accurate figure or not?

Mr. MARTIN. I think that is roughly accurate.

Senator KERR. They are aware of it, are they not?

Mr. MARTIN. I am certain they are.

Senator KERR. Then it is a reality, is it not?

Mr. Martin, how do you say I am speculating about it?

Mr. MARTIN. If you are saying monetary policy caused that.

Senator KERR. You are saying that?

Mr. MARTIN. No, I did not.

Senator KERR. Mr. Eccles said that; Mr. Humphrey said that; Mr. Burgess said that.

Mr. MARTIN. I do not know what they said and I do not care; but I say that the Federal Reserve Board and the presidents of the Federal Reserve banks who have worked on this are convinced that their policies did not produce this recession.

They feel the recession would be a whole lot worse and a whole lot more prolonged——

Senator KERR. You said we eased the bank credit restriction to slow down the economy?

Mr. MARTIN. Well, slowing down the inflation does not create unemployment.

Unemployment comes from overproduction, it comes from a lot of the things that come from running too fast.

Senator KERR. What happens when you slow the economy down without creating unemployment?

Mr. MARTIN. Why, you have a stability of employment that you do not have——

Senator KERR. How do you slow down the economy without bringing about unemployment?

Mr. MARTIN. I think you slow down the demand pressures on production.

Senator KERR. How do you have production? Don't you have to have people working to have production?

Mr. MARTIN. Why, production comes from machinery and all sorts of things, as well as workers.

Senator KERR. Automatically?

Mr. MARTIN. Yes, a lot of it does. You do not just add another 10 people and produce that much more.

Senator KERR. No, but you don't have any machine that runs without people, do you?

Mr. MARTIN. Not without people, no; but you have many changes that——

Senator KERR. If you have to have people to run machinery, and you show it does, doesn't that mean you do not have to have as many people?

Mr. MARTIN. Well, it may be that the machinery is more effective if it does not have as many people.

Senator KERR. Well, that may be true but you still have less people?

Mr. MARTIN. At the moment; yes.

Senator KERR. The degree to which you have less people results in unemployment, does it not, Mr. Martin?

Mr. MARTIN. Well——

Senator KERR. Doesn't it?

Mr. MARTIN. No, I do not think so, Senator.

Senator KERR. You do not?

Mr. MARTIN. No, I do not think so.

Senator KERR. If you have so many people running the economy and you slow it down with the result that you have fewer people that does not mean that you have unemployment?

Mr. MARTIN. That is not this sort of slowing down that occurred. This was a slowing down that came in demand; and if you were going to have a constant inflation based on consumer credit, based on real-estate mortgage credit, based on a buildup of inventories in many instance with borrowed money, and an expectation of passing on costs in still higher prices——

Senator KERR. Stop right there, let's take those again. You are building houses on borrowed money, and you did not like that.

Mr. MARTIN. No, I did not say I did not like it.

Senator KERR. Well, is what you referred to something that was going to slow down?

Mr. MARTIN. I said the rate at which we were building them and some of the terms that went with it had to be related to the only governor that our kind of economy has, which is the price mechanism and, in financial markets, the interest rate.

Senator KERR. The interest rate? So you increased the interest rate?

Mr. MARTIN. We let the interest rate increase with the demand.

Senator KERR. By restraining the flow of money you increased the necessity for those desiring credit to bid for it and the result was the interest rate went up, did it not?

Mr. MARTIN. The interest rate went up because of demand.

Senator KERR. And you intended for it to go up, didn't you?

Mr. MARTIN. Yes, but we did not create that condition.

Senator KERR. Well, who was it that withheld the additional increase of money?

Mr. MARTIN. We could just print the money.

We do not have to worry about——

Senator KERR. I know but you state here right in your statement that between September and March, member bank borrowings from the Reserve banks declined from about a billion to less than 150 million while excess reserves rose more than a hundred million thus net reserve position shifted by almost a billion dollars.

Now you took this action to bring that result about, did you not?

Mr. MARTIN. We increased the money supply because under these conditions we do not think that we have to worry about inflation.

Senator KERR. Well, you increased the money supply so as to make money available, didn't you?

Mr. MARTIN. That is right.

Senator KERR. And that brought interest rates down, did it not?

Mr. MARTIN. Yes. Let me——

Senator KERR. Just a minute.

That brought interest rates down, didn't it?

Mr. MARTIN. That brought interest rates down.

Senator KERR. All right.

That was the reversal, that was a relaxing of the restraints, was it not?

Mr. MARTIN. That is right.

Senator KERR. Now, isn't it a fact that the restraints you had imposed had reduced the money supply and that resulted in the higher interest rates?

Mr. MARTIN. The higher interest rates——

Senator KERR. That is correct, is it not, Mr. Martin?

Mr. MARTIN. That is right.

Senator KERR. And that is what you did it for, wasn't it?

Mr. MARTIN. We did it not because we wanted higher interest rates——

Senator KERR. But you did it knowing you would have higher interest rates, didn't you?

Mr. MARTIN. We would much rather——

Senator KERR. I say, knowing that you would have higher interest rates?

Mr. MARTIN. Oh, yes, indeed.

Senator KERR. And you thought that would be one of the brakes?

Mr. MARTIN. One of the governors.

Senator KERR. You thought that would be one of the brakes on the situation, didn't you?

Mr. MARTIN. One of the governors on the economy; right.

Senator KERR. Well, one of the governors; that was one of the things that would slow it down, is it not?

Mr. MARTIN. That is right.

Senator KERR. And that slowing down resulted in the unemployment, did it not?

Mr. MARTIN. I do not think so.

Senator KERR. Well, didn't it result in building fewer houses?

Mr. MARTIN. It resulted in building fewer houses.

Senator KERR. Didn't it result in producing less goods?

Mr. MARTIN. Not quite—you see, one of the problems we have today is overcapacity.

Senator KERR. No; one of the problems we have got today is overproduction.

Mr. MARTIN. Overproduction; all right.

Senator KERR. But you see the capacity that was built, Mr. Martin, was built on the assumption that men had a right to think we would have an economy geared to full employment.

Men did not know this Federal Reserve Board was going to impose these restraints, turn that screw tighter and tighter and tighter.

Mr. MARTIN. Well, now, let's just put it the reverse.

During this period, suppose we had just supplied money ad infinitum, printed it, and kept interest rates at 2 percent.

Senator KERR. Mr. Martin, I will be glad to speculate with you on that, but we are talking about history now. We are talking about what you did do.

Mr. MARTIN. Well, I am talking about——

Senator KERR. You are talking about what might have been, and even the poet said: "Of all the sad words of tongue and pen, the saddest of these: that might have been."

I am talking about what is and what was and how it came about.

Mr. MARTIN. All right; and it is the interpretation of history then. But I insist—and I just want the record to show this—I insist that I do not think the Federal Reserve Board has any apology to make with respect to the tight-money policies.

Senator KERR. I know they have not any apology to make because they still believe what they believed then.

Mr. MARTIN. Except one point.

Senator KERR. But I will tell you this: There are a lot of people who think you ought to apologize but that would not put them to work.

Mr. MARTIN. This is a free country and we have only one apology to make, and that I made—that is, along with other Government agencies we should have been tighter. We should have been more restraining than we were.

Now, on that score, I accept a portion of the blame for the current recession. But on no other score.

Senator KERR. Now then, I want to go back to the power to tax being the power to destroy.

Isn't a fact, Mr. Martin, that these restraints have, in part, resulted in this economic condition of unemployment?

Mr. MARTIN. The monetary restraints?

Senator KERR. Yes.

Mr. MARTIN. No, I do not think so.

Senator KERR. You said awhile ago they were in part responsible, not fully but in part.

Mr. MARTIN. For slowing up the economy, but they were not——

Senator KERR. After the economy slowed up we had more unemployment than we had before.

Mr. MARTIN. We got out of balance.

Senator KERR. Do we have more unemployment now that we have slowed down than before?

Mr. MARTIN. We have more unemployment, but the reason for it is the imbalances that occured with the inflationary surge of 1955 and 1956.

I do not think there has ever been a recession that is more clearly traceable to the excesses that preceded it than this, and it is not—that goes for governmental expenditure and for stimulus in a great many areas and for spending and undersaving.

Senator KERR. All right.

Now, then, I am going to tell you something.

Do you remember the story of the Revolutionary War reasonably well? The American Revolution?

Mr. MARTIN. I am——

Senator KERR. Are you acquainted with the fact they had one?

Mr. MARTIN. I am indeed, sir. Very proud of it.

Senator KERR. What is the commonly accepted cause of it?

Mr. MARTIN. Taxation without representation.

Senator KERR. Taxation without representation.

The power to tax being the power to destroy, those old boys decided they were not going to take it, didn't they?

That taxation without representation?

Mr. MARTIN. That is right.

Senator KERR. Do you know how much taxation it was that caused them to rebel?

Mr. MARTIN. I am afraid I do not.

Senator KERR. Would you like to know?

Mr. MARTIN. I would.

Senator KERR. I am going to tell you. I am going to relate it to the situation today, because the Federal Reserve Board has participated in bringing on another recession——

Senator GORE. Not nearly as much as Charlie Wilson lost by selling his bonds or Humphrey made by keeping his.

(Off the record.)

Senator KERR. I asked the Congressional Library how much tax did the British Crown collect from the American Colonists, leading up to the Revolutionary War.

In 1763 and 1764, the British Crown established the Stamp Act, which was designed to bring in a hundred thousand pounds or roughly $500,000 per year.

This tax was abandoned in 1766. In 1767 the Crown imposed duties upon glass, lead, paint, paper, and tea.

It was estimated that these duties would bring in £400,000 or roughly $2 million per year.

However, the people in the Colonies refused to buy these items subject to this tax so that all the Crown actually collected was approximately $80,000 per year and it was reported that the cost of collecting this tax amounted to about $75,000 per year, leaving them a net of about $5,000.

In 1770 all of these duties were repealed except the tax on tea.

Now that is what caused the revolt, the American Revolution. You believe in the value and integrity of the private banking system, do you not?

Mr. MARTIN. I do.

Senator KERR. I do, too, and you would like to see it preserved, would you not?

Mr. MARTIN. I would.

Senator KERR. I would, too.

How do you think the people are going to feel when they realize that without authority of law and in violation of the mandate of the Full Employment Act, we have got an agency here that take actions that costs people more money every day than the tax which the British Crown tried to collect and brought on the American Revolution.

Mr. MARTIN. Well, Senator, all I can say to that is that I am sure you and I have exactly the same objectives in wanting everybody to be employed and to do better than they are doing.

Senator KERR. How much penalty do you think the 5½ million unemployed are taking every day?

Mr. MARTIN. I do not know, I don't think you can measure it.

Senator KERR. If $10 a day is a fair wage, and there is an excess, let's say, of 3 million unemployed above normal, that would be $30 million a day, would it not?

Mr. MARTIN. I don't think you can measure those things in dollars, but let's——

Senator KERR. That is what it would be, would it not?

Mr. MARTIN. All right. Take whatever dollar amount you want.

Senator KERR. That is what it would be, was it not?

Mr. MARTIN. I still insist——

Senator KERR. I know, but that is the penalty they are paying, isn't it, Mr. Martin?

Mr. MARTIN. That is right.

Senator KERR. Is that the penalty they are paying?

Mr. MARTIN. $10 a day——

Senator KERR. Is that an average wage?

Mr. MARTIN. I don't know.

Senator KERR. You don't know?

Mr. MARTIN. No; I do not know.

Senator KERR. You mean that you are the Chairman of the Federal Reserve Board and 1 of 7 men that Marriner Eccles says has more power than any other group on the economic welfare of this country and you do not know what the average wage of American workers is?

Mr. MARTIN. Senator Kerr, I can find out, but I do not keep that type of information——

Senator KERR. How many of your staff have you got here?

Mr. MARTIN. Well, I have got three awfully good men here.

Senator KERR. All right. Can either one of them tell you what the average wage is?

Actually, Mr. Martin, it is better than $15 a day.

I was trying to take just a very reasonable figure.

Mr. MARTIN. I think that is fine.

Senator KERR. Have you got that?

Mr. YOUNG. Not that.

Senator KERR. What is the average hourly wage in industry?

Mr. YOUNG. The average hourly wage would exceed $2.

Senator KERR. No; it is not. I want to tell you, you need somebody with information down there, Mr. Martin. [Laughter.]

Mr. YOUNG. We have it right here.

Mr. MARTIN. We have it——

Senator KERR. What is it?

Mr. YOUNG. Average hourly earnings in manufacturing in March was $2.10.

Senator KERR. All right.

Mr. YOUNG. In current prices. $2.06 in 1957 prices.

Senator KERR. Well, that is $2.10.

How near does that come to being average across the board?

Mr. YOUNG. Well, that is——

Mr. KERR. That is it.

Mr. YOUNG. There is quite a variation—for example, in retail trade, it is $1.68.

Senator KERR. All right.

Mr. YOUNG. In building construction, $3.

Senator KERR. All right.

Mr. YOUNG. In nondurable goods it is $1.92, and in durable goods it is $2.24.

Senator KERR. All right. Now on the basis of the information you now have before you, which apparently was a stranger to you, what would you advise your Chairman to answer, as to what was a fair average statement of what the average wage was of workers in this country?

Mr. YOUNG. This is a big area here——

Senator KERR. You mean you are so submerged in information——

Mr. YOUNG. Well, you have a big area of service employment, you know, sir.

Senator KERR. Well, the unemployed figures we were talking about is not of doctors and lawyers; is it?

Mr. YOUNG. You have a lot of people engaged in service employment who are in trucking and all that sort of thing.

Senator KERR. All right.

Mr. YOUNG. Who are——

Senator KERR. Give the man some figure.

What are you here for? You are just like I am, there is nothing in your looks.

Mr. YOUNG. If you want to take $10 a day——

Senator KERR. What?

Mr. YOUNG. If you want to take $10 a day as an average, why that would be a conservative average for the purposes of this discussion.

Senator KERR. It certainly is a very low average, very low estimate, is it not, $10?

Mr. MARTIN. Let's accept $10 a day.

Senator KERR. All right. If there is an excess of 3 million unemployed above normal, that is $30 million a day penalty they are paying, is it not?

Mr. MARTIN. That is, and we want to do everything we can to get them back where they are not paying that penalty.

Senator KERR. But, Mr. Martin, you more than any other did that which got them in that condition?

Mr. MARTIN. Well, I am sorry to disagree with you on that, Senator.

Senator KERR. I know that you are.

But the record substantiates my statement and I am again asking you how long do you think the American people are going to tolerate the use of authority by an institution that results in that kind of penalty on people?

Mr. MARTIN. I hope that the American people will have enough understanding of what their basic liberties and their basic opportunities are so that, whether they ask the Federal Reserve Board to do it or whether they abolish the Federal Reserve System and get somebody else to do it, they will not give up the general approach recognizing that private property, competitive enterprise and the profit motive operate through the price mechanism to create the greatest wealth that has been created——

Senator KERR. How much comfort do you think that is to a fellow who goes home to look at the wife and six kids and hasn't anything to eat and no job.

Mr. MARTIN. I do not think——

Senator KERR. How much comfort do you think they can get out of the philosophical approach to the profit system?

Mr. MARTIN. I do not think he gets much comfort. I do not expect him to get comfort.

Senator KERR. How long do you think he is going to be willing to be the casualty——

Mr. MARTIN. Well, the question is how are you going to put people to work?

You can eliminate unemployment tomorrow by putting everybody in the Army, I suppose, or by——

Senator KERR. Is that your remedy?

Mr. MARTIN. No, it is not.

Senator KERR. Well, you are one of the men who has responsibility for carrying out the mandate of the Full Employment Act. What is your remedy?

Mr. MARTIN. One of the remedies we have we are employing at the moment.

Senator KERR. By increasing the unemployed?

Mr. MARTIN. No, by a policy of easier money which the Federal Reserve is presently pursuing; it is placing its major emphasis not on inflation—we still believe it was the inflation that produced this—but we are placing our major emphasis on fighting deflation.

Senator KERR. But, Mr. Martin, you are abandoning any integrity of belief there because you have put a policy of restraint into effect to stabilize the value of the dollar, you said.

Mr. MARTIN. I certainly did. We certainly did.

Senator KERR. All right.

Now you have reversed that policy in the face of the fact that you had not achieved the objective.

Mr. MARTIN. In the face of the fact that we have not what?

Senator KERR. Have not achieved the objective. Here are the figures this morning. The cost of living went up 8 points in March.

Mr. MARTIN. I have tried to make the point, Senator, and maybe I cannot make it, but it is clear to me, that the reason for this tail end of the employment, of the price level, is the knots that we got into in the process of inflation that got ahead of us—and it did get ahead of us——

Senator KERR. Mr. Martin, you reversed your policy, you did last November, you said last October, at the time when that increase in cost of living is still going up.

Mr. MARTIN. Because we are accepting your point that we are not looking to the stabilization of the dollar alone.

We are looking primarily to stabilization of employment. That does take precedence with us over the stabilization of the dollar. We are not trying to make the dollar——

Senator KERR. At which point did it take precedence?

Mr. MARTIN. There is the whole problem.

Senator KERR. When we got 5½ million unemployed?

Mr. MARTIN. No, that is the whole problem—it should have taken precedence and I—when we get on into the current recovery, which I am sure is going to come, we recognize at this time it should have taken precedence in 1955 and 1956, not only with the Federal Reserve but with the Government producing surpluses.

Senator KERR. Mr. Martin, we are living in 1958.

Mr. MARTIN. We cannot go back.

Senator KERR. Is it your idea the unemployed must pay the penalty for your mistake in 1955?

Mr. MARTIN. I do not think it was my mistake; it was our mistake.

Senator KERR. You said it was your mistake; you said you did not do enough in 1955.

Mr. MARTIN. That was one of the factors.

Senator KERR. What was the other?

Mr. MARTIN. I think the Government should have had a larger surplus than it had.

Senator KERR. How are you going to do that?

Mr. MARTIN. I think that is where the problem——

Senator KERR. How are you going to do that?

Mr. MARTIN. That is where the problem of fiscal policy comes in.

Senator KERR. Is that your responsibility?

Mr. MARTIN. No, that is not my responsibility.

Senator KERR. Then you are telling us that this situation now resulted from somebody else's operations, and a while ago you said that it was brought on in part by your failure to act in 1955.

Mr. MARTIN. I said that if we—we are vulnerable in the sense that we might have done more than we did. But I never claimed that monetary policy can—is all controlling or the only thing in the economy.

Senator KERR. It has a lot of effect——

Mr. MARTIN. It has.

Senator KERR. Because you have been putting on an act here of tightening her up and then untightening it.

What are you doing that for, if it does not mean something?

Mr. MARTIN. We are asked by the Congress in the Federal Reserve Act to utilize a managed currency to create as stable conditions for growth and improvement in employment as it is possible to have, and in accord with that mandate which is given us in the Federal Reserve Act and which we accept under the Employment Act, we are doing the best we can.

I want to make the point that where this thing got off the track was in 1956 primarily where I think we let exuberance run away with us in the economy, and at that time, I think——

Senator KERR. You do not think we ought to have an exuberant economy?

How somber do you want it?

Mr. MARTIN. I want an economy that will have sustainable growth. When you get wages running too fast, and prices——

Senator KERR. As between no growth at all, and unsustainable growth which would you take?

Mr. MARTIN. I don't believe you would have no growth at all.

Senator KERR. We are not having any now.

Mr. MARTIN. But you are talking about a very short period of time.

Senator KERR. How long can people go without food?

Mr. MARTIN. Well, now, let's do not——

Senator KERR. You think these unemployed over the long pull——

Mr. MARTIN. We should do everything now in our power to help alleviate the suffering and misery of any of the unemployed.

Senator KERR. Mr. Martin, I say do you think that they should be as interested in 1960 as they are in 1958?

Mr. MARTIN. The unemployed?

Senator KERR. The unemployed.

Mr. MARTIN. I think there are going to be opportunities for unemployed——

Senator KERR. You know Eisenhower has been trying to get them to think about the employment they are going to have. Are you thinking about them now?

Mr. MARTIN. I am not thinking about the unemployed in these terms.

Senator KERR. What we are talking about are these employed.

Mr. MARTIN. We are talking about these people.

Senator KERR. And you said nobody has more concern about those people than you do?

Mr. MARTIN. That is right. And I want to do everything and pledge before this committee the activity of the Federal Reserve Board and the Federal Reserve banks to do everything within their power——

Senator KERR. But you said you would not do it at the expense of a stabilized dollar?

Mr. MARTIN. I did not. I answered you positively that if there was a choice between a stabilized dollar and unemployment, we would do what we could do to help the unemployment situation.

Senator KERR. Yes, but throughout 1956 you did that which was to slow down the economy that had the result in unemployment and you said you did it for maintaining the stabilized dollar.

Mr. MARTIN. There you and I have a friendly disagreement as to whether that is the case. I don't believe that it slowed down employment in 1955 or 1956.

Senator KERR. I am talking about 1957.

Mr. MARTIN. 1957. It had gotten ahead of you, and the difficult thing about——

Senator KERR. Now, Mr. Martin, let's see if it had gotten ahead of us. Let's see if it had gotten ahead of us in 1957.

Mr. MARTIN. In 1957 you already had the start of a gallop in the cost of living that has continued right up to this report that you just read me.

Senator KERR. Isn't it a fact, Mr. Martin, that every economic indicator in the book showed a slowdown before the middle of 1957.

Mr. MARTIN. I do not know that every indicator did. I think a number of them did.

Senator KERR. Do you know how many bankruptcies there were in 1957?

Mr. MARTIN. There were quite a few.

Senator KERR. Do you know how many?

In 1953 there were—this is fiscal—40,087.

In fiscal 1954 there were 53,136.

Would you like to have a copy of this?

In fiscal 1954 there were 53,000.

In fiscal 1955 there were 59,400.

In fiscal 1956 there were 37,761.

Do you know what the estimate is for fiscal 1958?

Mr. MARTIN. No, I do not, but it is probably up.

Senator KERR. 85,000.

I give you a chart, showing bankruptcy cases filed and pending, fiscal years 1905 through 1957, and ask you to tell me when the sharpest increase in that period occurs according to that chart.

Mr. MARTIN. Well, I would say late 1956 and 1957 on this, if I am reading it right.

Senator KERR. Doesn't that make it perfectly clear that the indications were apparent to anybody who wanted to read them that instead of this thing galloping away from us that the seed of the recession was there.

Mr. MARTIN. The seed of the recession was there from the moment——

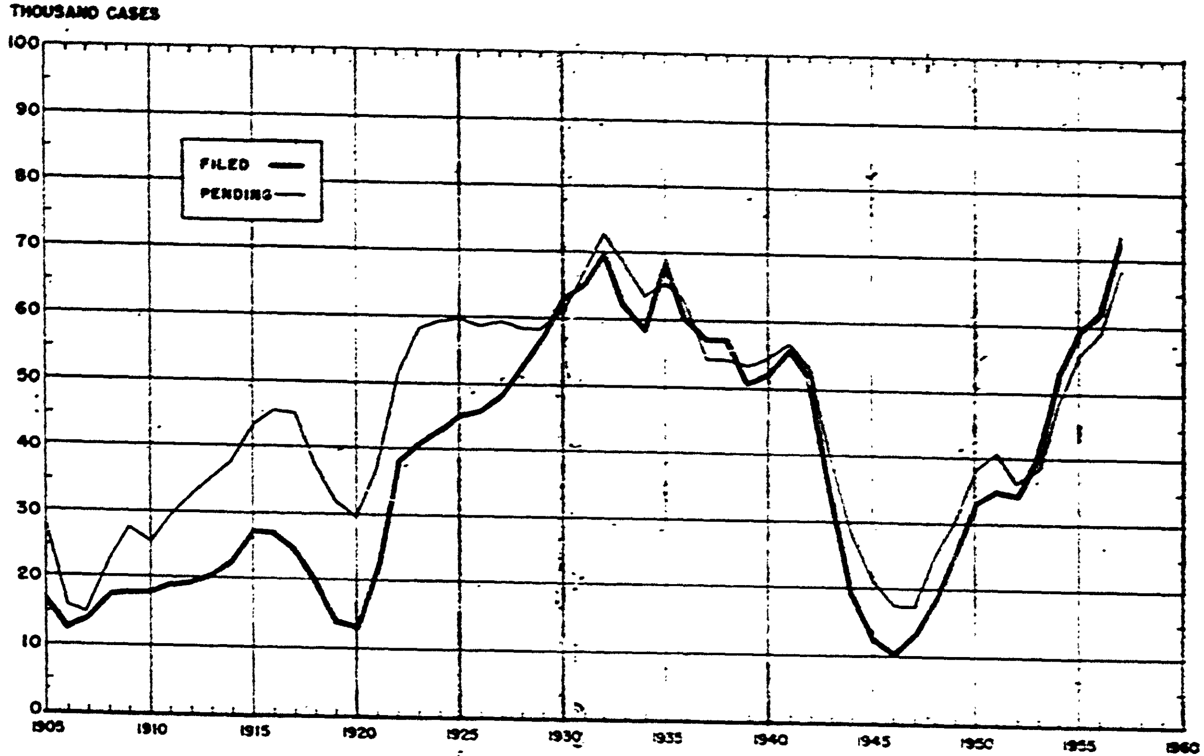
Senator KERR. I want that put into the record, that chart.

(The chart follows:)

DISTRICT COURTS

BANKRUPTCY CASES FILED AND PENDING

FISCAL YEARS 1905 - 1957



Mr. MARTIN. The seed of the recession was there from the time that this inflationary swing began to get away from us which I say was late 1955.

We raised the discount rate in November of 1955.

We were worried about it at that time.

We had a number of people at that time who told me it was just as clear as could be that we were headed for a collapse; this was 1955. Those people turned out to be wrong in 1955 and 1956, and late 1956 and early 1957.

Now these swings must be gaged over quite a period of time. I was worried about this thing from the middle of 1956 on.

I thought it had gotten ahead of us.

Senator KERR. The downturn was apparent in 1957.

Mr. MARTIN. But the downturn—there was no real assurance that the downturn was going to become dominant in the economy, in my judgment, until late September when we found that the fall upswing that was normal was not occurring.

Senator KERR. Well, the rate of production of steel and every other indicator that I know of had either been practically stationary a month or two at a time or steadily down since February of 1957.

Mr. MARTIN. And it had been worrying us right through that time. But look at——

Senator KERR. But you were still putting the screws on in October of 1957?

Mr. MARTIN. I think it was quite appropriate that we should, because we did not want to let people come in on this bulge at the end and wish they had not come in later. We wanted to make this clear and this goes for abroad too. Look at the problem the British have had——

Senator KERR. Let's look at ours; I will tell you we have got all we can take care of.

Mr. MARTIN. Look at my statement.

Senator KERR. Do you get any consolation out of the fact that the fellows over there have got troubles, too?

Mr. MARTIN. I don't get any consolation from anybody's troubles.

Senator KERR. Let's stay with our own because that is all you and I have a legal mandate to do anything about.

Mr. MARTIN. I was not taking consolation from it; but am saying that the free world had been swept with the idea of creeping and chronic inflation as a desirable operation, and it was important that we make it clear that at least the Federal Reserve did not intend to avoid its responsibility to do what it could to halt that type of upsurge.

Senator KERR. Well, now, while the upsurge was still on you were trying to halt the decline?

Mr. MARTIN. We reversed policy. We have to lean against the wind, whichever way the wind is blowing.

Senator KERR. But the cost of living is still going up.

Mr. MARTIN. I have explained to you that with the cost of living, we may have a different situation if it is going to continue up indefinately; but as I said yesterday, and regardless of those figures, I still think prices are beginning to decline and the cost of living——

Senator KERR. You know men have been telling that to this committee since last August.

Mr. MARTIN. I have no doubt.

Senator KERR. And you were one of them. You told us that last year.

Mr. MARTIN. I think that is probably correct. But I think that the other factors in the economy now are such that it makes it clear to me that the cost of living index is going down before too long.

Senator KERR. You have been saying that for months, Mr. Martin, and it still goes up.

I believe the highest decline in any of the months took place this month, didn't it?

Mr. MARTIN. I don't know.

Senator KERR. Let's look there and see.

Have you got the April Indicator there?

Look over at page 23.

Mr. MARTIN. Yes, I have page 23.

Senator KERR. All right.

Now what other month, and the only months shown there are the beginning of January 1957, what other month there has had as high an increase as we have had in the last month? In March or February?

Mr. MARTIN. I think you are quite right, that is the highest.

Senator KERR. Now, then, Mr. Martin, that brings me to this question, and Mr. Chairman, it is now very apparent to me that Mr. Martin and I will still be talking in the morning.

I will be glad to go further——

Mr. MARTIN. Senator, I want to say one thing, I have an appointment tomorrow in New York that I just cannot break.

Senator KERR. What is tomorrow?

Mr. MARTIN. Tomorrow is Thursday, I will be glad to come back Friday——

The CHAIRMAN. The Chair wants to suggest if there is nothing very important in the Senate this afternoon we could continue this afternoon.

Will that suit you?

Senator KERR. Yes. We can go a little while longer and then recess until 2:30. Would that be all right?

Mr. MARTIN. Yes.

The CHAIRMAN. After Senator Kerr concludes this afternoon the procedure will be for those Senators who did not have an opportunity to question Mr. Martin when he was last before the committee in August to come first. That is, with the approval of the committee. tee.

Senator KERR. I will ask him a few more questions and then we will recess for lunch.

Mr. Martin, do you think that it is humanly possible to achieve the stability of the value of the dollar in the absence of legislative control of prices and wages?

Mr. MARTIN. Yes, I do.

I realize the difficulties, but I think it can be achieved if we——

Senator KERR. How? By monetary control?

Mr. MARTIN. By monetary and fiscal policy coordinated.

Senator KERR. What fiscal policies?

Mr. MARTIN. Well, I think that you have to——

Senator KERR. What do you refer to when you use the term fiscal policies?

Mr. MARTIN. Well, I would cover budget and tax policy under that term.

Senator KERR. You mean the amount of money collected by the Government in the form of taxes and the amount of money spent by the Government?

Mr. MARTIN. That is correct.

Senator KERR. Is their effectiveness related to the amounts of either or to the balance between the two or lack of it.

Mr. MARTIN. I think their effectiveness is related to the balance between the two.

Senator KERR. Well, you told us yesterday you thought we would have a $3 billion deficit this fiscal year.

Don't you think it will be more than that?

Mr. MARTIN. This fiscal year?

Senator KERR. Yes.

Mr. MARTIN. I was taking the Secretary of the Treasury's estimate.

Senator KERR. I thought his estimate was 3 to 4 billion?

Mr. MARTIN. I may have misread it—I thought he said 3 billion; but I made a projection for the following fiscal year.

Senator KERR. Of approximately 10?

Mr. MARTIN. Of approximately 10.

Senator KERR. Well, what should we do to avoid that?

Mr. MARTIN. Well, I pointed out yesterday that since we are now fighting a recession tooth and nail that I was willing to accept the hazards of that. But I questioned very much whether we wanted to add to that imbalance.

Senator KERR. By a bigger deficit?

Mr. MARTIN. By a bigger deficit.

Senator KERR. I know you have said that.

What is it, Mr. Martin, that everybody in this room and out of this room, industry, labor, agriculture, is striving to do with reference to their individual position insofar as their income is concerned?

Mr. MARTIN. To better it.

Senator KERR. Trying to better it.

Every workingman wants to get more money for his labor, does he not?

Every producer wants to get more money for his product.

Farmers want to get more for their farm products.

Industry wants to get more for its products.

Would you say it was a reasonable statement that without exception every active individual, organization, profession, industry, economic group, is striving to get more dollars for what they do or what they produce?

Mr. MARTIN. I think they are trying to improve their positions.

Senator KERR. And would you say that that statement I just made was accurate?

Mr. MARTIN. I would.

Senator KERR. Then if everybody in this country is working to do that, how do you conceive it to be possible that they are not going to make some progress in that direction?

Mr. MARTIN. I think they will make some progress in that direction.

Senator KERR. Well, as they make progress in that direction, they inevitably reduce the purchasing power of the dollar.

Mr. MARTIN. No; I do not agree with that at all.

Senator KERR. Well, you mean if a worker gets more dollars per hour that he has not reduced the power of the dollar to buy labor?

Mr. MARTIN. If it is related to his productivity.

Senator KERR. I know he would like to produce more but you did not indicate that you thought that labor was trying to get more dollars but have it limited to whether they produce more or not.

Mr. MARTIN. Well, wherever you have an excess that is not earned, you are just compounding your problem.

Senator KERR. You mean to tell me the doctor who is charging you $10 today to let you visit him in his office where he used to come to your house for a dollar and a half, is earning that difference?

Mr. MARTIN. Well, I hope he is.

Senator KERR. Do you think he is?

Mr. MARTIN. I don't know. But I say that in the long run——

Senator KERR. Let's take the salary of the men around this committee here, our salary now is $22,500 a year. You can remember when it was $5,000.

Do you think we are earning the difference or do you think we ought to turn it back if we are not? [Laughter.]

Mr. MARTIN. I will not comment on that. I will only say that the Federal Reserve Board only gets $20,500 so maybe that——

Senator KERR. What were they getting 15 years ago?

Mr. MARTIN. They were getting $15,000 15 years ago.

Senator KERR. What does the president of the New York Federal Reserve Bank get?

Mr. MARTIN. The president of the New York Federal Reserve Bank gets $60,000.

Senator KERR. A year?

Mr. MARTIN. $60,000 a year. But let me point out, Senator, that the New York bank is a quasi-Government institution, whereas the Federal Reserve Board is purely Government.

Senator KERR. Well, now, isn't the Federal Reserve Bank of New York a creature of the law?

Mr. MARTIN. It is a creature of the law and the law very specifically is an interesting document wherein you merge public and private interest, and there is a difference in the individual reserve banks.

Senator KERR. Is the Federal Reserve Bank of New York not responsible to the Federal Reserve Board?

Mr. MARTIN. It is responsible to the Federal Reserve Board.

Senator KERR. But now is the Federal Reserve Board responsible to nobody?

Mr. MARTIN. It is responsible to the Congress.

Senator KERR. How is it that the Federal Reserve Bank of New York is not responsible to a Congress if it is responsible to an agency that is responsible to the Congress?

Mr. MARTIN. Once removed it is, Senator; but this is an interesting——

Senator KERR. Aside from the interesting philosophical characteristic of it, he is getting $60,000 a year, is he not?

What was he getting 25 years ago?

Mr. MARTIN. I think he is worth considerably more than that.

Senator KERR. I am sure he is too, but what was he getting 25 years ago?

Mr. MARTIN. He has actually been downgraded. The salary of the president of the Federal Reserve Bank of New York 25 years ago was $50,000, and they then had an additional officer whoalso got $50,000.

Senator KERR. He did not get more than $50,000?

Mr. MARTIN. What?

Senator KERR. He did not get more than $50,000.

Mr. MARTIN. Which one?

Senator KERR. The president.

Mr. MARTIN. The president got $50,000.

Senator KERR. Well, he does not get any of that fifty thousand—he did not get any of the fifty thousand that the one that was working with him, did he?

Mr. MARTIN. No, he did not; but I am saying that in terms of salary, if you are talking about it in terms of 25 years—what is Congress up from, to $22,500, from $15,000?

Senator KERR. They were not making $15,000, 25 years ago.

Mr. MARTIN. Then the comparison is even worse.

Senator KERR. I do not know. It just might be that Congress is working all this time to more or less equalize proportionately its salary to some of the creatures it has brought into being.

Mr. MARTIN. I was only trying to point out that the Federal Reserve Board and the Chairman of the Federal Reserve Board get less than the Congress at the present time.

Senator LONG. If the Senator would yield at that point I was chairman of the subcommittee that put the bill through to raise yours before we raised ours. [Laughter.]

We raised yours from $15,000, if I recall, to $20,000.

Mr. MARTIN. From 16 to 20, Senator, that is right.

Senator LONG. You got your raise first. If you had waited until after Congress you might have gotten a better one.

Mr. MARTIN. I was not trying to make any invidious comparisons.

Senator KERR. Nor am I.

Mr. MARTIN. I am sure you are not.

Senator KERR. Nor am I. I am just trying to relate a condition to reality, and unless I am very badly mistaken, every group in this country is trying to increase the amount of dollars they get for their labor or for their products.

Mr. MARTIN. Right.

Senator KERR. And that their efforts are not related directly to production.

Mr. MARTIN. Well, I think that is right, and I think——

Senator KERR. You think that is correct?

Mr. MARTIN. I think that is correct, and——

Senator KERR. As I understand it, the farmer wants to get more per bushel for wheat, for each bushel whether he produces a hundred bushels or 10,000 bushels.

What he is trying to do is get more per bushel, is he not?

Mr. MARTIN. Whether he can or not on an economic basis——

Senator KERR. I know but he is striving to do that.

Mr. MARTIN. Right.

Senator KERR. I ask you again how is it possible for everybody in this country to be striving for a common objective without making progress toward attaining it.

Mr. MARTIN. Well, I think we have made some progress.

Senator KERR. And we are going to continue to make it.

Mr. MARTIN. We are going to continue to make it.

Senator KERR. And as we do we are going to reduce the purchasing power of the dollar.

Mr. MARTIN. Our progress will be slowed up and will not be as good if we do that. If we follow that course——

Senator KERR. Mr. Martin, if a man has to pay $10 today for a visit from a doctor where he could get it 10 years ago for $5, hasn't that reduced the purchasing power of his dollar?

Mr. MARTIN. The purchasing power of the dollar has been steadily diminished, but whether the real goods and services and benefits of people have been adequately compensated for by that, I think is very questionable.

Senator KERR. Whether they have been adequately compensated for or not, the purchasing power of the dollar continues to decline because everybody is trying to get more for what they do in terms of dollars.

Mr. MARTIN. And if we do not do better in managing our currency than we have done in the last couple of decades, I can foresee a time when we will wish we did not have the wage scale that we have got and some of the other things.

Senator KERR. Are we going to wish it enough voluntarily to change it?

Mr. MARTIN. I hope so, Senator.

Senator KERR. I say are we?

Mr. MARTIN. I don't know.

Senator KERR. Do you think so?

Mr. MARTIN. I don't know.

Senator KERR. You have no basis to think so, do you?

Mr. MARTIN. I try to be intellectually honest; I have striven as hard for intellectual honesty as anything in my life and it is very difficult——

Senator KERR. Let's face up to it now and just be intellectually honest enough to tell me whether or not you believe that workers, professional men, farmers, manufacturers are going to accept stability of the value of the dollar as it relates to the compensation or consideration they receive for what they do and what they produce without arbitrary controls?

Mr. MARTIN. Well, I think that if all of these people that you have cited understood the impact of arbitrary controls——

Senator KERR. I am not talking about what their understanding is, I am talking about what their action is going to be.

Mr. MARTIN. They will understand very quickly if the arbitrary controls get in.

Senator KERR. That is true, Mr. Martin, but in the absence of arbitrary controls, are they going to quit trying to get more wage per hour, more dollars per unit of production?

Mr. MARTIN. Well, the market process is reasonably effective. We have interfered with the market process so much that it has made it difficult——

Senator KERR. A managed currency is calculated to interfere with it?

Mr. MARTIN. A managed currency is definitely an interference with the market process.

Senator KERR. But you are the symbol of a managed currency, are you not?

Mr. MARTIN. No, here is where you have a basic misunderstanding.

Senator KERR. Are you not a representative of the agency that manages it?

Mr. MARTIN. I am charged with responsibility for managing the currency.

Senator KERR. Who has anything to do with monetary control except the Federal Reserve bank?

Mr. MARTIN. The Federal Reserve System is charged with that responsibility.

Senator KERR. The Constitution puts it in the Congress.

Mr. MARTIN. And it still resides in the Congress. Any time——

Senator KERR. We have delegated it to the Federal Reserve Board, haven't we?

Mr. MARTIN. Because——

Senator KERR. Haven't we?

Mr. MARTIN. You have.

Senator KERR. All right.

Then the responsibility under the law now is on you, is it not?

Mr. MARTIN. The responsibility is on us; but in moving to a managed currency, which this country did in the Federal Reserve Act, it did not—and if you will study the act pretty carefully, I think you will agree with me—it did not intend to repeal the law of supply and demand.

Senator KERR. Why did you boys do it?

Mr. MARTIN. I did not, and I do not think we have done it. I still think the law——

Senator KERR. What are the purposes of arbitrary controls, then relaxing if it is not to help guide the operation of the law of supply and demand?

Mr. MARTIN. They are to minimize—to be helpful in leaning against the wind.

Senator KERR. Well, doesn't that mean to change the unlimited operation of it?

Mr. MARTIN. Well, it is not control though.

Senator KERR. I see, you said awhile ago that there was a tendency here in this action of yours to change.

Now are you telling me that when your tendency is to change to the extent of leaning against the wind that you have no influence on it?

Mr. MARTIN. We have limited influence on it, but we do not make the wind.

Senator KERR. Then you do have some effect on it?

Mr. MARTIN. We have some effect, otherwise there would be no reason for our existence; but we do not have controlling effect.

Senator KERR. Well, but you are the sole agency that is operating to influence it, are you not?

Mr. MARTIN. Well, we are the sole agency that is charged full time with the responsibility for managing the currency.

Senator KERR. What other agency, have got any part time or any other phase of it?

Mr. MARTIN. No other agency has with respect to the currency.

Senator KERR. Budgetary control?

Mr. MARTIN. Budgetary and fiscal policy.

Senator KERR. That is a different field.

Mr. MARTIN. But you cannot completely separate them.

Senator KERR. But you do. You cannot change the fact that both are influential factors in an economy, Mr. Martin.

But insofar as their operation is concerned, they are separate. You do not have any responsibility to say how much taxes people pay, do you?

Mr. MARTIN. No.

Senator KERR. You don't have any appropriating authority of anything except the money you have got yourself?

Mr. MARTIN. No; but if we are to achieve what we are looking for, we will have to have coordination ultimately between fiscal policy——

Senator KERR. I understand that.

Mr. MARTIN. Budget policy, debt management policy.

Senator KERR. I understand that.

I am talking about what you referred to as influencing the law of supply and demand.

Mr. MARTIN. I simply say the law of supply and demand as applied to these workers is bigger than any of us; we may dam it up, alter its course, and do a lot of things with it but, just like gravity, it is still there and at some point it comes into play and you will have to deal with it.

Senator KERR. Well, the purchasing power of the dollar has been going down ever since this country started, has it not?

Mr. MARTIN. I regret——

Senator KERR. Well, has it?

Mr. MARTIN. Mr. Riefler says it has not since the start.

Mr. RIEFLER. It was roughly stable for the first hundred years.

Senator KERR. From when until when?

Mr. RIEFLER. From the start of the country until 1914. You had fluctuations but you did not——

Senator KERR. Here I have put in here as compiled by the Bureau of Labor Statistics a table which is based on the series published by the Federal Reserve Bank of New York, a table that was put into the record which shows that the purchasing power of the dollar in 1873 was as 160.50 is as to 100 as related in 1939.

Mr. RIEFLER. Here is the chart.

Senator KERR. Well, there is the table.

Mr. RIEFLER. There is a chart showing the same figures.

Senator KERR. Are those figures there correct?

Mr. RIEFLER. They are the same figures.

Mr. MARTIN. The same figures.

Mr. RIEFLER. Well, then, there has been a change, hasn't there?

Mr. MARTIN. Up and down.

Mr. YOUNG. You have just selected years there.

Mr. RIEFLER. It has been stable.

Mr. YOUNG. You have in that table selected years. This chart is for all years since 1800.

Senator KERR. Well, is that correct there?

Is this the price level of commodities?

Mr. YOUNG. This is the wholesale price level.

Mr. RIEFLER. It is a general statement.

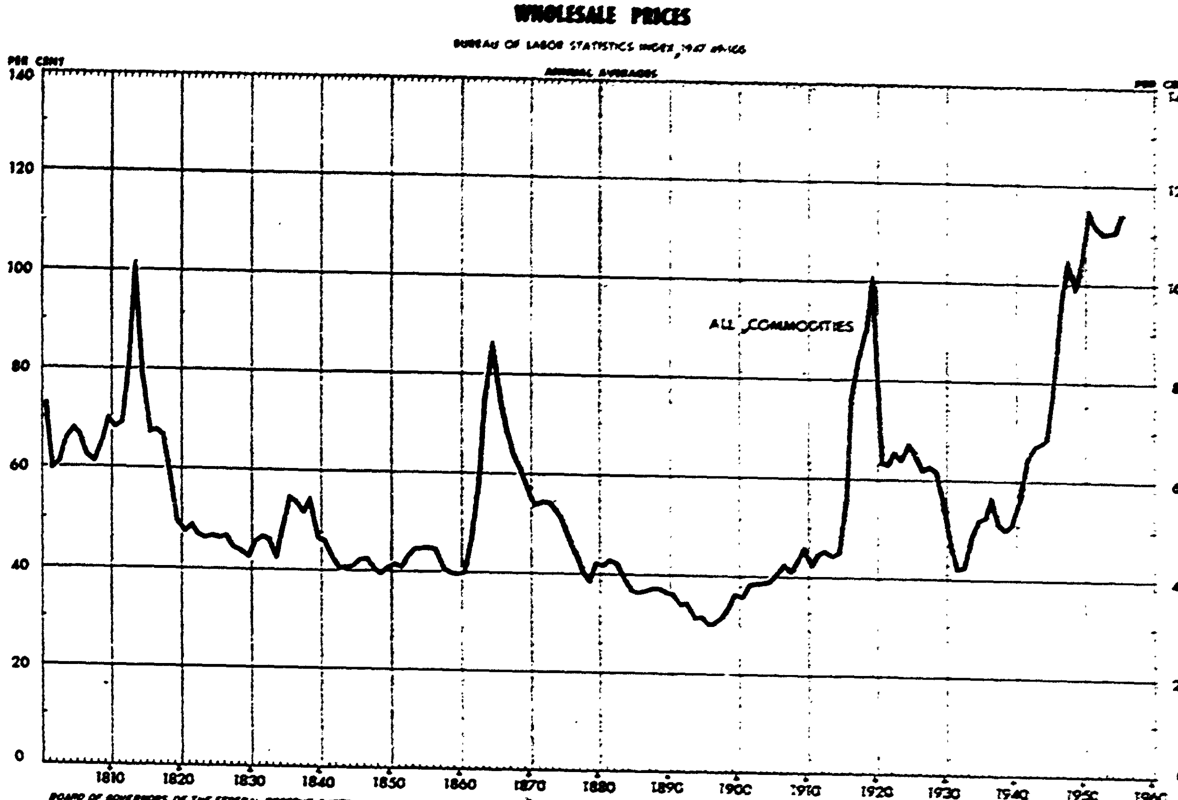
Senator KERR. You mean this from 1860?

Mr. YOUNG. The trend of this chart would be flat. You had the war of 1812, the Civil War, and then——

Senator KERR. I would like to have this chart then put into the record, Mr. Chairman.

The CHAIRMAN. Without objection.

(The chart is as follows:)



Senator KERR. I would like to ask you that question again, Mr. Martin. To the extent that people succeed in getting a higher wage or more money for what they produce, they reduce the purchasing power of the dollar, don't they?

Mr. MARTIN. No, not if their productivity is increased and——

Senator KERR. That is a question of whether they earn it or not, Mr. Martin.

If you have to pay a man more dollars to get an hour of work from him, doesn't that reduce the purchasing power of your dollar?

Mr. MARTIN. Well, it depends on the supply of dollars, that is what we are trying to do in regulating the money supply.

Mr. YOUNG. It would depend on his product. His product is going up over a period of time because of the tools and machines that he works with.

Senator KERR. Well, but if you then have to pay more for an automobile, doesn't that reduce the purchasing power of the dollar?

Mr. RIEFLER. Yes.

Senator KERR. If you have to pay more for the dentist to get a tooth filled, doesn't that reduce the purchasing power of your dollar?

Mr. RIEFLER. Yes, sir.

Senator KERR. If you have to pay a lawyer more to represent you per day in court, doesn't that reduce the purchasing power of your dollar?

Mr. YOUNG. Yes, indeed.

Senator KERR. Well, then, generally speaking, as people succeed in getting more per unit of what they produce, whether it is labor or commodity you reduce the purchasing power of the dollar, don't you?

Mr. RIEFLER. As you succeed in it.

Mr. YOUNG. If they suceed in it. If there is no more product——

Senator KERR. If they succeed in that effort?

Mr. RIEFLER. Everybody at the same time is trying just as hard as possible to get as much for the dollar he spends.

Senator KERR. Which one has been succeeding the most, the one that has been trying to get more for the dollar or the one trying to get more dollars for what they did?

Mr. RIEFLER. Since the inflation started, the former.

Senator KERR. Well——

Mr. RIEFLER. That is what this is all about.

Senator KERR. Well, for the period shown here, the 1913 dollar was 140.4 as compared to the 1939 dollar.

The 1946 dollar was 71.2. The 1957 dollar was 49.4, and the 1959 dollar still less, is it not?

Mr. RIEFLER. Yes.

Senator KERR. Is that right?

Mr. RIEFLER. Yes. A very bad record for the last 20 years.

Senator KERR. Doesn't that indicate to you, Mr. Martin, the only way you are going to have a stabilized cost or stabilized value of the dollar is to do it by arbitrary controls of wages and prices.

Mr. MARTIN. Well, I would certainly hope we never come to mandatory wage and price controls.

Senator KERR. I do too. But do you ever think we will have the stability of the dollar without it?

Mr. MARTIN. I honestly do not know, but I think it is possible to have it.

Senator KERR. Well, we have not had it without it, have we?

Mr. MARTIN. We have not had it in recent years.

Senator KERR. And we have done the best we could.

You have done the best you could?

Mr. MARTIN. We have done the best we could, right.

Senator KERR. And you will agree that Congress has done the best it could, or would not you?

Mr. MARTIN. I would not pass any judgment on Congress. I don't know.

Senator KERR. You would just rather reserve your judgment or you do not have any?

Mr. MARTIN. I just do not know, Senator, I am not close enough to the Congress to know what your problems are.

Senator KERR. Do you think you are doing any more violence to your conscience by presuming we had done the best we could, than I could by presuming you had done the best you could?

Mr. MARTIN. Well, I do not think violence—you understand, I don't expect you to—this is not a case of Alphonse and Gaston.

Senator KERR. No, it is a case of Bill and Bob. [Laughter.]

Now getting down to us, do you think that you are doing more violence to your intellectual integrity to presume the Congress had done about as good as it could, than we would do to ours to presume that you had done about as good as you could?

Mr. MARTIN. On that basis, I will reciprocate to the "Bob." But I don't know.

Senator KERR. Well, together we have not maintained the stable value of the dollar.

Mr. MARTIN. That is correct; we have not.

Senator KERR. And you don't really think that we will in the absence of mandatory controls, do you, Mr. Martin?

Mr. MARTIN. No, I would not say that. I think that we can do it and I hope we will have the will to do it.

Senator KERR. When do you think we will get that done without mandatory controls?

Mr. MARTIN. Well, I can't place a time on it. But I certainly hope to live to see it.

Senator KERR. Well, I do too, but I want to tell you right now, I think we are a little optimistic when we said we thought we would. I believe we had better recess until 2:30.

The CHAIRMAN. Will that be satisfactory?

Mr. MARTIN. That is fine.

The CHAIRMAN. The committee will recess until 2:30.

(Whereupon, at 1 p. m. the committee was recessed until 2:30 p. m. of the same day.)

AFTERNOON SESSION

Senator KERR. The committee will be in order.

STATEMENT OF WILLIAM McCHESNEY MARTIN, JR.; ACCOMPANIED BY RALPH A. YOUNG, WINFIELD W. RIEFLER, AND ARTHUR MARGET, DIRECTOR, DIVISION OF INTERNATIONAL FINANCE, FEDERAL RESERVE BOARD—Resumed

Senator KERR. The corrective measures which have been in process of being taken by the Board since it was decided to progressively relax the restraints on bank-credit expansion are being taken to improve the economic environment so as to encourage increase in employment, are they not?

Mr. MARTIN. That is correct.

(At this point, Senator Byrd assumed the chair.)

Senator KERR. It is your hope that the relaxing of these restraints will result in reduction of unemployment and the increase in employment?

Mr. MARTIN. Over a period of time; yes, sir.

Senator KERR. Well, that is the reason you put them into effect.

Mr. MARTIN. That is right.

Senator KERR. Do you think they will do that?

Mr. MARTIN. I think that they will; yes. I do not think that——

Senator KERR. Now then, Mr. Martin, if you think that the relaxing of these restraints will bring about a reduction in unemployment and an increase in employment, how is it possible for you to think, if you do, that the imposing of them would not result in reduced employment and increased unemployment?

Mr. MARTIN. Well, Senator, we are right back where we were this morning on that. The illustration that my very good assistant gave me during the lunch hour——

Senator KERR. I want to tell you, I knew you had him for some purpose.

Mr. MARTIN. He used a railroad track—if you have a train that is moving toward a curve very rapidly, and you brake at the curve—and we are talking now about resisting inflation, we are not talking about resisting prosperity—if you haven't put on the brake—the apology that I was making this morning was that we might have put the brake on harder before the train got to the curve, but we didn't—and when the train got to the curve it went off the track, that is exactly what the impetus was, because the engine—inflation—was running so rapidly.

Senator KERR. You think the train got off the track in our economy?

Mr. MARTIN. I think the train got off the track in our economy; yes. I think the inflation got way ahead of us.

Senator KERR. And you think it got off because you did not put the brake on quick enough?

Mr. MARTIN. No; not entirely.

Senator KERR. In part?

Mr. MARTIN. In part; yes.

Senator KERR. But everybody, Mr. Martin, is giving you credit, giving the Board credit, for now taking actions calculated to increase employment and reduce unemployment.

Mr. MARTIN. Well, our actions will contribute to that direction, and they will contribute to a climate——

Senator KERR. In which that will be the hoped-for result?

Mr. MARTIN. That is right.

Senator KERR. And in view of the fact that they are being relaxed at a time here of substantial unemployment, and in view of the fact that unemployment grew in substantial proportions while the restraints were on, I will say to you that I can arrive at no other conclusion than that the restraints contributed to the unemployment.

Mr. MARTIN. Well, I just disagree with you there.

Senator KERR. Mr. Martin, I am going to say this to you in all frankness: I don't believe you do.

Mr. MARTIN. I——

Senator KERR. That is the one statement you made that I just cannot have the regard for your intelligence that I do and then accept as being completely frank.

Mr. MARTIN. Well, I am sorry, Senator, but that is my sincere conviction, and I stand on it.

Senator KERR. I would like to have you clear up for me a little disagreement between Mr. Burgess and Mr. Eccles.

Mr. Burgess—you know who Mr. Burgess was or is?

Mr. MARTIN. Yes, sir.

Senator KERR. You have as much position with the Federal Reserve Board as he did and does?

Mr. MARTIN. Do I have as much position——

Senator KERR. Yes.

Mr. MARTIN. With the Federal Reserve as Mr. Burgess?

Senator KERR. Yes.

Mr. MARTIN. Well, Mr. Burgess hasn't been connected with the System for many years.

Senator KERR. He is not—I know he is not—one of the Board of Governors, but I got the impression from him that he had quite a lot of influence down there. That there might be others who had something to do with running it, but I couldn't tell for certain from what he told us. [Laughter.] And I just wanted to have you, you know, get me kind of correctly informed on that.

Mr. MARTIN. I think that I had some influence in the Federal.

Senator KERR. Any impression that I might have gotten from him, then, that you and the other six Governor positions were secondary, is not justified by the facts?

Mr. MARTIN. I think that is correct, if that was the——

Senator KERR. All right.

He said that insofar as practical operations were concerned, the power over our monetary system and financial structure as evidenced by the Federal Reserve Board and our commerical banking structure, the power was wielded by approximately 128 men. And here is the way he arrived at that figure: Seven members of the Board of Governors, 12 presidents of the member banks, that is 19; 9 directors on each of the member banks for a total of 108, making a total of 127.

Now, he was quite positive in his testimony that the powers of the Federal Reserve System were vested in these 127 men.

Mr. Eccles told us the other day that the 7 members of the Board of Governors were the ones that have that power.

Now, have I made clear to you the difference in the statements of the two men?

Mr. MARTIN. Yes.

Well, I think the final power is in the Board of Governors, but I think that the other men Mr. Burgess refers to also wield some power.

Take the problem of the discount rate as an example. The Board has the final power over the discount rate. We can review and determine what the discount rates should be, but we await a recommendation, and very seldom in the history of the System have we ever initiated a recommendation from an individual Federal Reserve bank.

That action cannot take effect until the Federal Reserve Board approves it. But to say the directors of the individual Federal Reserve bank have no authority or power as a result of that, I think would be going too far afield. And I don't think Mr. Eccles intended to imply that.

Senator KERR. Well, I don't know what he intended to imply. I will read you the testimony [reading]:

> Senator KERR. You are telling this committee that this power is not vested in the 127 men which Mr. Burgess so stoutly proclaimed or certified, or verified, but they were vested in 7 men.

My question to him was:

> You are telling us that the power is not vested in the 127 but is vested in the 7.
>
> Mr. ECCLES. Yes, I think that is correct.

Then I asked him to name those men, and he couldn't do it. I am not going to ask you, because I am sure you either can or that these men here with you could.

> Senator KERR. I am just trying to get you to make a positive statement that you are willing to stand by and stay with.
>
> Mr. ECCLES. Yes.
>
> Senator KERR. Now, do the 7 men have the power or do the 127 have it?
>
> Mr. ECCLES. The 7 have it.
>
> Senator KERR. The 7 have it?
>
> Mr. ECCLES. Yes.

Mr. MARTIN. I would like to say that we share in it.

Senator KERR. You share in it?

Mr. MARTIN. Yes.

Senator KERR. Any degree to which the other 120 share means in part they have the power?

Mr. MARTIN. I think they have the power—some power.

When it comes to the administration of the individual Federal Reserve banks, the Board of Directors is always subject to the supervision of the Board of Governors, but the Board of Directors of the bank is performing the normal functions of the directors of an institution.

The way the System was set up, you see, we appoint 3 of the 9 directors of a Federal Reserve bank, and 6 of them are elected by the member banks.

Senator KERR. The member banks.

Mr. MARTIN. The class A directors of a Federal Reserve bank are elected by the member banks, and must be bankers. One of these is from a large bank, one from a medium-sized bank, and one from a small bank. And the class B directors of a Federal Reserve bank are elected in the same way by the member banks, but they cannot be bankers. They must be representatives of borrowers.

Senator KERR. Well, they can be directors of banks.

Mr. MARTIN. No, they can't be a director—no, I don't think they can be directors of banks.

Senator KERR. I would like to have you get that verified.

Mr. MARTIN. I have had that checked; they cannot be directors. They can own stock in a bank, however.

Senator KERR. What?

Mr. MARTIN. Anyway, the intention is that one of the class B directors will represent large industrial or——

Senator KERR. Large community, the next one is medium, and the next one is the small?

Mr. MARTIN. That is right.

Senator KERR. But they are selected by the banks.

Mr. MARTIN. Elected by the bankers on the same basis that the bankers elect the banker directors.

Senator KERR. Yes.

Now you are telling us here that the full powers of the Federal Reserve System are in fact exercised by 127 men and not by 7 men?

Mr. MARTIN. Yes. I think if you are talking about the full powers, I think the final authority in the System is in the seven men at the top.

Senator KERR. Just like the final authority is in the Congress.

Mr. MARTIN. Yes.

Senator KERR. I hope—I don't know whether I do or not. I wonder if the seven members of the Board of Governors are any more active in the exercise of their full powers in relation to member banks than the Congress is in relation to the Federal Reserve Board of Governors. I will not ask you to comment on that unless you want to.

Mr. MARTIN. I will only say this, Senator, as a comment, that the seven members of the Board of Governors work only on this problem whereas the Congress has a vast variety of problems, and we have a meeting every day of the week as a Board, 5 days a week, and we devote our entire time and attention, as the law requires, to just the administration of the Federal Reserve System. In that sense, I think that the Board certainly exercises its authority in a different way than the Congress, by its very nature, can.

Senator KERR. I am talking about the degree to which the 7 members control the actions of the member banks, that is, the 7 governors control the action of the member banks. I know there is some reason to have those nine directors of the member banks or you wouldn't have them.

Mr. MARTIN. Right.

Senator KERR. I know there is some reason to have a president of those member banks or you would not pay one of them $60,000 a year, 3 times as much as you get.

Mr. MARTIN. Right.

Senator KERR. So I frankly thought at the time Mr. Burgess was talking and I thought at the time Mr. Eccles was talking that the directors and president of a Federal Reserve bank have a very considerable percentage and exercise a very considerable percentage of the powers of the Federal Reserve System insofar as that bank is concerned.

Mr. MARTIN. I think it is the intention that they should; and we certainly have done everything we can to place the Federal Reserve bank directors and presidents in a position to share with us their thinking and their views on broad policy questions as well as the administration of the individual Federal Reserve bank, and whenever a final decision is made on something like the discount rate, it has to be approved by us.

Senator KERR. I wonder now if you would tell me who makes up the Open Market Committee.

Mr. MARTIN. Well, the Open Market Committee consists of the 7 members of the Board and 5 of the 12 Federal Reserve bank presidents. Recently——

Senator KERR. One of those 5 must always be the president of the New York Reserve Bank?

Mr. MARTIN. That is right.

Senator KERR. Who actually handles the open market operations?

Mr. MARTIN. The desk of the open market account is located in the New York bank, and the manager——

Senator KERR. Now, that desk does not handle it.

Mr. MARTIN. Well, the Open Market Committee, which is the 12 men I referred to, gives the directions to the manager of the account with respect to how he shall perform——

Senator KERR. Who pays the manager of the account?

Mr. MARTIN. The manager of the account is paid by the New York Federal Reserve Bank.

Senator KERR. And who is his boss?

Mr. MARTIN. The president and directors of the New York Reserve Bank.

Senator KERR. Well, then, if they pay him and they are his boss, how can we arrive at any other conclusion than that the New York bank pretty well runs the Open Market Committee operation?

Mr. MARTIN. Because the manager of the account is subject to the direction of the Open Market Committee, of which the president of the New York bank is only one member. He has 1 vote in 12, and that is settled.

Now there has been a lot of discussion about this over the last few years as to whether there shouldn't be some way of taking the manager of the account away from the New York bank, although he may perform other functions besides those functions of dealing with securities for the account—take him away from the New York bank and have him paid by the open market committee.

We have come to the conclusion that that is largely unimportant, and that the important thing is the power of control over the manager of the account. I think, however, that eventually the System probably will fix it so that the open market——

Senator KERR. Say that again.

Mr. MARTIN. I say eventually, I think that the System may work it out a little bit differently than it is at the present time. At the present time, each year the manager of the account is appointed by the directors of the New York bank, and then the open market committee passes upon whether they are willing to approve him or not, and they also pass upon his salary.

Now some of us in the System have been working on this, and feel that it might be better to have the open market committee appoint the manager of the account, and then refer it to the board of directors of the New York bank as to whether they have any particular objections, since he is going to reside in their premises—whether he is in any way persona non grata to them. But that is a fine distinction, and I think that it works satisfactorily as it is at present.

Senator KERR. Well, it looks to me like, you see, a man handling the actual operation of that open market committee for the Federal Reserve Board of Governors——

Mr. MARTIN. For the Federal Reserve open market committee.

Senator KERR. Well, there are 7 out of 12 of them——

Mr. MARTIN. That is right.

Senator KERR. And they help appoint the other five.

Mr. MARTIN. That is right.

Senator KERR. It would seem to me like that his posture ought to be that of an employee of the Board of Governors rather than as an employee of the New York bank.

Mr. MARTIN. Well, I think there is a very real case that can be made that being in New York, and certainly the manager of the account likes to have some—if that is his home point of residence, the place that he works every day, short of bringing the account right here to Washington in the Board of Governors building, and since he performs other services for the Federal Reserve Bank of New York, and since there is no question about the control, as we have to approve the president and the first vice president of the New York bank—that is to say, their selection is subject to the approval of the Board of Governors.

Senator KERR. I understand that.

Mr. MARTIN. So we do have that control.

Senator KERR. Have you ever failed to approve one selected by the board of directors of that bank?

Mr. MARTIN. Yes; we have.

Senator KERR. How many times?

Mr. MARTIN. I don't know how many times in the System.

Senator KERR. If you do not know how many times, how do you know you have done it?

Mr. MARTIN. Well, I don't think we ought to go into personalities; but I know once in the time I have been on the Board that we didn't approve a recommendation of theirs.

Senator KERR. For a president of the bank?

Mr. MARTIN. That is right.

Senator KERR. How many have been approved when you did concur in their recommendations?

Mr. MARTIN. Well, there have only been two presidents in the last 7 years.

Senator KERR. Well, they have had the bank longer than that. They have had the bank since——

Mr. MARTIN. I couldn't give you the record. I could search the records for you. I don't know what the record is from the beginning of the System. I am only talking about the time I have been there.

Senator KERR. I see.

Mr. Chairman, I want to go further into that and a number of matters of organization, and with the permission of the chairman and the committee and with the concurrence of Mr. Martin, when would it be, in your judgment, a better time to do that?

The CHAIRMAN. We had better fix that date later.

Senator KERR. Mr. Martin, I want to thank you very much for the degree to which you have cooperated, and I think in most of the discussion you have cooperated, and I look forward to the pleasure of our resuming our discussion.

Mr. MARTIN. I look forward to it, Senator.

The CHAIRMAN. It is mutual.

Senator KERR. I hope it is.

(Off the record.)

The CHAIRMAN. The Chair recognizes Senator Bennett.

Senator BENNETT. Mr. Chairman.

Mr. Martin, I am sure it goes without saying that you believe in the maintenance of the independence of the Federal Reserve System.

Mr. MARTIN. That is correct, sir.

Senator BENNETT. You are an interesting servant of that System, because you came into the System while one party was in control of the administration, and you were reappointed to your job by the man who succeeded as President when the administration passed to another party; is that right?

Mr. MARTIN. That is correct, sir.

Senator BENNETT. Have you felt specifically during either of those periods that you were bound by a policy of either of those partisan administrations in your operation of your responsibility as Governor of the Federal Reserve, as Chairman of the Board of Governors?

Specifically, did you feel bound to an easy money policy under the aministration in which you first came to serve?

Mr. MARTIN. No, I did not.

Senator BENNETT. You were not committed or involved with any question of easy money?

Mr. MARTIN. No, sir.

Senator BENNETT. During the time you were serving under the appointment of President Truman, were there any changes in the Federal Reserve policy which tended, to use the phrase of my friend from Oklahoma, to tighten money?

Mr. MARTIN. Yes, I would say that during the period—I went on the Board in April of 1951, and I would say that the market was unpegged in early March of 1951, and there was some decline in bond prices and some failure to supply reserves in the open market to keep those bond prices up to par during that period, and there was a gradual increase in rates over 1951 and into early 1952.

Senator BENNETT. And, conversely, during the period since the other party has been in control of the White House, have there been periods of easing of credit restraints?

Mr. MARTIN. None of our policy has been a straight-line policy going entirely——

Senator BENNETT. That is right.

Mr. MARTIN. Going entirely one way.

In the period of the current administration, starting in 1953, I would say that there have been about half a dozen periods where credit was eased in accord with where it had been.

Senator BENNETT. So as far as your operation of your own responsibility is concerned, you have not been bound to a so-called tight money policy during the present administration any more than you were bound to an easy money policy during the preceding administration?

Mr. MARTIN. That is correct.

Senator BENNETT. You have made your decision on the basis of conditions as you saw them at the time.

Mr. MARTIN. That is right.

Senator BENNETT. This is a hypothetical question: If the administration had not changed and the business conditions had occurred as they have occurred since 1953, do you think there would have been any fundamental change in your approach to the problems as you faced them?

Mr. MARTIN. Not as far as I am concerned, no, sir.

Senator BENNETT. This morning the Senator from Oklahoma made a considerable point of the fact that you were in the Treasury when the so-called accord was reached.

For the record, was there any period when you were out of Government service between the time you left the Treasury and the time you began your service in the Federal Reserve System?

Mr. MARTIN. No. I went directly from the Treasury to the Federal Reserve System. There may have been a 2-day period.

Senator BENNETT. Two days.

Well, I think each man should be allowed that much time to change his hat, so to speak.

Do you believe that if there had, in fact, been no accord, and that this was a unilateral action on the part of the Federal Reserve System which, by inference, was either disapproved by the Treasury or the Treasury felt, or somebody felt, that the Treasury had been taken in by this basis, that the President would have appointed you and moved you from the job you were in over to the responsibility in the new assignment?

Maybe I am reading between the lines, but I got the impression in the questioning this morning that the Senator from Oklahoma believed that the Secretary of the Treasury was in the hospital and that this thing was somehow slipped over on the Treasury. Do you believe-----

Mr. MARTIN. I do not believe that at all.

Senator BENNETT. You do not believe that at all.

Mr. MARTIN. And if I had believed that, I wouldn't have taken the job.

Senator BENNETT. Can you tell us whether President Truman was conscious of the fact that there had been an accord and that you had been on the Treasury side of it at the time he appointed you to the Federal Reserve?

Mr. MARTIN. I think there is no question of it.

Senator BENNETT. I didn't think there was, either, but I thought we might try to get that into the record.

Now to turn to some questions which refer specifically to the area which has been covered by other questioners.

This morning there was a great deal of discussion about the relative responsibility of maintaining the stability of the dollar and main-

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taining full employment. Do you think over the long pull we can assure high employment by a deliberate policy of ignoring the stability of the dollar?

Mr. MARTIN. I do not. I think if we ignore the stability of the dollar, we cannot have high levels of employment.

Senator BENNETT. Would you agree that there is a brief period when inflation is running, when presumably high employment can be sustained past the normal point of readjustment, that the farther that goes the more difficult it would be to maintain high employment?

Mr. MARTIN. I agree with that completely.

Senator BENNETT. Is that not the history of the German inflation? I was very much interested to read recently a statement by a German economist, written in 1930. He pointed out that in the twenties when the inflation in Germany ran away it served to destroy employment because there weren't funds to invest in new production. People were anxious to spend everything they could for whatever was actually on the shelves, and after a while a very high unemployment resulted from a complete runaway inflation.

Is that your impression of what would happen in this country eventually if we adopted a basic policy of always easing up the money supply in the face of every problem?

Mr. MARTIN. Yes, I think so. I think we would undermine the saving and investment process completely.

Senator BENNETT. Another question which grows out of my impressions of the questioning this morning: Do you feel that when you decided last fall to reverse the direction of your policy, that you were thus admitting that the previous manifestation of that policy was wrong?

Mr. MARTIN. I do not.

Senator BENNETT. Would you repeat that process again if the conditions were more or less repeated?

Mr. MARTIN. I most certainly would and, as I indicated this morning, might do it more aggressively if the conditions were similar.

Senator BENNETT. A question was raised briefly this morning, and I cannot remember whether the Senator asked you to answer it or just throw it into the record, regarding the possibility of achieving a stability of the dollar by price and wage controls.

In your memory, during the periods when we tried price and wage controls, did we have a stable dollar?

Mr. MARTIN. We did not.

Senator BENNETT. So the history would indicate that that is not an effective way of achieving stability of the dollar?

Mr. MARTIN. I would question it as a way. I would question whether it is possible to do it that way.

Senator BENNETT. Turning now to some notes of my own:

I am interested in the fact that now, after 4 or 5 months since you turned your policy around officially, we still have inflation. Is there not a time lag involved in the application of your programs in either direction?

Mr. MARTIN. There definitely is.

Senator BENNETT. Would you feel that the fact that the cost of living went up again in March proves that your program was unsuccessful, and that on the basis of the fact that it has now gone up continuously for 5 months since November, that we are not going to have any stabilization of prices or that your monetary restraint had no effect on the situation?

Mr. MARTIN. No. I am quite confident that it will over a period of time prove effective.

Senator BENNETT. Do you think it would have leveled out if you had adopted a continually easy money policy through that period?

Mr. MARTIN. No. I think that, on the contrary, the cost of living would have been a lot higher than it is today.

Senator BENNETT. I am very much interested in this present recession—I have the impression that it is spotty, that it is not hitting all parts of the country at approximately the same intensity.

Do you have any figures which would indicate that?

Mr. MARTIN. I do not know that we have any figures which would indicate it, but we know steel, autos and railroads are the three lines that are the most dramatically affected and, as I indicated yesterday, in some of the areas—take Minneapolis, for example, I talked with the president of our Minneapolis bank the day before yesterday, and he indicated that outside of the mining, extractive industries in Montana and the Mesabi Range area and that closely connected with steel and the extractive industries, that things are, if anything, a little bit better than they were this time a year ago, and that there is very litle talk among the group he was moving with of recession at all.

Senator BENNETT. It is very interesting to refer to figures from my own State of Utah. The Utah unemployment is 4.2 percent now against the national average of 7 percent. That represents an increase in unemployment of 2,600 men. However, this includes 3,300 men who have lost their jobs in the extractive industry. So as of today, if you set the extractive industry aside, in Utah there is an increase in the number of jobs available of something like 700 men, and that is borne out by the experience I have more or less directly with business which is operating in Utah.

Much has been said about the automobile industry. Do you believe that during your period, during the period when you were restraining the supply of money, that consumer credit was so choked down that people could not have bought more automobiles if they had wanted to?

Mr. MARTIN. I do not believe that.

Senator BENNETT. Then you do not believe that it was the tightening of the supply of money that resulted in the decision of people in 1956 to buy approximately 3 million fewer cars than they had bought in 1955, and that would account for the further dropoff in 1957?

Mr. MARTIN. I do not.

Senator BENNETT. Do you believe if the easy money policy which is now being pursued—let's see how much additional bank credit has that made, about $9 billion?

Mr. MARTIN. I used the figure $9 billion yesterday on the basis of reserves supplied by reductions in reserve requirements. However, as has been pointed out, there was a diminution of our gold holdings which would have to be figured into that. But let's say that there is roughly $5 billion of prospective enlargement of bank credit that has become available.

Senator BENNETT. Well, if that is available, is there any force, any agency or source of authority in the United States which could direct the expenditure of that money into the area of these industries who have suffered more than some others?

Mr. MARTIN. No.

Senator BENNETT. I think for the record, Mr. Chairman, I should like to enter the report of the findings of the Gallup Poll published last Sunday which, in answer to the question Mr. Gallup asked: "If Government gave you back one-fifth of the money you pay in income tax, what would you do with the money?" 36 percent said, "We would buy something which we would otherwise not buy," 22 percent said, "We would pay on our debts," 18 percent said, "We would save it," and 11 percent said, "We would use it for our normal living expenses," and 7 percent said, "We would invest it."

That reminds me, at least, of the fundamental truth of the old adage, "You can lead a horse to water but you can't make him drink," and I am beginning to have the impression, as a man connected with a retail automobile agency, that we are seeing a little bit of a buyer's strike so far as the automobile industry is concerned; that the industry has gotten out of touch with the desire of the people, either in terms of product or price, and that this is probably having as much or more effect on the spotty recession in the automobile industry than anything else.

These figures may interest you, Mr. Chairman: In 1957, 10.7 percent of the sales of the least expensive American cars, of the big three, Chevrolet, Plymouth, and Ford, 10.7 percent of the total sales of these cars were in the least expensive model.

In 1958, 23.6 percent of the sales of the big three were in the least expensive models, indicating a resistance to the price of the automobile. And I think it is also significant that while the sales of automobiles generally are off substantially, the sales of the foreign cars have more than doubled in the last year, and the sales of the Rambler, that symbol of my friend George Romney, who is out fighting for the small car against the "dinosaurs," have also more than doubled.

So that indicates to me that people will buy if they find something which matches what they want and the price they are willing to pay.

And it is interesting to observe an indication in the last few days that the big producers are now frantically preparing to serve this lower-cost, smaller-package market, a thing that I know they have ignored for a long time.

Do you think the weather has anything to do with the situation in the last 2 or 3 months?

Mr. MARTIN. Yes, I think it has, Senator. I don't know how much, but I think it has definitely had some effect on it.

Senator BENNETT. Would your statement be strengthened by the report that there is a foot of snow in Salt Lake today? Apparently we cannot get out from under our winter, even though we have already had our State's Arbor Day, the sign of spring. [Laughter.]

In this process of attempting to use the power of Government to maintain some kind of a stability in the economy can we make that power work only on the low side of the cycle? Apparently, as Mr. Eccles said before the committee, we did not take advantage of the prospective surplus we had during the boom period. Now, can we operate on a Government program which says, "We will stop the recession, but we won't do anything to interfere with the boom because that makes us feel good and we think we are growing faster than we are"?

Do you think that is possible?

Mr. MARTIN. No, I do not think that is possible, and I think that is the root of our present trouble.

If we had been willing to face up to the reality of halting the inflation, which I think we could have halted, a year and a half or 2 years ago, we would not be in the difficulty we are in today; and, on that score, I think you will find that people are always more susceptible and amenable to easy money than they are to the factors which produce higher rates on money, even though interest is a wage to the saver as well as a charge by the lender. I think it is very important that we learn that we—I hope we will learn this time—that when the recovery comes, that the time to really fight recession is during the period when you have prosperity turn into an inflationary, upward movement, that there is the time when you can really fight the recession. That is a very, very difficult thing to get across to people, because people do not like to face facts.

Senator BENNETT. Well, I am reminded of the old saw, "When the devil was sick, the devil a saint would be. And when the devil was well, the devil a saint was he." And we are all touched a little with that. We feel that once prosperity has started it is going to continue indefinitely, and certainly that was the attitude of the automobile industry. When they got an 8-million-car year they figured that the next year should be a 9-million-car year, without realizing, as some of us dealers did, that in order to achieve that 8-million-car year they were forcing us to sell a lot of customers who should not have bought until the next year, and they were forcing us to sell terms when we should have been selling automobiles.

Has the national income shrunk as far as—has the shrinkage in the national income matched the increase in unemployment? They are on page 5 of the Economic Indicator.

Mr. MARTIN. Offhand, I would say no.

Mr. YOUNG. We do not have national income——

Mr. MARTIN. We do not have the first quarter national income in this publication.

Personal income in the fourth quarter of 1957 was 345.5, and in the first quarter of 1958 was 342.3.

Senator BENNETT. What was the highest point? Of course, you have got months in one schedule and years in the other, but in the schedule of months the highest point was the third quarter of 1957, when it was up to 346.9.

Mr. MARTIN. Right.

Senator BENNETT. So it has dropped about 1 percent.

Mr. YOUNG. A little over 1 percent.

Senator BENNETT. Would that not indicate there were psychological factors working in the situation, and it was not really a shortage of actual spendable money which was creating this present situation?

Mr. MARTIN. That is correct.

Senator BENNETT. Do you believe that the operation of monetary and fiscal policy can ever be a substitute or an offset for the personal economic decisions of freemen in a free market? Can you ever balance them out?

Mr. MARTIN. I think it is very doubtful that you ever could.

Senator BENNETT. In the first place, there is a time lag, is there not?

Mr. MARTIN. There is.

Senator BENNETT. So that from personal decisions made today, you could not begin to try to offset them.

If people overbought automobiles and houses and durable goods in the period beginning in 1955, could we not normally expect an inevitable period when the sale of those goods must slow down; and since they bought them on credit would not the sale of those goods slow down until the debts created had been repaid, at least in part?

Mr. MARTIN. That is right.

Senator BENNETT. Is that not another one of the situations in which we find ourselves?

Mr. MARTIN. It is another one of the factors.

Senator BENNETT. It is interesting that these people who reported to Dr. Gallup, 22 percent, the second largest group, said they would use any money they got to pay their debts. And I think that is very significant.

Mr. Martin, perhaps again you might feel that this is a little outside of your area, but do you have any comments to make about the relation of the rate of debt growth on the one hand, and price and wage increases on the other, and the rate of increase in productivity? Can we pull ourselves up by our bootstraps? Can we create prosperity by increasing debt and increasing wages at a much faster rate than we increase productivity?

Mr. MARTIN. I do not think we can.

Senator BENNETT. Probably for a short period of time while we live on inventory.

Mr. MARTIN. That is right.

Senator BENNETT. But that soon wears itself out.

Mr. MARTIN. That wears itself out very quickly.

Senator BENNETT. Is it reasonable to say that during the past few years some of these factors have been running ahead of the rate of increase in productivity?

Mr. MARTIN. I don't think there is any question of it. I think that through almost all of 1956 and the early part of 1957, there was no question of it.

Senator BENNETT. And until we get that back into a kind of balance, we are going to, we must continue to, expect trouble.

Well, I could pursue some of these further, Mr. Chairman, but I think I have covered most of the things that interested me.

I realize that the material I am about to close with is already in the record. I am not sure the witness does.

Mr. Slichter, in his prepared testimony on pages 4, 5, and 6, made it perfectly clear that he backs you up that interest rates have not been high by historical standards; that there has been adequate money available.

In fact, the point he makes is that there has been a greater shortage of attractive lending risks than there has of money to lend, which would offset the claim that by your policy of restraining the growth in the money supply you have choked off people who could normally expect to have credit made available to them.

He made these statements particularly:

* * * The assertion that the new enterprises as a whole are failing in substantial measure to get the amount of capital which they could put to use

is unproved * * *. There is some shortage of medium term capital but there is a greater shortage of attractive risks.

* * * Attractive investment opportunities suitable for small, medium-term loans are much more scarce than investment funds.

So at least you have one supporter for the proposition that this present recession is not the direct result of your policies. You have at least two, because I feel the same way.

Well, thank you for the opportunity of questioning, Mr. Chairman, and with that I am through.

The CHAIRMAN. The Chair recognizes Senator Martin.

Senator MARTIN. Mr. Chairman, I think we all appreciate very much the testimony which has been given by this distinguished witness, not only at this hearing but the hearing a year ago.

I want to refer to some things which have not been referred to except by Mr. Baruch and Mr. Eccles and, just now, by my good friend Senator Bennett.

In order to give the basis of this, I want to read 2 or 3 paragraphs, Mr. Chairman.

We have had a good bit of discussion at these hearings about monetary policy, interest rates, deficits, and debt, as being related to inflation on the one hand, and the current recession on the other.

Now I want to refer to the wage-cost push on prices.

According to the Bureau of Labor statistics, unit costs for all manufacturing industry increased 21.7 percent from 1947 to 1956. Hourly earnings increased 60 percent. In other words, increased productivity offset only about one-half of the increased labor costs. The difference had to be made up by higher prices.

The price increase was 21.7 percent in that period, according to the Consumer's Price Index. Again, in the 1955–57 period, productivity increased only 1.1 percent, according to the President's Economic Report. In those 2 years hourly earnings, excluding overtime, increased from $1.82 to $2.01, or 10 percent.

Now look at the steel prices for a moment. Here I have used the audited figures of the United States Steel Corp. The total costs of all operations of the corporation increased $81 per ton of steel shipped as between the 3-year average for 1947 to 1949 and that of 1957.

The largest item was $30.71 increase for labor, $14.37 increase for taxes, $10.31 increase for products and services bought, and $3.19 increase for dividends.

Also in housing, I find that that the index for costs of a six-room house increased about 35 percent between 1947–49 and 1957. Construction labor costs increased much more than that. We have passed a $1.85 billion housing bill giving radically easier terms of down payment to encourage home purchases because of increased prices of homes.

Now facts such as these are reflections of inflation, are they not?

Mr. MARTIN. They are indeed.

Senator MARTIN. In every instance, was not the major factor in costs and, therefore, prices, the increased cost of labor?

Mr. MARTIN. I think that was the major factor in it.

Senator MARTIN. Do you think that increased costs and prices have any effect in cutting off some demand by potential buyers?

Mr. MARTIN. I don't think there is any question of it.

Senator MARTIN. During the Easter recess, Mr. Chairman, I talked to a great number of people on the street, laboring people, professional people, businessmen, and I asked them why they were not buying.

And the general answer was, "Prices are too high." That was the general answer that I got.

I devoted a lot of time to it, and I am only asking these questions because I feel you are just about as well informed a man as we have in our country, and I hope none of these questions may be embarrassing. If they are, why, don't hesitate a moment to say you do not care to answer them.

You indicated yesterday that the inflationary boom had something to do with the current recession. Would you agree or disagree that the rise of labor costs faster than increase in productivity was a contributing factor, both to the inflation and the current recession and unemployment?

Mr. MARTIN. I do indeed.

Senator MARTIN. Do you care to make any comment on that?

Mr. MARTIN. Well, that was one of the factors in the inflation. I do not think it was the only factor, but it was one of the basic factors. And when that begins to run at a gallop, why, it is just a matter of time before you cannot pass the cost-price relationship on to the consumer, the consumer does not buy then, so you have the cycle that produces the unemployment.

Senator MARTIN. To what extent can monetary policy influence the wage-price spiral, or is the latter an independent force beyond control of monetary policy?

Mr. MARTIN. I think that is very hard to answer positively, Senator. I do not think it can directly affect it. I think by indirection it can affect it in the sense that the posture of monetary policy, if it is not one of validating whatever price level appears, unquestionably tends to act as some restraint on imbalance, the imbalancing factors between productivity and wages.

Senator MARTIN. Yes.

Do you think wage increases to be granted this year and those which are already provided in existing contracts will produce the so-called purchasing power to relieve the present recession?

Mr. MARTIN. No. I think that is a spiral that is working in the wrong direction.

Senator MARTIN. I agree with you fully.

Do you think the current recession was caused by a deficiency in purchasing power because wages had not increased enough, or did the decline in purchasing power of the dollar have any influence in the matter?

Mr. MARTIN. I think the major factor was the decline in the purchasing power of the dollar.

Senator MARTIN. Mr. Martin, you indicated yesterday that you estimated we might have a deficit of $10 billion in fiscal 1959 and that therefore a tax cut would not be desirable.

Do you think a $10 billion deficit a favorable factor to reverse the recession and regain high employment levels?

Mr. MARTIN. Well, I do not like deficits under any conditions, Senator; but since we are in a recessionary period, the point I tried to emphasize yesterday was that I was willing to accept the deficit financing on a temporary basis as a stimulant to the economy; but I questioned whether it was wise, without having a clearer indication of the extent of the current recession, to perhaps double the amount of that deficit and put the Government so far in the hole that Congress would have to face up very quickly to the necessity of cutting down on various Government programs or of raising taxes in trying to get back into a budget balance again.

Senator MARTIN. We have had, of course, what we consider marvelous prosperity, and we have had the highest employment in the history of our country. And yet we have not decreased the debt, and it seems to me that that is a very dangerous situation.

A sound businessman and a good business concern every once in a while reduces its debt. It may go back to the bank in the future as it gets in position to expand, and get an additional loan, but it is gradually cutting debt during good periods.

And is that not sound business conduct, and ought not Government to do the same thing?

Mr. MARTIN. I am not one of those who are enthusiastic for increasing the Government debt.

Senator MARTIN. I know you are not.

Do you feel a higher figure of Government debt would put us back on an inflationary spiral, or assist in doing that?

Mr. MARTIN. Well, you are projecting into the future—I certainly think that it will tend in that direction.

Senator MARTIN. Mr. Chairman, I think that these hearings are doing an enormous amount of good. I will refer again to my visit home during the Easter vacation.

I did not find as much talk about recession back home as I have heard down here in the Capital City, although Pennsylvania has an enormous amount of unemployment. I think percentagewise we are about the third worst of the States of the Union, and a lot of that is because we have a great number of coal miners out of employment. We have mechanized the mines and with one of those machines now, 2 good men will take the place of probably 10, and it is a most unfortunate situation.

I think one of the most discouraging things I know of is a good sound man who wants to work and does not have a job, and I will do some things that I think are probably not entirely sound in order to help in that situation.

But I think people are beginning to discuss governmental debt, and they are worried terribly about it. I did not hear of hardly anyone who wanted a tax cut as long as there was danger of deficit. Some folks did.

I appreciate your answers to these questions that I have been asking, which have been just a little different from those anyone else has submitted. I like to see people have good wages. But, on the other hand, I am worried, because there is no question that productivity in our country has not kept up with the increase in wages, and I feel it is one of the very dangerous things confronting our country, and I am wondering how you feel about that.

Mr. MARTIN. I concur in that view, Senator.

Senator MARTIN. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator Martin.

Senator Malone desires to ask a few questions.

Before he proceeds, we will have a short recess.

(Short recess.)

The CHAIRMAN. The Chair recognizes Senator Malone.

Senator MALONE. Mr. Martin, I am glad you have come back to see us.

Mr. MARTIN. Thank you, sir.

Senator MALONE. I have received much comment on the testimony that you gave previously but some of the comment of other witnesses has tended to confuse a part of your testimony.

Would you explain how added money and bank deposits may be obtained to finance the Government?

I ask you this question because you will remember that you testified that you and your board could judge the amount of money that ought to be in circulation for what you called a future sustained economic growth.

Do you remember that part of your testimony?

Mr. MARTIN. I do, sir.

Senator MALONE. Then you do have the authority to put additional money in circulation when you judge that in the future the business of the country would need that additional money in circulation for what you termed a sustained economic growth?

Mr. MARTIN. Yes. If I recall that testimony, Senator, I used the picture of the river, the stream. We were trying to keep the stream flowing.

Senator MALONE. Yes.

Well, I am still confused as to how any one man can tell how much money is needed in circulation a year or 2 in advance when the combined judgment of all the financiers and businessmen of the country often fall by the wayside trying to do the job.

But nevertheless, I am asking you these questions because you have said that you have that authority and exercise it.

You do have it?

Mr. MARTIN. We have a responsibility for it——

Senator MALONE. How do you put more money in circulation when in your judgment it is necessary for a sustained economic growth?

Mr. MARTIN. Well, our three instruments are we can purchase securities which adds to the money supply——

Senator MALONE. Purchase securities from whom?

Mr. MARTIN. From the Government, from the open market, Government securities.

Senator MALONE. In the open market or could you purchase securities issued by the Treasury?

Mr. MARTIN. We could purchase a limited amount of new securities issued by the Treasury.

Senator MALONE. Then instead of going into the open market the Treasury could issue new securities for you to purchase, could they not?

Mr. MARTIN. They could, in limited amount.

Senator MALONE. And that would put more money in circulation.

How would it put more money in circulation if you merely purchased the securities that were already on the market?

Mr. MARTIN. Well, Mr. Young pointed out here that our authority to buy directly from the Treasury would be limited at the present time to $5 billion.

Senator MALONE. How would it be limited to $5 billion?

Mr. MARTIN. That is what the law is at the present time.

Senator MALONE. You mean we have raised the debt limit $5 billion?

Mr. MARTIN. Oh, no, this direct borrowing authority is for temporary accommodation only. We can buy securities directly from the Treasury under a law which I believe will expire in June of this year, but it has been renewed every 2 years for the last—about the last 10 years, I should say.

Senator MALONE. You anticipate that it will be renewed this time?

Mr. MARTIN. It may very well be renewed.

Senator MALONE. Are you recommending it?

Mr. MARTIN. I would recommend it; yes.

Senator MALONE. Are you recommending it?

Mr. MARTIN. I will recommend it——

Senator MALONE. The President will recommend it or just you recommend it?

Mr. MARTIN. I will support the President if he recommends it.

Senator MALONE. Well, just how does the recommendation come about?

Do you recommend it directly to Congress or does the Treasury or the President recommend it directly to Congress?

Mr. MARTIN. I think the Treasury recommends it to the Congress.

Senator MALONE. Directly?

Mr. MARTIN. Direct.

Senator MALONE. Without the President saying anything?

Mr. MARTIN. I think that is right.

Senator MALONE. Well, that clarifies the situation.

Now, with only that authority can they then issue new certificates for you to purchase?

Mr. MARTIN. That is correct.

Senator MALONE. So that you would not have to go in to the open market to buy?

Mr. MARTIN. That is correct.

Senator MALONE. And if you wanted to put additional money in circulation, and I think you testified that you could put a billion or two billion dollars of new money into circulation, if you thought the business of the country would need it, for that "sustained economic growth," did you not?

Mr. MARTIN. I did.

Senator MALONE. But you are limited in the new securities that they might issue for you to buy that had never been on the market before by this 5 billion limitation?

Mr. MARTIN. In buying direct from the Treasury, yes, sir.

Senator MALONE. Securities that had never been sold before?

Mr. MARTIN. That is right.

Senator MALONE. That would be new money in circulation in fact?

Mr. MARTIN. That is right.

Senator MALONE. Would you call it new money if you went into the market and purchased securities that were already on the market?

Mr. MARTIN. It would——

Senator MALONE. The question may be awkward.

How would it provide new money in circulation if you went into the market and bought securities already circulating in the market?

Mr. MARTIN. Well, it would have somewhat the same effect. We would buy the securities. The money supply would be increased by roughly that amount.

Senator MALONE. What kind of money do you use to buy these securities?

Mr. MARTIN. We use credit.

Senator MALONE. What kind of credit?

Mr. MARTIN. We use credit, Government credit.

Senator MALONE. Explain that for the record.

Mr. MARTIN. Well,——

Senator MALONE. You see we have to make the record that the people, not familiar with banking practice, will understand.

Mr. MARTIN. Well, to go back to my earlier testimony, the law specifically indicates that we can expand or contract credit within the limits of our reserves against Federal Reserve notes and deposits.

The total of the Federal Reserve notes and of the reserves that member banks deposit with us can never exceed four times the holdings of our gold certificates.

At the time you and I were discussing it before that ratio was roughly 47 percent. It is about the same today. Maybe 46 percent, something like that.

That authority is given us in the Federal Reserve Act. Of course the Congress can change the authority at any time it sees fit.

Senator MALONE. Is that the $5 billion limit you are talking about?

Mr. MARTIN. No, no. The $5 billion limit is on direct purchases from the Treasury. The deposit or note liabilities created by such purchases would come under the same overall limitation.

Senator MALONE. Would that be a limiting factor even in this case?

Could it be?

Mr. MARTIN. Yes, it could be.

Senator MALONE. Now, who owns those gold certificates that have been issued against the gold to which you previously referred?

Mr. MARTIN. Well, they are held by the Federal Reserve. We have roughly $22 billion of gold certificates.

Senator MALONE. They are owned then by the Federal Reserve banks, member banks, are they not?

Mr. MARTIN. The Federal Reserve banks.

Senator MALONE. The Federal Reserve banks?

Mr. MARTIN. Yes.

Senator MALONE. How many of these Federal Reserve banks are there?

Mr. MARTIN. There are 12.

Senator MALONE. All members of the Federal Reserve; what is the correct designation?

Mr. MARTIN. The Federal Reserve System.

Senator MALONE. Federal Reserve System.

Well, who owns these banks?

Mr. MARTIN. Who owns the Federal Reserve banks?

Senator MALONE. Yes.

Mr. MARTIN. Well, the Federal Reserve banks—the member banks of the Federal Reserve System subscribe to the stock of the Federal Reserve banks to provide the initial capital and surplus; they were set up as individual corporations.

Senator MALONE. These are private banks but they are members of the Federal Reserve System—the 12 of them?

Mr. MARTIN. Well, I am now talking about the relationship of the private banks—the member banks—to the Federal Reserve banks.

Senator MALONE. To the Federal Reserve banks?

Mr. MARTIN. Yes. To become member banks of the Federal Reserve System, the private banks buy stock in the Federal Reserve banks and that stock entitles them to participate in the management of the Federal Reserve banks by the election on the basis of the amount of stock held, of 6 of the 9 directors of the Federal Reserve bank.

It does not give them control of the Federal Reserve banks and, in that sense, the ownership which the private banks have of the Federal Reserve banks is not ownership in the sense of proprietorship.

It is ownership purely in the sense of direct participation in the management.

Senator MALONE. While we are on that subject, diverging a little from my question but I think it is all in the interest of clarity. There was a roundtable discussion on February 16, 1941, as I look up the record, at Temple University, and they were talking about how to finance national defense.

The participants were C. A. Siemkiewicz, assistant vice president of the Federal Reserve bank, apparently at that time in charge of economic research and statistics; Mr. Carl Scholz, professor of economics at the University of Pennsylvania; and John F. Bell, professor of economics of the faculty of Temple University.

They were discussing the implications of financing national defense, talking informally.

Now one of the questions Bell asked:

> If the banks were not willing to buy the bonds in a sufficient amount and if the people did not buy them either, and the Government was not able to raise the money through taxation, could it be gotten any other way?

The implication was that this $22 billion worth of gold that we have locked up in Kentucky might be available for the job?

Then the answer:

> I am glad you asked that, John, because there are so many misunderstandings about this phase of money. The truth of the matter is that gold is not available as popularly believed. Most of that gold is not available because it has been monetized. There are claims against it. For example, the Federal Reserve bank holds almost $20 billion in gold certificates on hand and due from the Treasury.
>
> Now these certificates represent monetization of the gold held by the Treasury so that at least that much of gold cannot be called free.
>
> It is locked up. Of course in the stabilization fund there is $1.8 billion. There are a few items that are not allocated that probably could be released.
>
> The amount that might be called free gold is that which is held in the working balance of the Treasury and on February 11 it was $54 million.
>
> So it is not correct to say you can draw on all the gold because that gold has been monetized. There are claims against it, and it cannot be used unless you want to run great hazards.

What does he mean by that statement?

Mr. MARTIN. It means that is in use and it refers to this requirement of 25 percent against the liabilities in form of deposits and reserves which the law compels the Federal Reserve to have at all times.

Senator MALONE. Just what does it mean then, that the Federal Reserve banks hold about $20 billion of gold certificates on hand at the Treasury and this gold is not available because it is owned by them—it is monetized?

Mr. MARTIN. It is monetized in the sense that it is used as a base for the currency. It could not be freed in the sense of just being disbursed. It is used as a base for our currency.

Senator MALONE. Is that the same gold against which we now have $16.5 billion worth of claims or balances held by foreign nations and individuals, recognizing that the individuals holdings might be turned into the Nation's balance and gold demanded for the entire amount of those claims?

Mr. MARTIN. I have the figures here, Senator, the free gold reserves, by which you mean——

Mr. MARGET. It is the difference between the $22 billion of——

Senator MALONE. You are answering the question?

Will you identify yourself?

Mr. MARTIN. This is Mr. Arthur Marget, who was with me previously.

Senator MALONE. Yes; I remember him well. I want him identified again for the record.

Mr. MARGET. Shall I answer it?

Senator MALONE. Yes; go right ahead.

Mr. MARGET. $22 billion is the figure for the gold stock against which these gold certificates that you mentioned, sir, are kept.

Now, the 25-percent requirement that we must keep against obligations of the Federal Reserve System means that of that $22 billion——

Senator MALONE. $22.4 billion, is that the exact amount?

Mr. MARGET. The latest data I have are for April 16, at which time it was $22,220 million.

Senator MALONE. It varies from day to day, does it not?

Mr. MARGET. Yes. Now the required reserves, that we have to keep against the obligations—notes and deposits—of the Federal Reserve System were as of that date, $11.81 billion. If you subtract this requirement from what we had, that leaves you a figure for free gold of $10.41 billion.

Senator MALONE. The $10 billion plus would be available for any use that the Congress wanted to make of it?

Mr. MARGET. No, sir; the reserves do not belong to the United States Government. The $22 billion are the gold certificates which are in the vaults of the Federal Reserve bank, against which the Federal Reserve bank has certain obligations.

The extra amount of that reserve—the difference between total reserves and required reserves—would permit either domestic expansion on the basis of it still keeping within the 25 percent limit, or would be available for meeting requests for conversion of deposits kept here by central banking authorities, monetary authorities abroad.

That is the figure that you gave, sir, of around $16 billion, if you include the holdings of international institutions as well as the Government.

I should add, as I think we went over this point when we discussed it last, Senator that of that total figure—which you gave as of $16 billion, but which would be about $13 billion odd, if we leave out the international institutions—only about $8 billion is held by official institutions or governments.

Senator MALONE. Now we cleared that up before, you will remember.

Individual holdings abroad can very readily be converted to nations' holdings making a total of about $16½ billion. Don't you remember clearing that up for me at the first hearing?

Mr. MARTIN. That is right.

Senator MALONE. You probably remember it required some time to clear that up at the last hearing.

Mr. MARGET. I remember we discussed that, sir, yes.

Senator MALONE. Do you not remember we cleared that subject up, the fact that the individual dollar balances held abroad in these nations are very readily converted to nation holdings and if this $16½ billion were demanded that we must either refuse payment in gold, or our remaining stock of gold would be only $5.7 billions.

Mr. MARGET. I think we made the point that governments, depending upon the monetary arrangements they had, could mobilize their nationals' foreign holdings.

It is not always easy—there are different degrees of ease to that, depending on——

Senator MALONE. We covered it adequately at the last hearing—part 3 of the published hearing. I do not want to go into that again unless you insist; time is short. But you do agree, as you and Mr. Martin testified before, that there are ways to convert those individuals, holdings to nations' dollar balances?

Mr. MARGET. The Government's dollar balances——

Senator MALONE. Their own government dollar balances—you remember that, do you not? And, further, if all dollar balances were presented, that we would wind up with $5.7 billion in the vaults.

Mr. MARGET. I remember the discussion, yes.

Senator MALONE. Well, you remember you finally testified that it could be done.

I will have to dig that up if you do not remember it.

Mr. MARGET. I have no objection to accepting it at this stage of the discussion.

Senator MALONE. It is understood that you so testified at the first hearing.

Now, then, if that is true and you only have $10 billion left, you are a bit shy of gold to meet your obligations.

Mr. MARGET. In the same sense, sir, in which any bank is shy. Any bank which runs on less than a hundred-percent-reserve basis is in exactly the same position.

Senator MALONE. Is it not customary that when one of the banks in an area is short they get it from other banks, or if all of them are short, that they can get temporary money from your Federal Reserve Board?

Mr. MARGET. Well, yes.

Senator MALONE. Well, now, who would Uncle Sam get it from if it was oversubscribed? He has no uncle.

Mr. MARGET. As a matter of fact, I would hope that we would so handle our affairs, just as I would hope most banks would handle their affairs, that we would not have to——

Senator MALONE. That is not the question.

I want you to answer the question.

Mr. MARGET. Yes, there is one institution we can go to, and that is the International Monetary Fund.

Senator MALONE. We financed that too, did we not?

Mr. MARGET. We and the other fifty-odd nations.

Senator MALONE. What kind of money did they put in?

Mr. MARGET. Each one put up 25 percent of their quota in gold.

Senator MALONE. How much gold is there in that monetary fund now?

Mr. MARGET. Something over a billion dollars.

Senator MALONE. It would not go very far, would it in making up the deficit?

Mr. MARGET. No, sir; that is why I made the point that I think for us as for these other countries, too. Basic reliance must be upon our own efforts rather than upon somebody from the outside.

Senator MALONE. Let's come back to the question.

The billion dollars would not go very far even if we could get it and I doubt if we could. It would take the consent of the other nations, would it not?

Mr. MARGET. Well, just as they require our consent when they ask for a drawing on the Monetary Fund.

Senator MALONE. Well, they do not have much trouble getting our consent, do they?

Mr. MARGET. Oh, yes, sir.

Senator MALONE. Do they?

Mr. MARGET. Yes.

Senator MALONE. Well, I had not heard of it.

Now please answer my question. If these balances were demanded by European countries, or the nations where these balances are held and it is all committed here but $10 billion and there are $16½ billion of these balances, would it not be a trifle embarrassing?

Mr. MARGET. If that should happen—The question is what sort of policy should the United States follow in order to prevent that happening.

Senator MALONE. Are there any that you could follow that would be sure to prevent it?

Mr. MARGET. I can express only my own view, Senator, which is that as long as we follow policies which give every reason for the foreign depositor to believe that our currency is not going to depreciate or to be devalued there is no reason that I can see why he should take his account out from this bank.

I cannot think of a better bank.

Senator MALONE. Just what are we doing that would inspire a foreign nation with such confidence? There is one more question, at least: We are depreciating our currency every day, are we not?

Mr. MARGET. Well, sir, the chairman has talked about the efforts of the system to fight inflation.

One of the reasons why, among other things, the system makes these efforts is that we want to convince the world, as well as serving our own interests more narrowly, that our currency is and is going to continue to be a sound currency.

Senator MALONE. The point is that it is depreciating every day, is it not?

Mr. MARGET. That was discussed this morning, sir.

Senator MALONE. That is all right; and our living has been depreciating since we left the gold standard in 1933—and still is depreciating. I am asking you now—it ought to be fresh in your mind.

Mr. MARGET. I think one of the Senators, Senator Kerr, I think, pointed out that the last figure for the cost of living showed a further rise which——

Senator MALONE. Of course, you know it did depreciate last year and the year before and the year before that, and it is depreciating at about the same rate, do you not?

Mr. MARGET. Yes, but I think, if I may say so, sir, that the rate of depreciation does make a difference. Whether it is the rate——

Senator MALONE. What is the rate?

Mr. MARGET. Well, I think that the rate at which the dollar has been depreciating over the last year or so is less than what was previously——

Senator MALONE. When did it become less; the last 30 days? Upon what do you base your opinion—the record shows that there has been little change in the depreciation.

Mr. MARGET. No, sir; I think the record——

Senator MALONE. Was last year's depreciation less than the year before?

Mr. MARGET. I don't have the price figures here. One of my colleagues could handle that. Could you give the figures, Ralph?

Mr. YOUNG. Well, it probably would be more last year——

Mr. MARGET. We must remember, in talking about years, Senator, to distinguish, let's say, within 1957 in terms of the action prior to November or the latter part of October, and what follows.

Senator MALONE. Well, now, while your associate is looking up the facts, didn't Mr. Martin testify under my questioning, at his last appearance, that the 1947 dollar was worth 47 cents?

Mr. MARGET. I do not remember, but I should not be surprised.

Senator MALONE. That is right, is it not?

Mr. MARTIN. Yes, sir.

Mr. MARGET. I don't have the testimony.

Senator MALONE. We will rely on the record.

Mr. MARGET. There was a considerable degree of depreciation.

Senator MALONE. As a matter of fact, he did testify to that fact. You remember that, Mr. Martin.

Mr. MARTIN. I think that is correct, in the testimony. Whatever is in the testimony is correct.

Senator MALONE. Yes. We will rely on that. Now, then, if in 10 years it depreciated 53 percent, and it is not yet slacked up, why do you say that you are going to convince the world that our currency is always going to be worth what it is now?

Mr. MARGET. May I say just two things, sir, in reply to that question?

Senator MALONE. Yes.

Mr. MARGET. In the first place, the fact that our performance has not been as good as any one of us should have like to see it means to us that we must not slacken in our battle.

The second point I would make in answering your question, "Why should they have any confidence," is this: That, unsatisfactory as our record has been by the standard that we set for ourselves, it has been better than that of most countries in the world, and that, therefore, when a country is asking where it will keep its deposit, it looks around and decides that the United States may not be perfect, but it is better than the others.

Senator MALONE. You can stay here until you answer the question. I can stay here all night. If you want to get away, you better start answering the question.

I presume you are trying to cure inflation although there has been no visible results.

The facts are, you are not stopping it.

Are not those the facts?

Mr. MARGET. I think the chairman has said that none of us is really satisfied with our performance.

Senator MALONE. That is not the answer. I want you either to quit testifying at all, or else answer my questions. Now, is it a fact that you have not slacked up the inflation in the last 3 or 4 years?

Mr. MARGET. I suppose the chairman will respond for the System. I can give you only my personal view. I think that the effects of the System in that direction, while not as successful as we should have liked——

Senator MALONE. I am going to ask you not to interfere until Mr. Martin again—you have evaded every question.

Now, Mr. Martin, what about it?

Mr. MARTIN. I would say, Senator, that the inflation has gotten ahead of us in the last few years.

Senator MALONE. That is right. That is a good answer, and we will stand on that one. We have not stopped inflation one iota, have we?

Mr. MARTIN. We have tried; we have tried over the last 3 years. Our record has not been very good.

Senator MALONE. It has not been very good. I think you are a good witness. You have tried to stop inflation, while printing more money without a stable base, and it has not worked.

Is it not a fact then that the only way you could stop inflation would be to tie the money to some stable thing, like gold, or something better, if you can think of something more stable? The facts are that we cannot create additional money, without tieing it to a metal base such as gold or silver.

Mr. MARTIN. Well, that takes us back to our earlier point. I think, if you dry up the money stream completely, you can certainly stop inflation. And I think we have the will, we have the means—whether we would have the will as a Government to stop inflation or not, you would be a better judge of that than I, Senator.

Senator MALONE. No; I am not a better judge of money manipulation or I would not be asking you questions. This is your field. If you are in my field of engineering you could ask me questions.

Mr. MARTIN. Well, I think that it is partly your field, too, though, and that is the point that I make.

Senator MALONE. It is my field to the extent of one vote on this committee, but you have testified that you have the authority to issue new money in accordance with your judgment for the future "sustained economic growth." You can buy new securities from the Treasury that they will issue for your benefit, within the limits of the $5 billion?

Mr. MARTIN. That is right, and we can expand credit, the money supply, and we have the means, we have the open-market purchases. We have our reserve requirements and we have the interest-rate mechanism. Those are the three tools which are at the disposal of the System. Managing the monetary supply——

Senator MALONE. Are there not a couple of other tools that you utilize to control the economic system—the stock market margin, and the discount rate and the interest rate?

Mr. MARTIN. We have control over the stock market.

Senator MALONE. Tell me exactly what control you have. Can you demand 100 percent?

Mr. MARTIN. Margin on the purchase of securities? We could.

Senator MALONE. And you could let them purchase it without any downpayment?

Mr. MARTIN. That is right.

Senator MALONE. Then you do really control, to a large extent, the rate at which stocks are likely to be purchased on the exchange, do you not?

Mr. MARTIN. No; I would not say we control the rate. We control the margin on which they might be purchased.

Senator MALONE. Well, doesn't history show there is a lot of difference in the rate of stock purchases if you only have to put down 10 percent or if you have to put down 90 percent?

Mr. MARTIN. No; I don't think so, Senator.

Senator MALONE. You don't think so?

Mr. MARTIN. I think that if the opportunities—that if people think that the opportunity for making a profit in stocks is clear in one way or another, they will find the means of producing whatever margin is required, even if it is 100 percent. It may slow up some of the activity in the stock market.

Senator MALONE. Activity; what do you mean by activity?

Mr. MARTIN. The number of shares turned over.

Senator MALONE. That is what I am talking about.

Mr. MARTIN. But you must also talk about prices, the increase in prices of these securities.

Senator MALONE. That is the gamble—that is the reason that all "horseplayers" die broke. The rate of purchase of a stock affects the price of the stock, does it not?

Mr. MARTIN. Not necessarily.

Senator MALONE. If there is a run on a stock, everybody tries to buy it today; what does it do tomorrow, generally?

Mr. MARTIN. Well, there are purchasers and sellers.

Senator MALONE. I am talking about purchasers now. If everybody wants a stock, and nobody is anxious to sell, it goes up, does it not?

Mr. MARTIN. It goes up; that is right.

Senator MALONE. Well, then, let's come back to that original question. I would not like to pass that with your present answer on the books. Does not your regulation of the margin have something to do, and I will adopt your words, with the rate of turnover of stocks, the rate of purchase and sales?

Mr. MARTIN. Yes; I think it does.

Senator MALONE. As a matter of fact, it might be controlling under certain conditions; might it not?

Mr. MARTIN. Under certain conditions, it might.

Senator MALONE. What else is it that you control; the stock-market margin, and the discount rate?

Mr. MARTIN. The discount rate, which is the charge that we place on member bank borrowing funds from the Federal Reserve banks.

Senator MALONE. What latitude do you have in fixing the discount rate?

Mr. MARTIN. We have no latitude at all, except——

Senator MALONE. Could you make it 10 percent or 2 percent?

Mr. MARTIN. We could make it 10 percent, but it has to be related to whether there is a desire to borrow.

Senator MALONE. I understand that. But, if you wanted to, you could put it high enough to discourage borrowing pretty successfully; could you not?

Mr. MARTIN. We could place a rate on it that would be prohibitive.

Senator MALONE. Then you could put it down to the point where even us ordinary people might go into the borrowing market; is that right?

Mr. MARTIN. Well, not unless they wanted to borrow.

Senator MALONE. Well, what makes a person want to borrow when he can buy property or investments that he thinks might be advantageous; what influences him to borrow money—when he can borrow it so that he can make a profit?

Mr. MARTIN. That is right.

Senator MALONE. Well, the interest he has has something to do with it; does it not?

Mr. MARTIN. That is one of the factors.

Senator MALONE. You control that, don't you?

Mr. MARTIN. We control that.

Senator MALONE. That, I think, will be very helpful in the record, and is the answer I was trying to get in the first place.

Do you believe it is a sound principle for the Government to expand its expansion powers in part by having the banks deposit currency against the Government I. O. U.'s or whatever you might call it?

Mr. MARTIN. Do I think it is a sound principle?

Senator MALONE. You say you could do it. So, is it a sound principle to do that—is it a sound principle to create such money, deposit currency against Government's promise to pay, and that is about what you issue.

Mr. MARTIN. If it can be usefully used.

Senator MALONE. Then whose judgment prevails; in whose judgment does it rest as to whether or not it be usefully used? I think you have answered, that it is your judgment or that of your board?

Mr. MARTIN. That is right.

Senator MALONE. You think it is a sound principle?

Mr. MARTIN. Well, it is the Congress which enacted the Federal Reserve Act.

Senator MALONE. What do you think about it? Do you think it is a sound principle?

Mr. MARTIN. I do, sir.

Senator MALONE. Well, is not this procedure what is commonly called monetization of Federal debt?

Mr. MARTIN. I think so; yes.

Senator MALONE. Is there anything wrong, in principle, in monetizing the Federal debt?

Mr. MARTIN. It depends on the limits to which you carry it.

Senator MALONE. What are your limits?

Mr. MARTIN. I have given you the limits in the law on our relationship to gold.

Senator MALONE. You mean you are talking about the $5 billion now?

Mr. MARTIN. I am talking about gold as a base for our currency.

Senator MALONE. Is it the base?

Mr. MARTIN. It is. We have a requirement——

Senator MALONE. I think we have a theoretical base, but go ahead.

Mr. MARTIN. We have a requirement that our deposits and Federal Reserve notes can never exceed four times our holdings.

Senator MALONE. I seem to recall we had a 40-percent requirement and, when you found yourself short of gold, they dropped it to 25, did they not?

Mr. MARTIN. And the Congress can do that at any time it sees fit.

Senator MALONE. The Congress can drop it entirely if it runs out of gold——

Mr. MARTIN. To 5 percent, if it wants to.

Senator MALONE. To nothing, as a matter of fact if the foreign countries demanded all of our gold.

Mr. MARTIN. It could.

Senator MALONE. If we continue our loans, do you think we are headed that way?

Mr. MARTIN. I do not think so, Senator. I certainly hope not.

Senator MALONE. Suppose these foreign commitments, I call them commitments, if they have a dollar balance, and they have a $16.5 billion balance, if even a substantial part of them were to be demanded, we would be in trouble, would we not?

Mr. MARTIN. We would be in trouble; that is right.

Senator MARTIN. You testified before, I think, that you could refuse to honor these balances in gold, or did you say that you would have to have congressional action in order to refuse payment in gold if they were presented?

Mr. MARTIN. If we were to refuse, we said we would go to Congress.

Senator MALONE. Do you have to go to Congress when you refuse to pay in gold?

Mr. MARTIN. I don't think we would have to, but it would be unsound not to.

Senator MALONE. Well, it would be permission after the act. Congress would have very little choice in the matter but to approve what had already happened to allow you to do officially what you had already done unofficially.

Would Congress have much choice?

Mr. MARTIN. Well, you are assuming the worst. If we were busted, I do not think it would make much difference.

Senator MALONE. I am not assuming the worst—I am trying to find out for the record just how our monetary system is being managed.

A managed currency means a managed economy, which has always proved the beginning of the end of any nation's economic system. I am of the opinion that Russia's secret weapon may be gold.

They may suddenly put the ruble on the gold standard. If they do that, and I am expecting it to happen by 1959, then that is when the foreign nations will demand $16.5 billion of their gold.

What will happen to our currency then?

Mr. MARTIN. Well, we will be in trouble if that happens.

Senator MALONE. If the ruble were put on a gold standard as such, just as the dollar was before 1933, and foreign nations decided that the gold ruble money was sounder than the dollar backed by practically nothing but paper, do you think we would be in trouble?

Mr. MARTIN. How do you think the Russians would go about doing that?

Senator MALONE. I think they are mining 20 or 30 billion dollars in gold, and so fast it would scare you to death.

Mr. MARTIN. Well, I remember your interesting observations on Bulganin—your visit with Bulganin and Krushchev.

Senator MALONE. That is right.

Mr. MARTIN. And I rather gathered from that discussion that you questioned whether they were going to tie their currency to anything.

Senator MALONE. I never questioned that they would tie the ruble to gold when they were ready

What I say about Russia when I left, badly garbled in the one-economic-world papers in this country, was that in a very short time they would make themselves self-sufficient in everything they needed for war and peace in the area under their control.

Do you not remember that?

Mr. MARTIN. Yes.

Senator MALONE. And I said further that there would be no successful revolt, since they are protected from Turkey and other predatory nations even though they may not like the government under which they live. Georgian and Armenian Governments have been overridden by Turkey 40 or 50 times in the last century, but they are not about to do it now, because they would be destroyed in 30 minutes by Russia.

The third thing that I said was that all the power in the Eastern Hemisphere had moved to Russia, there was none in any other nation in Europe or Asia.

Even the State Department found that out just 2 years later in October 1957—through our sputnik.

If those three things were true I said in my statement that we had better make the American system work, do you not remember?

Mr. MARTIN. I agreed with you on that.

Senator MALONE. Our system is not working very well right now; for your ears alone and 160 million other people. Our managed currency is not what we would call a howling success.

Mr. MARTIN. I think it could work better.

Senator MALONE. It is getting worse. Therefore I think that Congress should do something about it.

This thing that is happening to us is now plowing so deep, so much deeper than the things that Congress is talking about and the White House is talking about, that it ought to scare everybody within an inch of their lives.

It is catching up with us, 24 years of this manipulation and reckless managed economy is catching up with us.

Now, there is nothing in your opinion then, wrong in the principle of monetizing the Federal debt?

Mr. MARTIN. Not within the limits that are set down by law.

Senator MALONE. That Congress sets?

Mr. MARTIN. Yes.

Senator MALONE. Why does Congress set those limits?

Is it pressure from the White House and Treasury and the Federal Reserve bank?

Mr. MARTIN. Well, Congress sets those limits because they think those are the proper limits at the time they set them.

Senator MALONE. "They set those limits." Thinking is another matter. They may start to think, however, if they take a few more trips home and take another look at our managed or mismanaged economy.

Now your report of the Board of Governors of the Federal Reserve System for 1945 states on page 1 that approximately $95 billion or 40 percent of the borrowing by the Treasury between June 30, 1940, and the end of 1945 was raised by selling Government securities to the commercial bank system.

Was that a sound procedure and should it be repeated?

Mr. MARTIN. No. That was wartime finance, and I think it was unfortunate that so much was sold through the banking system.

Senator MALONE. You do not think it is a sound procedure except in a real emergency?

Mr. MARTIN. And that was a war period.

Senator MALONE. But you would not call it a sound procedure unless it was absolutely necessary?

Mr. MARTIN. That is right.

Senator MALONE. Well, can and do the Federal Reserve banks monetize the Federal debt?

Mr. MARTIN. They do at times.

Senator MALONE. And they can at any time?

Mr. MARTIN. That is right, sir.

Senator MALONE. To what extent can the reserve banks monetize the Federal debt?

Is there any limit?

Mr. MARTIN. Well, they are limited by the law that we have previously discussed, which, of course, could be changed by the Congress.

Senator MALONE. Which law is that now?

Mr. MARTIN. The limitation of 25 percent of gold certificates.

Senator MALONE. If they made it 50 percent why then it could be continued further?

Mr. MARTIN. That is right.

Senator MALONE. If they made it 40 percent again why then you would have to pull in some of the—correct the machinery and pull in the money?

Mr. MARTIN. That is right.

Senator MALONE. To what extent do you think they should monetize the Federal debt, in your opinion, how far could they go on a sound principle?

Mr. MARTIN. I don't know, Senator. I think that our present ratio is adequate. I think——

Senator MALONE. 25 percent?

Mr. MARTIN. Well, we have now 47 percent—46 percent is the actual ratio. The closer you get to the 25 percent, the closer you are getting to the danger point, you see.

Senator MALONE. Well, how far would you consider it would be safe?

Mr. MARTIN. I just would not know.

Senator MALONE. Well, would it not be a sounder principle for the Treasury to obtain its funds from taxation and borrowing from savers rather than to monetize the Federal debt.

Mr. MARTIN. I definitely think it would be.

Senator MALONE. We have gone quite a ways down the other road; have we not?

Mr. MARTIN. We have.

Senator MALONE. You would like to get back on the other track?

Mr. MARTIN. That is right.

Senator MALONE. How would you go about doing it?

Mr. MARTIN. Well, I think the Treasury has taken some steps that way recently by selling longer term securities, placing the debt outside of the banking system.

It has a long way to go, but it has made some progress.

I think every opportunity should be taken to do that. You and I would be in agreement with that.

Senator MALONE. What effect would that have, would that decrease the Nation's currency supply or at least it would not add to it?

Mr. MARTIN. It would not add to it.

Senator MALONE. And it would tend to decrease it?

Mr. MARTIN. It would tend to decrease it.

Senator MALONE. Is there any valid principle to justify creation by the Government of currency against Government debt?

I mean is there a valid reason except in an emergency such as you described?

Mr. MARTIN. No; I don't think so.

Senator MALONE. Then are we getting close to finding a reason or lack of reason why the Congress should give you this extra $5 billion? Or renew it?

Mr. MARTIN. Well, I think that $5 billion is a convenience to both the Treasury and to us. It is for short-term purposes only.

Usually that borrowing lasts only for a day or so. It is not a permanent holding. It is for convenience in the money market.

Senator MALONE. You would rather go to the people or the savers, the savings accounts to get your money rather then to monetize the Federal debt or the creation of Government currency against the Government debt?

Mr. MARTIN. I would.

Senator MALONE. Do you find yourself in a position that you just try to live hand to mouth and keep ahead of the hounds here since you are always pressed.

Mr. MARTIN. I think that is an apt description—certainly in the field of inflation. Inflation got considerably ahead of us.

Senator MALONE. You might describe it in a different manner. We just have not let the dust settle for about 25 years; have we? Do you think we have?

Mr. MARTIN. Well, I think there have been periods when it has settled.

Senator MALONE. Where are these periods?

Mr. MARTIN. Well, one period was 1952-55. I think there we had a relatively stable price level.

Senator MALONE. Brought about by the Korean war?

Mr. MARTIN. That was after the Korean war.

Senator MALONE. It was the aftermath; was it not?

Mr. MARTIN. No; it was more than the aftermath, because the problem was created in the immediate aftermath which was 1951, 1952.

Senator MALONE. When did the Korean war end? It was still on until 1953.

Mr. MARTIN. I don't know exactly.

Senator MALONE. It did not end until 1953; did it?

Mr. MARTIN. Well, the main impact of it on us was over, I think, by 1952.

Senator MALONE. The war was still on; was it not?

Mr. MARTIN. I would accept your——

Senator MALONE. Seven million young men out of the country who were not around asking for jobs; were they?

Mr. MARTIN. Right.

Senator MALONE. Made times pretty good; didn't it?

Mr. MARTIN. Times were very good.

Senator MALONE. I do not suppose you remember back this far, but how many men were there unemployed in the United States about the time they started World War II; do you remember?

Mr. MARTIN. About 1939 or 1940?

Senator MALONE. 1940; yes.

Mr. MARTIN. Well, nearly 10 million; weren't there?

Senator MALONE. Well, my remembrance is that it was between 8½ and 10 million.

We had not really cured anything by all of the maneuvering and expenditure of money until they started another war, had we?

Mr. MARTIN. We still had a disease with us, no doubt about it.

Senator MALONE. But we were working on an emergency since 1933, were we not?

Mr. MARTIN. That is right.

Senator MALONE. When we went off the gold standard and started the inflation of the currency and priced ourselves out of all foreign markets, that was about the time, was it not?

Mr. MARTIN. That is right.

Senator MALONE. Has not ever stopped or slackened materially?

Mr. MARTIN. Well, I mentioned the period 1952 to 1955 which I think was not bad.

Senator MALONE. But we still had the war on to live by, did we not?

Mr. MARTIN. We had——

Senator MALONE. And whenever there is a war on people who are not actually in the war have it as a pretty prosperous period, don't they? Isn't that the history?

Mr. MARTIN. Yes. That is the history. I think in that period the war ended in 1953—you had 2 years we were out of war.

Senator MALONE. Well, that is considered a long time to keep out of war now, starting with the period 1933—or preparing for war?

Mr. MARTIN. War or preparation for war has been the order of the day.

Senator MALONE. For 25 years?

Mr. MARTIN. A long time; yes, sir.

Senator MALONE. Yes. I remember it was 1955 when I had completed my visits and inspection of all of our star boarder foreign nations and then I went behind the Iron Curtain and stayed 2½ months with the result I have already discussed with you, and I am very perturbed that our system is not working as well as it ought to, and when it does not, we may be heading for something that we would not like. I traveled 14,000 miles in Russia and was amazed at the misconception that our American people have—fostered by our State Department.

Do you feel that way, too?

Mr. MARTIN. I am not perfectly happy with the way things are going.

Senator MALONE. I am going to ask you a question about other governments.

You cannot justify and you do not like creation of government currency against government debt in addition to what we have.

You have already said that you would prefer not to.

How about the German Government in this Reichbank driving down the value of the German mark during World War I and up to 1928 practically to zero by monetizing Government I O U's, isn't that about the way they did it?

Mr. MARTIN. I think that is about right. Could I ask Mr. Marget to comment on that?

Senator MALONE. Yes; I think you had better just ask him from now on and then answer yourself.

We will get along better.

Mr. MARTIN. I am not entirely familiar with the German picture.

Senator MALONE. Well, you are familiar with the fact that the German mark was really a pretty valuable piece of currency when we went into World War I there, and then a wheelbarrow load of it along toward the last would not buy a pair of eggs.

Mr. MARTIN. Yes, sir.

Senator MALONE. Wasn't that the method they used generally speaking in monetizing the Federal debt and through I. O. U.'s?

Mr. MARTIN. Inflation got ahead of the Germans so far that they had to start over again.

Senator MALONE. What do we have here, if we continue to appropriate money. Just what kind of a barrier is there that would keep us from going the same route since we have no hard money standard?

Mr. MARTIN. Only the good sense of the people and the Congress.

Senator MALONE. The good sense of the people I will go for, but the people unfortunately are not on the Senate and the House floor, unfortunately, I say, since Congress for 24 years has followed the White House in inflation, free trade and billions to foreign countries.

If the people could vote on the Senate and House floor there are several things I am pretty certain we would quit doing tomorrow, maybe tonight, and three of them would be free trade, billions to Europe, and inflating the currency. There would be no question in my mind what would happen if the homefolks were on the Senate and House floor.

Now could the value of a currency be impaired in this the way the Germans operated if paper money and bank deposits were issued only against gold and silver and productive activity which would liquidate the credit when it matures?

That is a question I do not suppose has been asked for 25 years, but let's just assume that we based our money on this gold and silver.

I know you do have some money, some silver certificates for which you can get metal. The silver certificates you can go to the bank or to the Federal Treasury and get the silver—you are award of that.

But there is no gold certificate for which an individual can get gold.

You are aware of that, too, are you not?

Mr. MARTIN. That is right.

Senator MALONE. I have introduced a couple of gold bills in the Senate, one of them would let the people of the United States buy and sell gold to see what they think it is worth.

Maybe after a few months or a year or so we might have some idea what our own people thought it was worth. Then I have a second bill to go on the gold standard.

Do you think that might be a good idea?

Mr. MARTIN. A free gold market in this country?

Senator MALONE. Yes.

Mr. MARTIN. I do not think it is necessary as long as we buy all gold at $35 an ounce.

Senator MALONE. Well, what do the people get who buy it from you and take it across the pond?

Mr. MARTIN. I don't know what they pay, but——

Senator MALONE. I mean, what do they get for it? I thought I made that clear.

Mr. MARTIN. Well, what is the price of gold?

Mr. MARGET. Practically $35.

Mr. MARTIN. Practically $35. There has been very little fluctuation recently, Senator.

Senator MALONE. Any place in the world?

Mr. MARTIN. Only in Calcutta, and that is a very abnormal market.

Senator MALONE. What is it worth in Calcutta?

Mr. MARTIN. In Calcutta and Bombay, there is a premium, Senator.

Senator MALONE. How much?

Mr. MARTIN. In March, Calcutta was $62—I mean Bombay was $62 for bar gold.

Senator MALONE. I went into every nation in Africa, in 1948, and of course every other nation in the world, and one of my questions always was what is gold worth and how much gold at that price they thought it would take to saturate the market.

Sometimes they thought it might not take very much, but there were few places that it was not worth more than the $35 per ounce.

Mr. MARTIN. Well, according to this table, in most of the areas it is about $35 an ounce; and this Bombay market, Mr. Marget tells me, is so thin that you can practically do no business.

Senator MALONE. It would not take much to saturate it.

Mr. MARTIN. Yes.

Senator MALONE. In South Africa, it was worth about $75 an ounce in 1948. But on inquiry, I did not understand that it would require very much additional gold to saturate the market at $75.

Mr. MARTIN. Right.

Senator MALONE. What is the reason, if this gold is $35 or $36 all over the world, that we could not return to the gold standard and allow people to buy it and sell it?

Mr. MARTIN. You remember we discussed this before.

Senator MALONE. Yes, we did.

Mr. MARTIN. Under general conditions, if it were not for the comments that—well, you and I discussed it at some length in relation to your visit with Bulganin and Khrushchev. Now the warlike attitude or the unsettlement of the world which we have had with sputnik and that type of thing, is such that I would not think there would be any point in our making gold generally redeemable after not having had it redeemable for all these years.

Senator MALONE. Perhaps it will be a few months before Congress settles down. The people already have. Sputnik did not mean anything. It gave us a weapon to scare hell out of everybody and collect more taxes, but the thing that will scare me if Russia gets it before we do is a 3,000- to 5,000-mile missile that you can place in any certain area within small limits, and neither of us have it now.

We may throw a few people up on the moon. There are a few names I could suggest to go first.

But what we had better do is to keep building these long-range planes, the best ones we know how to build, and that is B-52's and B-58's, and these 2-Mach fighters.

I rode in one of them the other day, 35,000 feet high, 1,500 miles an hour. It is quite an experience. I have been riding planes since 1927. As a matter of fact, I had one of them attached to my battery field artillery in France in 1917.

We must keep ahead in long-range bombers until the missiles take their place—and only men like General LeMay and General Twining and others of their stature will know when that happens; when that happens, of course, we can slack up on manufacturing planes. We can defend the Western Hemisphere from North America today, and we can make the Western Hemisphere self-sufficient, everything we need for war or peace, just like Russia can make themselves self-sufficient for war or peace in the area that they control.

We had better start thinking about doing just that, instead of saying, as you have, "As long as things are unsettled, we cannot have a sound currency."

Things are not unsettled, really, any more than they have been for a long time. There has always been a war in Europe. That is the history. But we separated ourselves from them for a century and a half.

Then we entered into a 40-year trade war between England and Germany in 1917. There is no use debating whether or not we should have entered it—that time is past. We utterly destroyed the only nation that could handle Russia.

Now about this sound money, should the Government add to the currency supply by any process? I am asking for your opinion now. Your opinion that this is not the time is another question, but should the Government issue money not backed by our gold only issue certificates against that gold and silver?

Those are the only two money metals I know anything about. What do you think about that?

Mr. MARTIN. You mean should they increase the amount that they—I don't quite understand it.

Senator MALONE. Should we add to the currency supply except by adding to our gold and our silver supply and by issuing certificates against that gold and silver?

Mr. MARTIN. Well, we have to have a normal expansion and contraction of currency at various times of the year.

Senator MALONE. What makes you think so?

Mr. MARTIN. Well, as a cattleman, don't you have to have credit at certain periods, until you sell the cattle?

Senator MALONE. For a long time, and we had depressions every so often, if you will look at the chart, and I presume you have, ever since we have become a nation. But a free economy must be allowed to fluctuate. But what we have now is a controlled economy, is it not?

Mr. MARTIN. No; I wouldn't say it is a controlled economy.

Senator MALONE. Well, you have a controlled money supply.

Mr. MARTIN. We have a managed money supply.

Senator MALONE. Can you have a managed money supply without a managed economy? Isn't that what you are managing?

Mr. MARTIN. No; I don't think it is quite the same thing. The money supply——

Senator MALONE. What are you managing the money supply for? Isn't it to manage the economy?

Mr. MARTIN. No; it is to——

Senator MALONE. To regulate the economy?

Mr. MARTIN. Yes; all right.

Senator MALONE. You will go for that word.

Mr. MARTIN. Yes.

Senator MALONE. In other words, you have a Federal Reserve Board, of which you are the chairman, which regulates—which manages the money supply, in order to regulate the economy. That is what you are doing it for, is it not?

Mr. MARTIN. In order to regulate the fluctuations in the economy, that is, the swings of the economy; not to tell one group that they can or cannot make automobiles, or any other product.

Senator MALONE. Yes; but you want to manage the economy so there will be no dips and rises. You just want to manage it.

Mr. MARTIN. We want to have growth with stability.

Senator MALONE. Now then, under your managing, you can also decrease the money supply available, can you not?

Mr. MARTIN. We can.

Senator MALONE. How do you do that?

Mr. MARTIN. By just the reverse of the other process. We can sell Government securities instead of buying them. Then the banks have the securities and we have the money. You decrease the money supply.

Senator MALONE. Can you force them to buy them? I suppose you offered them for sale and you keep offering them at a lower price until they are so attractive they buy them; is that it?

Mr. MARTIN. That is correct.

Senator MALONE. Even down to 75 or 80.

Mr. MARTIN. That is right. We do not operate for profit.

Senator MALONE. You don't need to tell me that. I have watched it now for 30 years. You do not have to prove that you do not operate at a profit. No one else does, either, under this managed system, unless they know when you are going to make one of these formal announcements. There has been more than a faint suspicion that some of the information has leaked at different times.

But when a man gets caught 3,000 miles away from Washington, and he has borrowed some money, and has to refinance, and his profit disappears above a 3 or 4 percent money, and suddenly it is 5 or 6, he is broke.

I guess you would know about that, wouldn't you?

Mr. MARTIN. Yes.

Senator MALONE. Well, that is what is the matter with us now.

Now whether it was right for you to do that, I am not discussing. If you have the right to do it, which you have testified you do, through congressional action, you are working through your judgment when such manipulations should be made—you make or break people through no fault of their own.

Of course, some of us think that the Congress should adopt a principle and then everyone could use his own best judgment and would rise or fall on that judgment. But we have abandoned that principle, have we not? Because you can increase the money supply or decrease it. You have testified to that, have you not?

Mr. MARTIN. We can, but we are certainly trying to do it for benevolent purposes.

Senator MALONE. I am sure you are, but it has not worked that way. I am sure your intentions are of the best. They say that hell is paved with good intentions.

Now, you have not quite answered that question. If you answer that we should increase the currency supply by other means than increasing the gold and silver holdings or the price of the metals, then you do not need the gold and the silver back of the money, do you?

Mr. MARTIN. You have to have a relationship.

Senator MALONE. Do you?

Mr. MARTIN. Yes; I think so. You have to have some relationship.

Senator MALONE. But it can be 5 percent. It does not make any difference, 25 percent, 40 percent, just whatever you think it ought to be or how much gold and silver you own at the moment or the price you fix on it.

Mr. MARTIN. But, even if you vary it, you still have to have some relationship to the metal.

Senator MALONE. I wish you would think about that a minute. We may reach a point pretty soon if you can go down to 5 percent or 1 percent of the gold, and if suddenly all these nations holding, or enough of them, demand the gold, and you only had 5 percent, you would go to 5 percent, would you not, or at least you would advise Congress to let you do that, and the money would be gone anyway, so they would have to let you do it.

Well, then, 5 percent, or 1 percent, if that would do it.

Mr. MARTIN. Why have any money at all. Why not just——

Senator MALONE. I am just about to tell you, you may be out of gold money one these days and the paper may be worth so little.

But answer my question about this gold and silver. As long as you owe most of your gold to foreign nations in the strict sense, if they present their claim, you are down; however, you did testify you could stop the payment in gold, but that you would come to Congress to get their consent for you to stop such payments. You testified, previously, that such action would have a severe depressing effect on our currency in the world market, did you not?

Mr. MARTIN. Right.

Senator MALONE. You believe that?

Mr. MARTIN. I do.

Senator MALONE. And you also testified that it might cause a severe depression in the United States, did you not?

Mr. MARTIN. Right.

Senator MALONE. And you believe that?

Mr. MARTIN. I do.

Senator MALONE. Then you do believe that you should not be tied to gold and silver in any way at all, that is, of any certain percent; that you ought to be able to lower that percent at any time upon your own motion, so to speak?

Mr. MARTIN. No; not on our recommendation.

Senator MALONE. Well, whose recommendation would it be?

Mr. MARTIN. Well, I would assume that we would try to manage things in such a way that we would not come back to you for this.

Senator MALONE. I suppose that is what you assumed when it was 40 percent, but it was lowered to 25 percent, was it not, when you were short of gold?

Mr. MARTIN. Yes.

Senator MALONE. Now you have already testified that there is $16.5 billion in Europe that may be converted to nations' dollar balances for which gold could be demanded. You have testified you could refuse it, but they could demand it on the same basis they have been paid in gold for many years, could they not?

Mr. MARTIN. Right.

Senator MALONE. You have also testified it is all committed but $10 billion to the Federal Reserve—monetized.

Mr. MARTIN. Right.

Senator MALONE. If my bank account were in that position—and it has been that way many times—I would not get too much sleep. How do you sleep?

Mr. MARTIN. Well, I try to get a good night's sleep, Senator.

Senator MALONE. I suppose there is a difference between a nation's obligations that you might have to meet on Saturday, and a personal obligation.

Mr. MARTIN. Well, I worry enough, I can assure you of that.

Senator MALONE. Well, I am not trying to worry you unduly, but I just do not think we are in good shape by your own testimony.

Now, to finance a prospective Government deficit, should not Secretary Anderson organize staffs and campaigns to sell Government securities to the people and avoid sales to banks, if we wanted to get away from this situation?

Mr. MARTIN. As far as he can, I think he should.

Senator MALONE. Would not this procedure put the Government financing and our currency on a sounder foundation than we have been and are building through recent and current practices?

Mr. MARTIN. I think the Treasury has been trying to do that, sir.

Senator MALONE. I hope that it has. And I have every confidence in Secretary Anderson, just like I had in Secretary Humphrey, that under a bad situation, an almost impossible situation, that he will somehow or other survive.

If our Government had to fall like France's every time it failed to do the proper thing, I expect we would be changing about as often as France does.

We had the testimony of a very prominent individual here not very long ago, Mr. Baruch, who testified that we never should have gone off the gold standard in the first place.

What do you think about it?

Mr. MARTIN. I think it would have been well if we could have stayed on the gold standard. I was never in favor of the shift in the Gold Act of 1934, of changing the price of gold, but I think the way the world has developed, that the modified gold standard which we have, barring the redeemability that you and I have discussed so much, has served us quite well and effectively, and I think that we should——

Senator MALONE. You mean we have arrived at 1958 with our money still buying ham and eggs?

Mr. MARTIN. That is right.

Senator MALONE. Regardless of the cost of production?

Mr. MARTIN. That is right.

Senator MALONE. How much further do you think we can go if we keep up the inflation pace?

Mr. MARTIN. That I don't know, Senator.

Senator MALONE. Do you have an idea we are in any danger?

Mr. MARTIN. I think we have some very, very real problems confronting us, not only domestically but internationally.

I have been very impressed with your comments on Bulganin and Khrushchev.

Senator MALONE. Our difficulty right now is that, whether we like their system or not—and my opening remark to Mr. Bulganin was, "We don't like your system and you don't like ours, so that is a good starting point"—they are making it work, whether we like it or not, are they not?

Mr. MARTIN. Right.

Senator MALONE. And the fact that their cost of production is lower and their purchase of food and clothing is in balance, gives them an advantage?

Mr. MARTIN. Right.

Senator MALONE. How do we think we are going to compete in a world market, then, with our inflated currency and cost of living?

Mr. MARTIN. Well, that is a problem. That is one of the reasons we have got to hold inflation down and get on a competitive price basis. You put your finger on it.

Senator MALONE. Do you think there is any chance of our getting on a competitive basis with anybody in the world markets today?

Mr. MARTIN. Yes. I am more hopeful.

Senator MALONE. How would you do it?

Mr. MARTIN. By efficiency.

Senator MALONE. My friend, I have some news for you. Every nation in the world—and that is the reason I went to every nation, to see their industries, to see their productivity, their plants, and their mines, every nation in the world can get our know-how and machinery. I have, for example, hanging in my office the helmet and the harness used to inspect the tin mines in Bolivia. How do you think we are going to compete with our inflated currency, with the $2 or $3 wages in all these nations of the world, like Mexico; South Africa, maybe a dollar a day when a man is promoted to a straw boss? How are you going to do it?

Mr. MARTIN. We have been successful.

Senator MALONE. I beg your pardon, we have not.

We have paid to Europe $70 billion since World War II for them to build up a dollar balance for which, your own testimony says, they can demand gold, and to build plants and develop mines to compete with us with their low-cost wages.

Do you think that is competitive?

How do you mean we have been competitive?

Will you explain it to me?

Mr. MARTIN. Well, I think on a price basis, Senator, that we have, by and large, been able to compete in the world markets over a period of the last few years reasonably successfully.

Senator MALONE. You do?

How can you say that? What makes you think so?

Mr. MARTIN. I think it is the efficiency of our labor and technological processes.

Senator MALONE. Would it be news to you——

Mr. MARTIN. I have not been to many of these countries as you have——

Senator MALONE. I have inspected all of them. I even went into Lithuania, where there is hardly room to land a plane, and I only knew about it because Jack Sharkey was a pretty good fighter and he was a Lithuanian and that is all I knew about Lithuania until I landed there.

This I am going to tell you and it will pay you to study it before you testify before another committee and make such statement again.

The last plant in the world, whether it is a textile plant, a smelter or a mining operation, or machine tool operation, is the best plant in the world because it is the last one.

Did you know that?

Mr. MARTIN. Well, there certainly has been a tendency that way.

Senator MALONE. Tendency—I spent 2 weeks in northern Chile, for example, spent much more time in Chile than that, but 2 weeks at one place. Where do you think the finest smelter in the world is, the most efficient copper smelter, where do you think it is?

Do you think it is in Salt Lake City?

Do you think it is in Phoenix; do you think it is in Ely, Nev.?

I have news for you; it is in northern Chile because it is the last one and this is what we do, I say "we" we Americans are smart. We take anywhere from 3 to 7 or 8 percent of American top workmen and go into these countries and train these native workers and with our piecework method in about 2 weeks to 30 days, they are making a hand and they do it just as good as an Irishman or a Dutchman. Therefore, practically the only difference is the difference in wages, the differences in wages and the manipulation of their money supply in terms of the dollar which they practice all the time.

I hope that you will study this and not testify again that we can compete on an even basis with anybody.

Mr. MARTIN. Of course there has been a little inflation in Chile, you know, too.

Senator MALONE. A little but when they can get 14 cents a pound for their copper, they will make just as much money as they make in Ely, Nev., at 30 cents; is that news to you?

Mr. MARTIN. Just comparing it with our currency, I would say the rate of inflation in Chile has really been spectacular compared to ours.

Senator MALONE. Let me explain what happens there.

You see you are in a field I have been studying.

Mr. MARTIN. Right.

Senator MALONE. So when I went to Chile there were seven values for the peso.

One was the value that the companies, the copper companies had signed up many years previous, to pay a dollar for every 19.37 pesos.

The banking rate was 160 pesos to the dollar.

The street rate was about 190, which made their labor cost them about $8 or $9 a day but the workingmen were getting $2.40 per day.

I had a long talk with the Chilean President, one of the finest men I ever met. He is the one who just canceled a trip over here.

Mr. MARTIN. President Ibanez; yes, sir.

Senator MALONE. That is right. I know him very, very well, I mean as well as you can get acquainted with a man in a very short time. He is a fine man.

The only dictators and presidents of these South American nations I did not see were one in Equador that they just run him out into the timber and I could not find him, and the other one was President of Panama and they just shot him the night before.

They had just shot the King of Siam about a week before I got there in 1948.

But I did the best I could and talked to his possible successor or someone who was temporarily taking his place. But this President of Chile is a fine man and he does not understand what we are doing, and since we do not understand it either it becomes quits.

He called those copper companies in very soon after my visit and adjusted the price of the peso in terms of the dollar nearer the market price, and then more investments were made in Chile which I knew were ready and so informed him.

Because over an engineering business of 30 years I know how these matters are handled. No further money would have been invested until the price of dollars in terms of the peso would have been invested.

That is the first thing you determine.

The President agreed with me. He called his Senate together, and I talked with them. I was and am very much interested in Chile and in their welfare, but I am also interested in the welfare of the people in Ely, Nev., and in the economic system in the United States. In Ely alone there are about 1,400 of our men on the street today on account of imports of copper.

I am just going over to the floor when you and I get through and I will make a statement for the record and if you will look at the Congressional Record in the morning, providing I get there before Congress adjourns, you will see it and know why I am interested in your manipulations of our economy.

There were 3,500 employees there, and due to imports of copper they are down to 1,200 or 1,400 folks out of work and the copper smelter in Ely is no more efficient, if as efficient, as the northern Chile smelter. So the difference in wages is important.

If you will study the situation it will scare you to death.

My heart goes out to you with all the responsibility you have to manipulate our currency and our economic structure so that everyone will make money. There are hundreds of areas in the United States today exactly parallel to Ely, Nev.; Winnemucca, Nev.; Henderson, Nev.; Piche, and Caliente, Nev., shut down because of the idiotic free trade policy of bringing lead, zinc, tungsten, metals, wool, beef, lumber, and hundreds of other products into this country from the 2- or 3-dollar wage of foreign nations.

These are largely American investments. Did you know there were more than $50 billion of American investments in these countries with some of the best plants on earth, shipping the stuff back here, with the low-cost labor.

Did you know that?

Mr. MARTIN. I knew it was substantial.

Senator MALONE. Well, that is substantial, I should say.

Then you have four lending organizations, one of them the Import-Export bank and the World Bank that Mr. Henry Dexter White organized, and two other organizations that lend money to nations and to American investors that go there to use the cheap labor and bring the stuff back here at a price that no American workingman or investor can compete with.

Textiles coming from Japan manufactured with 20-cents-an-hour labor, with American investors, American machinery, and no one is going to say successfully that the Japanese cannot do as much work as an American in a day.

Down in Henderson, Nev., they were making approximately half of the titanium used in the United States—the new metal with the highest weight strength ratio of any known metal and a high heat resistance We are making about half of the titanium made in the United States, Du Pont is making the other half here in New Jersey; last year they imported more titanium from Japan, with American investors and our process at 20-cents-an-hour labor than they made at Henderson.

They have just laid off 500 men at Henderson as a result.

Do you think we can compete with them?

Mr. MARTIN. Did you go to Japan on your trip?

Senator MALONE. Yes, I went to Japan.

I inspected the place we hit with the bomb, and Tokyo, including the industrial areas.

Does that change your mind at all about our competing with foreign nations' workingmen?

Mr. MARTIN. Well, I still think we can. I hope we will——

Senator MALONE. Our American corporations are in these countries. Any conclusions that we can compete with them with our higher standard of living is just so much hogwash.

Our crockery industry is gone. If you have any doubt send your wife down to the stores. She will tell you.

It is gone.

They can make precision instruments like binoculars for one-fourth of what you make them here and just as good quality.

As long as 1948, 1949, 11 or 12 years ago, on my desk I put a sewing machine on one corner, after I came back from Japan, made by Japanese, it looked almost exactly like the Singer sewing machine on the other corner of my desk. Twenty feet away you could not tell them apart and the trademark of Japan was underneath so you had to turn it over to see it.

Each guaranteed to do the same thing, same kind of work. What do you think the difference in price was?

Ours was $72 wholesale, and their was $19.

Why this is crazy, it is the craziest thing on earth and men like you should not testify to something that is so obvious to everybody is wrong. I appreciate your situation in saying those things because I know you have been so busy regulating the economy you have not paid much attention to it.

Mr. MARTIN. Well, you have given me a lot of food for thought.

Senator MALONE. It is not going to be food very long.

These men are on the street and they are going out in droves every day.

That is not what I came over here to talk to you about, however much I appreciate the willingness of this witness, Mr. Martin, who, in my opinion, is doing as good a job as can be done under the congressional acts applicable to the regulation of our economy.

It is just a responsibility that should not be on any one person's shoulders.

If we continue what we are doing without tying our money to a solid base, we are not going to stop inflation. It is going to get worse.

We are now breaking the backs of the American investor and the American workingmen, and we will live to regret it.

One of the finest chemical manufacturers in the United States told me 3 years ago when we had this matter before this committee to extend the 1934 Trade Agreements Act for 3 years, 1955 to 1958, which we did and it now expires in June 1958 of this year, he told me then, he said, "I can invest my money in Germany or outside of the United States and compete, but I do not want to do it." He was in my office a few days ago and said, "I now have the plants in Germany. But I still do not want the 1934 Trade Agreements Act extended because I would rather do the business here." But, he said, "I have done this in self-defense"—that is what you are doing to our own American people.

Automobiles—Ford and General Motors own about three-fourths of the automobile plants over there.

The cars are coming in. I should not have to tell you that.

So I appreciate your testimony very much. I would like to keep in communication with you because we believe that you are really trying to do a job—it is not your fault that all this responsibility should not be loaded on you. No human or group of human beings could possibly carry the load, in my opinion.

I think we have to get back to principles laid down by Congress. If I make a wrong investment I suffer for it, and if my judgment is good, I win.

This way you printed the money to pick up the check of each failure to keep everybody in business.

There is no such thing now as a safety valve for the economy.

A railroad will run just as good under a receivership as it does any other way and the air is squeezed out of it so that it can make a profit charging reasonable freight rates.

Still it appears that we are about to print a few more billion dollars and buy the railroads. So then we load a debt on top of a railroad already too far in debt to pay out.

Do you agree with that?

Mr. MARTIN. Right.

Senator MALONE. Mr. Chairman, that is all, and I thank you very kindly.

Mr. MARTIN. I appreciate your comments, Senator.

Senator MALONE. I am only 1 out of 96.

My friend, you do not need to worry, I think.

Senator BENNETT (presiding). The committee will now recess until 10 o'clock tomorrow morning, to hear Dr. Seymour Harris and Dr. Charles Abbott, if the time permits.

(Whereupon, at 5:20 p. m., the committee was adjourned, to reconvene at 10 a. m., Thursday, April 24, 1958.)

INVESTIGATION OF THE FINANCIAL CONDITION OF THE UNITED STATES

THURSDAY, APRIL 24, 1958

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 (chairman), Kerr, Frear, Long, Anderson, Gore, Martin, Williams, Carlson, ~~Bennett, and~~ Jenner.

Also present: Elizabeth B. Springer, chief clerk, and Samuel D. McIlwain, special counsel.

The CHAIRMAN. The meeting will come to order.

The Chair regrets that the Senate, meeting at 10:30, makes it necessary that we start now. Other members of the committee will come in later.

The first witness today is Dr. Seymour Harris.

Dr. Harris is chairman of the department of economics at Harvard University. He is a noted economist, who has written extensively on economic subjects. His teaching career has been centered at Harvard University, where he received a Ph. D. degree in 1926.

In addition to teaching and writing, he has served as adviser to several Government agencies here in Washington. Last year Dr. Harris appeared before the Finance Committee on April 3 in connection with the hearings on H. R. 5520, a bill to increase the maximum interest rates on certain United States savings bonds.

Dr. Harris, I express the appreciation of the committee for your appearance here today. You may proceed in your own way.

Dr. HARRIS. Thank you very much, Senator Byrd.

STATEMENT OF SEYMOUR E. HARRIS, CHAIRMAN OF THE ECONOMICS DEPARTMENT, HARVARD UNIVERSITY

Mr. HARRIS. Mr. Chairman, if it is agreeable to you, I would like to put my statement in the record and summarize it rather than read it, so you will not be bored too much.

Senator BENNETT. Mr. Chairman, the only trouble with that is we will not have the chance for questioning Mr. Harris.

Mr. HARRIS. I will follow this, but I will just simply summarize rather than read. Is that agreeable?

You can take me on any point in the statement as well as anything I say.

The CHAIRMAN. I think that is an excellent idea, to put the statement in the record and summarize it.

Senator CARLSON. Having heard Dr. Harris before, we won't be bored with anything he reads or says.

Mr. HARRIS. Frankly, after many years of being at hearings, I can assure you it will be more interesting if I summarize it rather than read it.

Senator BENNETT. I have no objection.

The CHAIRMAN. Without objection, the statement will be inserted in the record.

And, Dr. Harris, you may make your statement.

(The statement in full is as follows:)

CONTENTS

THE FINANCIAL SYSTEM AND THE RECESSION

Statement before the Senate Finance Committee hearings on investigation of the financial condition of the United States, by Seymour E. Harris, chairman of the economics department, Harvard University

OBJECTIVES

In the last 75 years the Democrats have generally been associated with policies of monetary expansion and inflation, the Republicans with sound monetary policies. But in the last few years it has been the Democrats who have criticized the Republicans for support of inflationary policies.

The Democrats point to a 6-percent rise of prices in 2 years, accompanied by a restrictive monetary policy which failed to stop inflation and yet contributed toward a recession. In his statements before the Byrd committee, Secretary Humphrey time and again, as the President and Secretary had emphasized in the years since 1952, underlined stability of the currency as the number one objective of economic policy. A balanced budget was considered a facet of this policy of stability.

In contrast, the Democrats, though they now seek price stability, tend to emphasize this less over the years than the objectives of growth (expansion of output on an absolute and per capita basis) and equity. They seem prepared to sacrifice stability of the currency to some extent so long as the rise of output accompanying a small rise of prices is large, relatively speaking. They would not be unhappy with a rise of prices of 1 percent per year and a gain of output of 5 percent per year; but would be unhappy with an increase of prices of 5 percent accompanied by a gain of but 1 percent in output.

Democrats might risk an unbalanced budget if it stopped a serious recession, both because in their view the relative gain of output and the treatment of the underprivileged, e. g., the unemployed, would justify such a policy.

But I am not insisting that these distinctions relate to all members of both parties. But in a general way the Republicans are more likely to be interested in protecting savings and income of fixed income groups, whereas Democrats tend to stress output and distributive policies favoring low-income groups.

Inflation in a general way also raises issues of equity: the pensioner, the worker with relatively fixed money incomes suffers. But in a depression the uneven distribution is greatly increased, with many losing all claims to income. Hence the Democrats seem more disposed to attack directly the greater inequities of unemployment and risk the smaller inequities of a modest inflation.

HISTORY SINCE 1929

To understand current trends, we should reexamine briefly the history of the last generation.

First, note the table below. In current dollars the annual rise of gross national output (GNP) from 1929 to 1957 was $11.7 billion. In dollars of stable purchasing power, the gains were respectively 9.8, 6.9, and 5.7 billions as measured in dollars of 1957, 1947, and 1929 purchasing power.

That is to say, in 1929 dollars, the gain was roughly one-half as much as in dollars of current purchasing power. That is, inflation accounted for one-half of the rise of GNP. The large increase of prices is associated primarily with war.

TABLE 1.—*Gross national product (GNP), 1929–57*

[In billions of dollars]

	Total change	Annual
Current dollars	330	11.7
1957 dollars	240	9.8
1947 dollars	184	6.9
1929 dollars	161	5.7

Second, table 2 reveals that in dollars of stable value, the largest average increase in GNP occurred in the war years 1939–45. In the postwar reaction the gains were substantially small. From 1952 to 1957 there was further improvement.

Unemployment averaged 9 percent in 1929, twice as high in the 1930's, less than 6 percent in the war years inclusive of the semidepression years of 1939–40, and only about 4 percent in the postwar years.

The maximum unemployment was 24.9 percent in 1933; 17.2 percent by 1939; and a minimum of 1.2 percent in 1944.

In the last three columns of this table we compare the relative rise of GNP and of the cost of living. The best record was made in 1933–39, with a gain of seven times as much in output as in cost of living; the least satisfactory record in 1945–52 and 1957, when the rise of output was but one-quarter as large as that in the cost of living. But these ratios do not tell the whole story. The largest rises of output occurred in the war years; but the inflation also was large.

TABLE 2.—*GNP—1947 dollars, total and annual; rises by periods and percent of unemployment; and percentage rise of output and cost of living.*

	Total (1)	Annual (2)	Unemployment, percent of civilian labor force (3)	Percent rise gross national product, 1947 dollars (4)	Percent rise, cost of living (5)	Percent rise, gross national product / Cost of living (6)
1929–57	+184	6.9	9.5	124	+64	182
1929–33	−45.6	−11.4	18.3	−31	−27	194
1933–39	+53.7	+8.9	18.2	+52	+7.4	703
1939–45	+105.5	+17.6	5.7	+67	+29	231
1945–52	+30.6	+4.4	3.9	+12	+48	25
1952–57	+41.0	+8.2	3.9	+14	+5.8	241
1956–57	+2.7	+2.7	4.0	+.8	+3.3	24

NOTE.—1933, maximum, 24.9; 1939, maximum, 17.2; 1944, maximum, 1.2.

As low as our unemployment was in the years 1947–56, it averaged about twice as high as British unemployment. With so little unemployment and hence reserves of labor, a given excess of demand is bound to have a large effect. Hence the much greater rise of prices in Great Britain can be associated with an economic policy that sought to keep unemployment at a minimum level. Actually in the first 10 years of the postwar, unemployment in the United Kingdom averaged less than 2 percent as compared with 4 percent in this country; but prices rose 3 times as much in the United Kingdom.

WHY THE RECESSION

A. Plant and equipment

To many the recession is the usual cyclical setback. Excess capacity related to a capital boom is the disease diagnosed by many cycle theorists.

From 1946 to 1957, the investment in plant and equipment was close to $300 billion, and in inventories about $53 billion. In view of the effectiveness of a dollar of investment and the total amount outstanding before this boom began, it is not surprising that a common view is that excess capital formation is the explanation of the recession; and in the view of many, the recession will continue until excess capacity is reduced adequately.

B. Fiscal policy

But this is not an adequate explanation. "Excess" is a relative term. How much capital is needed depends in part upon the growth of the economy and the availability of purchasing power.

Hence any policies that interfere with growth or the expansion of monetary supplies may increase excess capacity; for demand and buying are reduced.

In this connection, Federal fiscal and monetary policy should be carefully scrutinized.

Thus in calendar year 1955, the Federal Government deficit on a cash basis was $729 million; but in 1956 this was converted into a surplus of $5,525 million, and in 1957, one of $1,194 million. In short, the Government had become an absorber of potential spending funds instead of a net disburser, and hence contributed toward inadequate buying.

In this connection, the large cut in new defense contracts in the second half of 1957 should not go unnoticed.

On orthodox budget accounting, deficits of fiscal years 1954 and 1955 were $3.1 and $4.2 billion; but in 1956 and 1957, surplus of $1.0 and $1.6 billion. Just as in 1937–38, a marked change in the relative income and outgo for the Federal Government had contributed to a business recession.

C. Monetary policy: Its failure

Undoubtedly monetary policy contributed to the recession.

The Federal Reserve introduced a dear money policy that cut the increase of active money to 3 percent in 1956 and 1 percent in 1957. On the basis of past history, expected growth, and in particular the tendency for the ratio of cash held to income to rise, this was a highly restrictive policy.

Had the Reserve stopped the inflation, something could have been said for this policy. But the failure to contain the inflation and the contribution to the recession spelled failure of this policy.

What high money rates meant to the economy is suggested by the declining rate of expansion of consumer and housing credit (see below). It is especially in these areas that the higher rates were felt. Business investments continued to mount until the latter part of 1957. In February 1958 consumer credit actually declined. Housing, consumers, and local government credit are especially affected by unavailability of credit and higher rates. A 1-percent increase in rates, for example, accounts for an increase of monthly rent of $10 for low-income groups.

[Billions of dollars change]

	1955	1956	1957
Consumer credit	+6.4	+3.4	+2.7
Mortgage debt	+16.2	+14.7	+11.6

D. Monetary policy and the Government bond market

This restrictive monetary policy had unfortunate effects on other counts. It amounted to an induced desertion of the Government security market. Whereas in the years before the 1951 accord, the charge was made that monetary policy was subservient to the Treasury, in 1956-57 the monetary authorities could be criticized for introducing a policy which largely abandoned the interests of the Treasury.

Thus from 1954 to 1957, financial institutions, under pressure of induced higher rates and unavailability of credit, disposed of $19 billion of public securities. Purchases of $15 billion by Federal agencies, State and local governments, individuals, etc., required a substantial drop in prices, that is, a large increase in rates that increased the annual costs of financing the debt by a billion dollars in 8 years, or about 15 percent. (The amount outstanding declined by a few billion dollars.)

E. Why the failure of monetary policy: Relevance of financial intermediaries

This failure of monetary policy to stop the inflation may be associated in part with the usual difficulties of monetary policies as evident over the history of the Federal Reserve System, in part with the declining significance of that part of the monetary and credit structure over which the Federal Reserve has control, and in part with the increased effects of cost policies upon prices.

Over the years the Federal Reserve has been fearful of introducing dear money policies that might bring a business reaction. The 1927-29 experience is the classic case. Aware that dear money policies if long continued would contribute to a depression—and it inevitably has—the monetary authorities chose to maintain output. But Mr. Martin was of a different viewpoint and he must be given credit for courage.

In the years since prewar, the Federal Reserve position has been greatly weakened by the increased importance of the financial intermediaries—Government credit agencies, insurance companies, savings and loan associations, finance companies, etc. Indeed, by controlling the supply of money, the Federal Reserve has an indirect influence on the intermediaries. But the relationship of monetary supplies and the activities of the intermediaries is a loose one. They can operate with varying amounts of cash and Government securities.

In this connection, the great advance of loans and guarantees by the Federal credit agencies is of interest. Note especially the rise of guarantees and the continued expansion of both items even during periods of monetary restraint. Apparently the Treasury and Federal Reserve were not on speaking terms with the credit agencies.

[In billions of dollars]

	Fiscal year 1953	Fiscal year 1958 (estimated)	Fiscal year 1959 (estimated)	Percent rise, 1953-59
1. Loans and investment	16.5	19.0	20.3	23
2. Guaranties and insurance	28.4	60.9	65.9	132

What greatly weakens the potency of the Federal Reserve is the large growth of housing and consumer credit, two types of credit largely absorbed by financial intermediaries not under the direct control of the Federal Reserve.

Thus, mortgage loans and consumer credit rose from $42 to $180 billion from 1941 to 1957. Financial intermediaries other than the commercial banks primarily provide this credit. But commercial banks are the direct target of the Federal Reserve. Commercial banks account for 15 to 20 percent only of this type of credit.

What is more, whereas the earning assets of commercial banks rose by 21 percent from 1951 to 1957, assets of life-insurance companies increased by 48 percent, and of savings banks by 155 percent, of Government credit agencies (guaranties and investments) by 118 percent.

In the light of the increasingly complex problems of the financial intermediaries, it is a striking fact that in the Byrd hearings Messrs. Humphrey, Martin, and Burgess said not a word about the possibility of improving integration with the Treasury and Federal Reserve, and control of these agencies. Indeed, when questioned by Senator Anderson, the Secretary of the Treasury admitted that Federal credit agencies had gone too far in guaranteeing credit.

F. Monetary failure: Liquidity of the economy

Not only is the Federal Reserve's influence undermined by these developments, but the high liquidity of the business world is another obstacle. The Federal Reserve admitted as much in its February 1958 Bulletin.

The fact is that as the Federal Reserve pressured the commercial banks and the latter in turn slowed up their expansion of loans to business, corporations reduced their cash balances and increased their sales of securities to the public.

New issues of corporations rose from $7 billion in 1955, to $8.2 billion in 1956, and $11 billion in 1957. In the years 1956 and 1957 they reduced their holdings of cash and securities by $4 and $1.5 billion.

It is not surprising then that all savings made available to corporations remained as high in 1956 and 1957 as in 1955, when all uses of savings had risen from $21 to $30 billion.

Incidentally, total savings remained roughly unchanged in 1957, despite the theory held by the Federal Reserve that the objective of monetary policy was to increase savings and reduce investment. Ultimately, investment began to decline, and by 1958 the reduction of income is likely to reduce both savings and investment.

G. Monetary failure: Cost inflation

The final barrier confronting the Federal Reserve is the tendency of wage rates to rise in excess of the percentages suggested by rising productivity—not in the highly productive industries, but overall—and of many industries to raise prices more than costs.

This is the inflationary cost push. A drastic monetary policy may then prevent a rise of prices and especially if supported by adequate fiscal measures. But the price is almost certainly likely to be a serious decline of output.

Apparently the Federal Reserve was prepared to risk this.

In short, a recession of fairly serious proportions followed an investment boom. A restrictive monetary policy which on the whole favored corporations against small business and local and State governments, and a turnover from fiscal expansionist to contractionist policies contributed to the reversal of business conditions.

THE CURRENT STATE OF THE ECONOMY

Most signs in April point to a continued recession. Indeed, as the Federal Reserve has suggested, with the exception of the 1929–33 depression, declines have not continued for more than a year. Hence, with a turning point (down) in the middle of 1957, the next turning point (up) should be around June. But most economists are not disposed to be that optimistic.

Signs are not too favorable. Unemployment in February 1958 was 2 million in excess of a year earlier, or a rise of about 60 percent. In addition, the hourly week had declined by almost 4 percent, or the equivalent of about 2½ million additional jobs. Hence, the total equivalent rise of unemployment is about 4 to 5 million.

All the active factors point to a serious recession.

Plans for business investment suggest a decline of 13 percent for 1958. In fact, the decline is likely to be larger, for with a depression psychology plans tend to be revised downward. Any expansionist programs must offset this serious decline.

In addition, purchases by consumers are begining to reflect the business decline and loss of confidence. The market for autos and homes for credit especially are affected. This setback accompanied the higher money rates and is related to the decline of investment and the rise of Federal Government surpluses. The Michigan Survey Center points to declining confidence of consumers.

A comparison of the following points to the trends. Large losses of investment inclusive of inventories are to be found especially by comparing the fourth quarters. Consumption stayed up well but did not give the lift as in earlier quarters. Government purchases of goods and services continued to rise—but not the excess of expenditures over receipts. A crucial item is the unusual excess of exports, a stimulant not likely to be maintained at the 1957 level—the excess of exports was $7.8 billion in 1957, as compared to $4.7 billion in 1956 and $4.2 billion in 1955. The balance on goods and services was $8.1 billion in 1957 and $6.8 billion in 1956.

TABLE 3.—*Gross national product and some components, 1956–57*

[In billions of dollars]

	1956	1957	4th quarter 1956 [1]	4th quarter 1957 [1]
Gross national product	414.7	434.4	[1] 426.0	[1] 432.6
Personal consumption expenditures	267.2	280.4	272.3	282.4
Gross private domestic:				
(a) Investment	65.9	64.4	68.5	61.3
(b) Change in business inventories	4.6	.8	5.1	−2.7
Government purchases of goods and services	80.2	86.4	82.8	87.0
(a) Federal	47.2	50.4	49.0	49.7

[1] Seasonally adjusted. Federal Reserve Bulletin, February 1958.

It is clear that new purchasing power to be injected into the economy must offset reductions of business investment, of inventories (an annual rate of decline of about $3 billion in the 5 months ending January 1958 as against an annual rate of rise of about $3 billion in the preceding 7 months) and of the excess of exports over imports in all of the order of 10 to 15 billion dollars (annual rate). Any reduction of consumption are indeed additional—and housing and autos are experiencing declines of purchases.

Many seem to believe that the major declines are in autos and housing. For example, Senator Javits opposed a tax cut on the grounds that the depression was in housing and autos where the stimulus of a cut would not be effective in increasing purchases.

But note the following:

Percent decline, industrial output, from peak in 1957 to January or February 1958 [1] *(seasonally adjusted)*

	Percent	Month
Industrial production	−11	February.
Manufactures	−11	Do.
Durables	−16	Do.
Primary metals	−31	January.
Metal fabrication	−12	Do.
Fabricated metal articles	−9	Do.
Machinery	−12	Do.
Transportation equipment	−13	Do.
Autos	−20	Do.
Clay, glass, and lumber	−11	Do.
Furniture, etc	−9	Do.
Nondurables	−5	February.
Textiles	−9	January.
Rubber and leather products	−13	Do.

[1] Federal Reserve Bulletin, February 1958.

THERAPY

A. *Monetary policy*

Our problem is largely that of increasing purchasing power and purchases as the means of stopping the decline of output and the rise of unemployment. Capacity is available; demand is inadequate.

Once investment begins to decline, there should be a drastic reversal of monetary policy. Excessively concerned over inflationary trends, the Federal Reserve has moved altogether too slowly. Its first steps in the latter part of 1957 were too late and too little.

In 1957 the Federal Reserve disposed of $790 million of securities and in the first 9 months of 1957 no less than $1.7 billion. This was a very restrictive policy. Yet for many months after the turning point the Federal Reserve did nothing; and even today we have had a rise of reserves through reduced requirements of but one-half billion dollars and a few rather inconsequential cuts in rates.

Although the turning point occurred in the middle of 1957, the Federal Reserve did nothing until late in 1957, and even since its measures have been halfhearted. The table below shows the degree of inactivity. Reserves of member banks are but 1 percent in excess of those a year ago and 1 percent less than at the turning point. Discounts are roughly unchanged. In the open market the reserve banks as an expansionary factor have increased buildings of Government securities by but $480 million, or 2 percent.

It is well to compare these activities with those of the Federal Reserve in the great depression.

In the years 1930–32, the Federal Reserve increased its holdings of Government securities by $1.7 billion, or by about 250 percent. A corresponding increase in 1957–58 would involve an increase of about $55 billion to $60 billion of public securities held—not one of a few hundred million dollars.

We are not suggesting purchases of these proportions. But what has the Federal Reserve to lose in purchasing a few billion dollars additional of securities? A rise of $1 billion to $8 billion in member bank reserves even (with debts to the reserve largely repaid) might do some good and certainly would not do any harm. One result would be downward pressures on interest rates, a condition for recovery.

TABLE 4.—*Reserves, discounts, and Government securities held, Federal Reserve banks, 1957–58*

	Feb. 27, 1957	June 30, 1957	Feb. 26, 1958
Reserves....billions of dollars..	18.68	19.17	18.91
Required reserves....do..	18.22	18.62	18.44
Excess reserves....millions of dollars..	465	546	470
Discounts and advances....do..	713	1,003	153
U. S. Government securities....billions of dollars.	22.85	22.95	23.38

Source: Federal Reserve Bulletin, March 1958.

What is the Federal Reserve waiting for? Indeed, monetary policy in a recession can be of only limited usefulness; but that does not excuse inactivity.

B. Tax cuts

What are the other measures available? A tax cut is one. Much sentiment is to be found for a tax cut. In 1954, an $8 billion tax cut was widely acclaimed as a successful therapeutic measure. Actually it was not so important as is often suggested, for it could be interpreted as an offset to the large reduction of Federal spending of 1954. In many respects the problem was simpler in 1954. Confidence was at a high level, and investment markets had not yet become saturated. Furthermore, neglecting issues of equity, the Government concentrated relief on business and other high income groups, thus stimulating investment.

Now confidence has been impaired and a reversal of investment trends is more difficult. The decline in stock market values is also a deterrent.

A tax cut should be under consideration nevertheless. In the present state of the capital market, the emphasis should be on relief to consumers. But dollar for dollar a tax cut is less effective than a dollar of spending. To some extent tax cuts are absorbed in additional saving.

The Joint Committee on Internal Revenue Taxation (Alternative Plans for Tax Relief for Individuals, 1958) has made the following estimates of costs of tax relief:

	Millions of dollars
1. Quickie tax relief: Reduce withholding tax from 18 to 0 percent. For a 6-month period beginning July 1, 1958, the costs would be..	6,000
2. Change in exemption: rise from $600 to $700: The cost would be.. Those with incomes of less than $5,000 would gain $1,092 million (almost 40 percent).	2,764
3. Increase exemptions from $600 to $650 and provide a 5 percent reduction in taxes. Cost.... Those with incomes of $5,000 or less would gain $901 million (or less than 29 percent); large gains for high income group.	3,140
4. Tax credits: a $20 tax credit; this would cost.... Those under $5,000 would gain 43 percent.	2,548
5. Reduce rates by 2 percentage points in all brackets: Cost would be.. The gains would be 24 percent for those with incomes of less than $5,000, 44 percent for those with incomes of $5,000 to $10,000, and 32 percent for those with incomes of $10,000 or over.	3,123

	Millions of dollars
6. Split rates of first \$2,000 taxable income: 10 percent for first \$1,000; 20 percent for next \$1,000; cost would be	6,958

	Percent
Under \$5,000, gains	40.8
\$5,000 to \$10,000	50.1
>\$10,000	9.0

	Millions of dollars
7. A 10 percent reduction in tax: Cost would be	3,059
Incomes under \$5,000 would gain 20 percent; \$5,000 to \$10,000, 30 percent; >\$10,000, 41 percent.	
8. Reduce individual rates from a top 91 percent to 42 percent and the starting rate from 20 to 15 percent—in 5 stages over 5 to 9 years. Cost:	
1 year	2,302
Full effect	11,491
Percent gains in toto: equals 16, 31, and 52 percent for the 3 groups (\$5,000, \$5,000 to \$10,000, and over \$10,000).	

Possibly some cuts in excise taxes would also be appropriate. Of revenues of about \$10 billion, the Federal Government collects more than one-half of the excise taxes from tobacco, alcohol, and gasoline. A case might be made for cutting taxes on automobiles, communications, transportation, retailers excises, recreational items, amusements, etc., by one-third. The cost would be about \$1 billion.

But though I would be prepared for such cuts, I am not insisting on an immediate cut of taxes.

c. Expenditure policy

In the original presentation of Keynesian antirecessionary economics, the stress was put upon rising public expenditures financed out of deficits as a cure for depressions. One reason for this emphasis was the application of the multiplier principle, that is, of the relation of the ultimate rise of income to the original expenditure.

But in more recent years the emphasis has been shifted to tax cuts. First, because their effects are likely to be more immediate. Second, and related, because spending programs take time to effect especially if they are to be useful. Third, tax cuts seem to be more popular with the electorate than more public spending out of deficits.

In the present situation both tax cuts and increases of public spending are likely to increase deficits. But it should be stressed that any rise of income related to these policies may well offset, or more than offset, these effects. This assumes, of course, that the policies are reasonably effective.

At present (April 1958), the prospects are for a substantial deficit in any case. Expenditures are likely to rise by a few billion dollars aside from special antirecession measures; and estimates of revenues for the fiscal year 1959 are excessive, given the effects of the recession. Generally a business downturn brings both reduced income and curtailed expenditures, and especially the former. But in view of the security crisis and the increased willingness to act quickly in a recession, expenditures are likely to rise by several billion dollars above the January 1958 estimates for fiscal year 1959.

We can look forward to a deficit of \$5 billion or more without the use of antirecession measures. Should we increase expenditures and cut taxes \$5 to \$10 billion additional, then the net effect might be a larger deficit. But a substantial expansion program, if boldly introduced, might stop the decline and induce recovery. Then, instead of increasing deficits, the effects might be a rise of income and a reduction of deficits.

I am inclined to favor increased expenditures as the first attack, though I would hold tax cuts as a second line of defense. But we must be bold.

The case for expenditures rests on higher multiplier than tax cuts and the distorted pattern of spending by the American people. By the larger multiplier, I mean only that a dollar of public expenditures yields a larger total rise of income than a dollar of tax remission, in part hoarded in the first instance.

In re spending patterns, I note this point, that since 1940, the country has tended to move in the direction of increased relative private expenditures and reduced public welfare outlays relatively, e. g., on education, health, urban redevelopment, unemployment, etc.

D. Expenditures and growth

These outlays must, of course, be related to incomes and the demands of the military. How much additional we can afford depends on the growth of the economy. On the basis of past experience, we can look forward to a rise of GNP of $150 billion to $200 billion in 10 years. (Dr. Burns' estimate in 1956 was $200 billion.) This increase stems from rising productivity and the increased numbers on the labor market.

Indeed, the rise is not likely to be steady. Years of large rises like those of 1942, 1948, 1951, and 1955 are likely to be mixed with gentle increases or possibly even declines like 1946, 1954, and 1958. In some years there are likely to be deficits, offset by surpluses in the other years.

A program of $10 billion additional for civil benefits per year, say $100 billion in 10 years, starting with $5 billion and rising to $15 billion, or 5 percent of the increase of GNP, need not be excessive. And if well planned and distributed on the basis of antirecessionary needs it may cost the economy little if anything. The gains of income and even Government revenue may offset entirely or largely the rise of outlays.

E. Priorities in expenditures

Priorities should be determined on the basis of contributions to American life, to the treatment of recession and to the cost to the Federal budget. There are, indeed, other and related criteria. For example, the choice of fields of expenditures favors certain regions against others: Development of natural resources helps the West especially; roads, the sparsely populated areas especially; social security programs, the industrial areas; education, most States, though a Federal program tends to favor low-income States.

What is more, tax cuts favor especially the richer regions, though to some extent this is determined by the nature of the cut. For example, in view of the distribution of expenditures and taxes, Congressmen from the low-income States (e. g., South, West, and Mountain States) would tend to favor spending over tax reduction States. Congressmen from industrial States tend to favor improvements in unemployment compensation, urban development, and housing programs and tax reduction.

Table 5 gives some indication of the interests of different regions in more spending as against more tax cuts.

TABLE 5.—*Percent United States total, various indexes inclusive of Federal revenues and expenditures*

	National income, 1955, percent of United States total	Manufacturing wage and salary disbursements 1955, percent of United States total	Revenue incidence, fiscal year 1952 (United States=100)	Expenditure incidence, (United States=100)	Military prime contracts, 1950-54, percent of United States total	Estimated military purchases, 1952, percent of United States total	Expenditures, total, fiscal year 1952 (benefits) (United States=100)
	(1)	(2)	(3)	(4)	(5)	(6)	(7)
Total	100	100	100	100	100	100	100
New England	6.62	8.82	6.06	6.29	8.0	7.5	5.96
Connecticut	1.81	2.70	2.32	1.92	4.3	2.2	1.25
Massachusetts	3.29	3.79	4.10	3.03	2.6	2.9	3.07
Middle East	29.46	28.32	31.87	23.92	28.6	26.1	23.29
New Jersey	4.08	5.43	4.00	3.61	5.3	5.3	3.03
New York	11.95	11.26	15.86	9.60	15.5	10.1	9.02
Pennsylvania	6.83	8.72	7.28	6.28	4.3	6.9	6.75
Southeast	14.42	10.97	11.52	17.09	6.8	11.5	2 06
Southwest	6.65	3.40	5.62	8.22	4.7	6.2	8.25
Texas	4.06	2.31	4.04	5.41	3.5	4.6	5.44
Central	26.07	37.17	27.61	25.30	30.1	31.7	25.32
Illinois	6.91	8.24	7.60	5.21	4.9	5.7	5.48
Indiana	2.70	4.03	2.15	2.87	4.0	4.1	2.40
Michigan	5.15	5.03	4.69	4.00	8.9	5.5	4.10
Ohio	6.08	9.02	5.81	5.81	6.2	7.3	5.01
Northwest	4.60	2.09	4.03	5.43	3.0	3.9	5.73
Far West	12.62	9.90	11.76	13.14	18.7	13.1	10.62
California	9.70	7.62	9.00	9.56	14.4	10.5	7.61
Washington	1.71	1.34	1.57	2.48	4.0	1.8	1.76

Sources: Computed from U. S. Department of Health, Education and Welfare, Statistical Materials on the Distribution of Federal Expenditures Among the States, by Selma Mushkin, 1956; cf. New England Textiles and the New England Economy, Report to Conference of New England Governors, by S. E. Harris, 1956, ch. 12; also S. C. B., August 1956.

Comment.—Cf., for example, the Southeast; a small percentage of manufacturing in relation to income and a larger percentage of the Nation's expenditures than of revenue (i. e., contribution to Federal taxes); and the Middle East or New England, where the relations are the reverse.

Hence the Southeast is likely to favor spending over tax cuts; and spending policies on roads, natural resources, etc., rather than on unemployment relief.

But the Northeast stands to profit more from tax cuts and from spending on unemployment, relief, etc.

On the issue of priorities, I would weigh education, for example, more heavily than roads. But these are matters of value judgments, not primarily economics.

From the viewpoint of effects on the Federal budget, I would list the possibilities as follows:

1. *Least costly—Federal guaranties as in housing.*—(Note the large increases mentioned above.)

These might be greatly extended to guaranties of bond issues of State and local governments for school construction and other services; also to colleges for student loans. (This would be much the most effective Federal aid for higher education from the viewpoint of the Federal budget. Scholarships and tax remission for higher education are much more costly to the budget than a loan guaranty system.)

3. *Federal loans.*—These programs are also relatively costless compared to the results. (I do not include farm loans, which are disguised subsidies.) They could easily be extended to State and local government for necessary enterprises. Though we must note that because of tax-exempt features local governments and a fortiori State government can frequently borrow more cheaply than the Federal Government. At rates of borrowing charged equal to costs to the Federal Government, the advantages to the country are large. Even at a 1-percent subsidy, the outlays per year per billion dollars of loans are but $10 million per year.

At present, for example, the Government lends for college housing at 2⅞ percent. The amount available is $750 million. Extension of coverage, given the needs of higher education in the next 10 to 15 years, would easily absorb $5 billion to $10 billion. This amount is in excess of the half billion dollars per year the colleges can raise on their own. The funds might be made available at costs. In housing, a subsidy of 1 percent would greatly expand housing.

On grounds of equity as well as effectiveness of per dollar Government outlay, a great deal is to be said for an improvement of the unemployment compensation (UC) program and the area redevelopment program. The costs of these programs are not large. The liberalization of the UC program can be financed largely out of State funds now available, approximately $8 billion. (In the last 5 months of 1957, income roughly equaled benefits, not a very good record in a recession.) What is needed is minimum Federal standards and reinsurance by the Federal Government. In the next year, however, some help will be needed by the Federal Government to extend benefits and coverage along the lines of the McCormack-Mills bill. But now is the time also to introduce Federal standards, as proposed in the Kennedy-McCarthy bill.

Under both UC and an area redevelopment program, the advantage is small costs compared to benefits. Even when adjusted for the present rate of unemployment, the costs of the area redevelopment program need not exceed $500 million. For the payments are made when they are most needed. The process is not, as with most programs of spending, one of waiting for the spillover to affect the distress areas. Under usual public works programs much more has to be spent to achieve a given effect than through the direct approach, e. g., UC and area redevelopment.

But there should also be other programs as well. The Government is wrong to curtail programs in the midst of a recession, as the 1959 budget did. The Housing Act is a step in the right direction, though it does not go far enough. Expansion of the Community Facilities Act is also helpful. In fact, any programs in which State and local governments are asked to share costs are less costly to the Federal Government than those financed exclusively by the Federal Government and also have the advantage of wide distribution.

But we should not neglect our natural resources even when the burden is put exclusively on the Federal Government. These are costly outlays, and the immediate results are rather localized. But ultimately they increase our incomes, real and psychic, and the effects are gradually spread to other areas. The President was wrong to announce in January no new projects. He has had to retreat from this position, and he should yield more. So far the expansion has largely been one of redistribution in timing.

OUTLINES OF A COMPENSATORY PROGRAM

We seem to be moving to a point where, according to the CED, we may be operating at a level of 7 percent below that of productive capacity in the next few months. That means a loss of about $30 billion at an annual rate. Mr. Keyserling, the ex-Chairman of the Council of Economic Advisers, suggests that the loss in the first quarter of 1958 may be estimated at an annual rate of close to $55 billion. His larger estimate takes into account short falls even in 1957. Furthermore, unemployment is now in excess of 5 million, or with allowance for the reduction of hours, the rise has been from 3 to more than 7 millions in a year. With private spending declining at an annual rate of $10 billion to $15 billion, vigorous measures are required to deal with the problem.

The CED proposes a $7-billion tax cut and rescheduling of outlays. I would not rely exclusively on a tax cut but would choose first rescheduling and expansion of spending programs. I take this position because on the whole tax cuts favor the "haves" against the "have nots" and because there is some wastage in tax cuts. In part the increased income left to the private economy as a result of a cut is not spent.

This depends, however, upon the nature of the tax cut. For this reason, I would favor tax cut No. 6 on page 18, namely, the split rate for the first $2,000 of taxable income. The annual cost would be $7 billion; but it might be introduced for a 6-month period subject to renewal.

I should add that with a deficit of spending of $10 billion to $15 billion, say $12 billion, it is not necessary to increase spending and reduce taxes by an equivalent amount. The outlay or tax cut tends to multiply.

Hence, I propose a tax cut of $3½ billion (for 6 months) and public spending of $4 billion—both for calendar 1958. Obviously the total spending program at an annual rate must be larger if $4 billion above budgetary provisions (January 1959) are to be spent in calendar 1958.

The slowness of getting money actually spent points to the need of a tax cut. Furthermore, I favor spending programs that are especially effective in helping those in need—e. g., unemployment compensation or a rise in the aid for the old, or area redevelopment—rather than spending for public works which we hope will ultimately spill over and which might not be justified once the recession is over.

In the listing of programs below, I have taken into account those already approved in 1958 and some in process of going through Congress; and also the considerations mentioned above.

I must emphasize the point that such policies need not and should not increase the deficits. We start with a probable deficit of $5 billion for fiscal year 1959. With private spending declining, income falls and Government revenues suffer. A vigorous spending and tax cutting policy would stop the decline and raise income, and out of this additional income the Government's tax receipts would rise. In addition we would have worthwhile public assets and relieve distress.

Finally, I stress the point that though our primary purpose is to treat the recession, the policies required to give the Nation the civil benefits it needs, and the assurance of growth should receive careful consideration.

A POSSIBLE PROGRAM

A. Accepted or considered programs by the Congress

Estimated (on the optimistic side) amounts of additional spending though not all in 1958

	Billions of dollars
A community facilities loan program to States has made some progress	1.0
Roads: The Congress has approved a road program of about $7 billion for 2 years. The additional amount for fiscal year 1959 seems to be $625 million. In addition, there has been redistribution of substantial amounts over time in favor of outlays in 1958	.625
Unemployment compensation (UC): The McCormack-Mills bill proposes help from the Federal Government to deal with extension of UC in coverage and benefits. Since the cost of UC this year is likely to be about $8 billion (out of a reserve of $8 billion to $9 billion), the additional cost to the Federal Government would be at least $1 billion. The Kennedy-McCarthy bill also requires additional Federal funds but emphasizes also the need of Federal minimum standards and reinsurance	1.0
Area redevelopment: The Douglas and Payne bills required loan funds of a few hundred million dollars and rather small grants. But with unemployment almost doubled, the program would require about $500 million, mainly in loans	.500
Education: The administration bill calls for $1 billion over 4 years and the Democratic bill for $3 billion over 6 years. A compromise at about $400 million per year is likely. (This is in the budget for $250 million.)	.400
Housing: The Housing Act provides for $1 billion revolving fund for FNMA purchases of mortgages and additional guaranties. A rough estimate is about $500 million used this year	.500

The total involved is $4 billion. It is dubious that as much as $3 billion will be spent in this calendar year 1958 even if allowance is made for the rescheduling of some public works and small increase in new projects allowed by the President and acceleration by defense contracts.

B. Additional outlays

A strong case can be made for $2 billion additional for security outlays. (See the Rockefeller Report.) Budgetary considerations have played an excessive part in determining security outlays with unfortunate effects on the security position of the country.

I would also recommend an additional program of $2 billion (of which no more than $1 billion is likely to be spent in 1958) to cover increased outlays on public housing, hospitals, urban redevelopment, construction, aid in education, development of national resources.

All but the last would be matched by contributions of other governments or private sources.

Here are some suggestions of the order of magnitude.

[In millions of dollars]

	Current expenditures	Additional expenditures proposed, mainly 1958
Education, construction (all levels)		1,000
Urban renewal grants (204 cities on June 30, 1957)	241	[1] 300
Public housing, payments on 400,000 units	114	100
Hospital construction	112	100
National resources	1,492	500

[1] Legislation is proposed for additional authorization, not expenditures for fiscal year 1959.

C. Optimistic estimate of expenditures in 1958

Hence in all as a maximum, I should say, these programs would provide in 1958 the following:

	Billions of dollars
1. Maximum of $3 billion under programs already passed or far along. A likely figure is $2 billion	2
2. Additional security, 1958	1
3. Proposed additional programs, $2 billion—one-half in 1958	1
Total	4

This is not really adequate. Perhaps a billion additional may be needed for general aid, inclusive of liberalization of benefits under old-age insurance.

[Release date: April 24, 1958]

The Financial System and the Recession

Statement before the Senate Finance Committee hearings on investigation of the financial condition of the United States, by Seymour E. Harris, chairman of the economics department, Harvard University

(SUMMARY—PRIMARILY FOR PRESS)

Causes of the recession

Undoubtedly the investment boom was an important factor. In 11 years the country expanded its plants, equipment, and inventories by $413 billion.

Excess capacity is a threat though it is relative. The policies that impaired growth and buying power increased excess capacity.

Restrictive monetary policy contributed to the decline. The Federal Reserve raised rates and curtailed monetary expansion in 1956 and 1957 far below the amounts required by a growing economy.

This restrictive monetary policy is reflected in the reduced stimulus given by consumer and housing credits in successive years.

[In billions of dollars]

1955	20.8
1956	18.1
1957	14.3

A turnover from deficit financing to substantial surpluses also helped bring on a reversal—from a stimulative factor, that is, adding to spending, governmental finance had become a depressive factor, that is, reducing spending and paying off debt.

Cash income and outgo, Federal Government

[In millions of dollars]

1955: Deficit	729
1956: Surplus	5,525
1957: Surplus	1,194

EXTENT OF THE RECESSION

On numerous important indices (e. g., industrial production, steel production, new orders, mfg.) the recession has advanced beyond those of 1948–49 and 1953–54, and especially in the degree of pessimism which is not measurable.

Unemployment has risen in a year by 2 millions and by more 4 millions or 1⅛ times when adjusted for the cut in the working week. In some cities (e. g., Detroit and Buffalo) unemployment is approaching, or is in excess, of 15 percent.

The decline is especially great in manufacturing and hence substantially affects all census industries except paper and printing, chemicals and food products.

THE FAILURE OF MONETARY POLICY

Despite a vigorous policy, the Federal Reserve failed to stop the inflation and yet helped bring on a recession.

Excessive emphasis on the objective of an absolutely stable dollar—an emphasis also favored by the Administration, led to this debacle. The goal of growth was rather neglected?

Why the failure?

The authorities failed to deal with the financial intermediaries over which their control seems to be very limited. Yet these institutions (e. g., life insurance companies, Government credit agencies, pension funds) continue to grow much more than commercial banks through which the Federal Reserve tries to exercise their control.

Another reason for failure was the high liquidity of business. They could dispose of cash and securities to expand operations.

That the largest expansion was in consumer and housing credit also did not help the Federal Reserve. Commercial banks account only for 15–20 percent of this credit.

Finally, to stabilize prices with a large cost inflation could only be done by inducing unemployment through a restrictive monetary policy. This the Federal Reserve accomplished.

THERAPY

The spending of the private economy is running down at the rate of 10–15 billions per year. New spending must be injected by the Government at that annual rate, or at a lower rate if we allow for secondary effects of new spending or tax cuts. This is a condition for stopping the decline.

MONETARY POLICY

We expect a much greater lift here. The reserves and the excess reserves of member banks are much below what they ought to be. They are roughly at the level of a year ago and the high point of the boom.

What is the Federal Reserve afraid of? They should purchase several billions of Government securities as a means of increasing the supply of money and ultimately depressing interest rates—a must for recovery. This can do no harm and may do some good.

So far the Federal Reserve has shown much less acumen and courage in this recession than it displayed in 1931–33.

The policy of selling long-term Government securities in the midst of a recession is foolish and costly and should be stopped once and for all. These securities compete with private enterprise and keep rates up.

EXPENDITURE POLICY

We propose a spending program of $4 billion for calendar year 1958—above budgetary requests of January.

In listing the items, we take account of the congressional action and trends so far, of the need of more security outlays, and the wisdom of doubling outlays on hospitals, urban redevelopment and public housing. We also propose a rise of one third in spending on natural resources and a $1 billion program for educational construction.

It is especially important to stress the use of expenditures that directly help those needing it, for example, unemployment compensation—as against the more costly ones that need a spill over to be generally useful, e. g., public works.

The programs should also favor loans and guarantees against direct spending. Effects on budgets are less serious.

But though the primary objective is treatment of the recession, we also keep in front of us the important objectives of spending for civil benefits, e. g., education help, development of natural resources, and for growth.

TAX POLICY

I prefer a spending to a tax-reduction policy. The former favors especially those in need and yields larger results per dollar of cost to the Treasury than an equivalent tax reduction.

But tax cuts give quicker results, and we need immediate responses if we are to stop a snowballing of the decline.

Hence I urge a $3 billion tax cut for 6 months in 1958 (to be extended if necessary). My choice of alternatives is a splitting of the rate on the first $2,000 of taxable income—10 percent on the first $1,000 and 20 percent on the next $1,000. What is needed is a lift to consumption and this type of tax remission should contribute that.

IN GENERAL

We propose a really cheap money policy, a rise of spending of $4 billion and a cut of taxes of $3 billion in calendar 1958. Against a deficit in calendar 1958 of about $3–4 billion, the total gross deficit would then rise to about $10 billion.

But at present incomes this is equivalent to less than half of the annual deficits in the 1930's. What is more these expenditures and tax cuts should be largely if not wholly offset by additional tax receipts—and not to mention the needed public assets and services which would be made available.

Mr. HARRIS. Let me begin by saying that in a general way the Democrats have generally been associated with monetary expansion and inflation, although to some extent this charge has not been justified, and the Republicans with sound monetary policies; but in the last few years it has been the Democrats who have criticized the Republicans for support of inflationary policies.

We now know that the price level rose by seven-tenths of 1 percent in the last month and something like 6 or 7 percent in 2 years.

In his statement before the Byrd committee this summer, Secretary Humphrey time and again as the President and the Secretary had emphasized in the years since 1952, underlined stability of the currency as a No. 1 objective of economic policy.

Balanced budget was considered a facet of this policy of stability.

In contrast the Democrats though they now seek price stability emphasize more than the Republicans do the objective of growth and equity and I might say, Senator Byrd, I am going to try to be awfully hard to be nonpolitical here although I sometimes find that a little difficult.

I think the issue can be put in the following way: I think most of us would accept a rise of prices of 1 percent if output rose by 5 percent. But if the price level rises by 5 percent, and output rises only 1 percent then, of course, this is not a very desirable policy.

I think the Democrats are ready to risk an unbalanced budget if it stops a serious recession because in their view the relative gain of output and the treatment of the underprivileged, the unemployed, would justify such a policy.

But I am not insisting these distinctions relate to all members of both parties. I am insisting however there are greater difficulties if you have deflation than if you have inflation, because with deflation, and falling prices, or with deflation without falling prices, you get a great deal of unemployment, and therefore you concentrate the disease upon a limited part of the population.

They lose all claims to income, whereas a modest inflation simply brings about some redistribution of income.

Now if you go through a very quick historical background of this whole problem, on page 2 you will notice there is a table on the growth of the gross national product since 1929.

In current dollars the increase has been $330 billion or roughly about $12 billion a year.

If you correct for price level and using 1929 dollars, the gain has been about $5.7 billion a year. In other words, half the gain has been real and half has been fictitious, that is inflationary and this increase in prices, I believe, is largely asociated with war.

Now, if you look at the table, table 2, on the next page you would notice that the largest gains in gross national product occurred in the war years and there was further improvement from 1952 to 1957.

If you consider unemployment over the years, unemployment averaged 9 percent in 1929, twice as much in the thirties, 6 percent during the war, and 4 percent in the postwar period.

One good index of how effective policy is, is to compare the rise in the cost of living and the rise of output percentagewise.

This is done on page 3 in table 2.

On the whole here the best record is in the years 1933-39 when there was a rise in output 7½ times as large as the rise in the cost of living.

This, however, does not tell the whole story actually. As I said the largest gains were made during the war years.

The maximum amount of unemployment was 25 percent in 1933, and in 1939 it was 17 percent and in 1944 we reached a low of 1 percent.

Our average in the postwar period of 4 percent should be compared with the United Kingdom average of 2 percent, and it does seem that when you get down to 2 percent you encourage or become vulnerable to inflationary forces, because you are working on a small margin and at 2 percent of unemployment, a serious inflation may appear and it is interesting that prices have gone up about 3 times as rapidly in the United Kingdom as in the United States in recent years and this is partly explained by the greater degree of employment or the smaller degree of unemployment in the United Kingdom.

Now all that is by way of background.

Let me then go on to the present recession.

I believe, and I am now on page 4, I believe now that excess capacity is an important aspect of the problem.

From 1946 to 1957 we had $360 billion of investment in plant and equipment, and $53 billion additional in inventories.

But I hasten to add that excess capacity is a relative matter. How much excess capacity there is depends upon how much money and spending power there is around, and if you use monetary and fiscal policies in such a way as to cut down the total amount of purchasing power and the demand, then a given amount of capacity becomes much more excess.

Now in relation to this general problem I should like to point out that the fiscal policy of the United States Government has contributed to this general development. For example, in calendar year 1955, the Federal Government deficit on a cash basis was $720 million. But in 1956 this was converted into a surplus of $5.525 billion, and in 1957 one of $1.194 billion.

In short the Government has become an absorber of potential spending funds instead of a net disburser and hence contributed toward inadequate buying.

On orthodox budget accounting which is not quite so relevant for studying business situations, the deficits in 1954 and 1955 were $3.1 billion and $4.2 billion; but in 1956 and 1957, there were surpluses of $1 billion and $1.6 billion.

Just as in 1937–38 a marked change in the relative income and outgo for the Federal Government had contributed to a business recession.

Now about monetary policy: I believe in a general way that monetary policy has been a failure.

I say this being well aware of the difficult problems that the Federal Reserve encounters in trying to do its job.

It is a tough assignment, and one must not be unsympathetic with the difficulties they have.

On the other hand, I hear that yesterday there was a long discussion between Senator Kerr and Mr. Martin (at least according to the Wall Street Journal), on the issue of Federal Reserve responsibilities.

I might say, Mr. Chairman, that I once wrote an 800-page book on the Federal Reserve system and have not discovered, and have not still, that the Federal Reserve is given any authority to stabilize the price level.

Its job is to accommodate trade and commerce and in the 1920's when the Federal Reserve was asked by many Congressmen to support a directive to stabilize under congressional legislation, the Federal Reserve refused; and in the 1930's they were asked again if they would not like to have the right to stabilize, not only the right but the responsibility, to stabilize the price level, in the 1930's again they, including Mr. Eccles, refused.

So that for some strange reason they have changed their mind now and feel that stabilization of the price level is the only objective or largely the only objective of economic life.

Perhaps this is a little unfair. I think they do say they are interested in growth and other factors but from their activities, I would say that their primary objective and interest is in stabilizing the price level.

Now I would say a monetary policy that had stopped the inflation, even if it contributed to the recession in the eyes of many might conceivably be considered a successful policy.

But when the policy not only does not stop the inflation but contributes toward the recession, then I wonder whether this is really a successful policy. And it is interesting to note that in 1956 there was a rise in the total supply of money of 3 percent only, and in 1957 only 1 percent. This is way below our need, and since the peak, the total supply of money has gone down by 1 percent, and the total amount of bank loans by 1 percent.

What high money rates meant to the economy is suggested by the declining rate of expansion in consumer and housing credit. I think one of the large contributions to the recession has been the smaller contribution of consumer credit and mortgage debt to the sustaining of the economic health of the Nation.

If you will look at the table on page 5, you will notice that consumer credit rose by 4.6 billions in 1955, 3.4 billions in 1956, and only 2.7 billions in 1957; and mortgage debt rose 16.2, 14.7, and 11.6. A decline in the use of this kind of credit contributes to a change in the economic situation, and this, I hold, was in no small part brought about by monetary policy.

I need not add the great difficulties that local governments have had in obtaining the necessary supplies of credit as a result of the high money rate policy.

Now, the issue arises: What is the responsibility of the Federal Reserve toward the Government-bond market?

In 1951 there was an accord worked out between the Federal Reserve and the Treasury, as we all know.

In my estimate, Senator Byrd, this accord has been misinterpreted. I think there was something to the general idea that the administration had supported the bond market excessively and therefore did get too much money out and did contribute to some extent to inflation.

But it does not seem to me that this means the Federal Reserve is an independent organization or should be an independent organization, and the reason I raise this point right here is the following: It was charged from 1945 to 1951 that the Government-bond market had been supported excessively.

Let us look at the policy from 1955 on.

The policy since 1955, and to some extent 1953, was not a policy of supporting the Government-bond market, but a policy of abandoning the Government-bond market, and it seems to me in our kind of an economy where the Government is a very important borrower of funds and a very important part of the economy, the Federal Reserve has no right to desert the Government-bond market the way it has.

What has happened, of course, has been that since 1954 something like $20 billion worth of Government bonds were disposed of by the financial institutions of the country, and somebody had to buy these $20 billion worth of Government bonds, except for a few billions that were redeemed, and this, of course, meant you would have to buy them at a much lower price. Hence the monetary policy resulted in a great changeover in the relative prices of different assets, and the burden of the monetary policy was put excessively upon the Government-bond market. The financial institutions sold the bonds in large quantities.

I will come in a minute to the problem of what has happened to the interest rate since this high money policy was introduced.

I am now on page 6.

You will note the monetary policy, I think, has failed for various reasons. In the first place, I think there has been very little integration of monetary and Treasury policy.

I can give you two examples of this:

In the first place, in 1957, when the Federal Reserve was introducing or sustaining a policy of dear money, the economists will tell you that in such periods what you do is you sell long-term securities.

This is the way you make the money market really a dear-money market. But did the Federal Reserve do this?

No; they did not. I mean did the Treasury do this?

No; they did not. They sold short-term securities.

Then again in the recent period of 1957–58, when the economy was having its difficulties, and one of the major objectives of monetary policy should be to bring the rate of interest down, what does the Treasury do but issue large amounts of long-term and intermediate securities, something like 9 billions of them.

Now in that kind of a situation you obviously are making it more difficult to achieve recovery and one condition for a recovery is a lower rate of interest.

Senator GORE. Will you yield, Doctor?

Mr. HARRIS. Yes, sir; I will yield at any time, Senator Gore.

Senator GORE. Several of these issues very quickly went considerably above par.

Mr. HARRIS. That is right.

Senator GORE. Which demonstrated, it seems to me, an effort to hold interest rates up rather than bring them down.

Mr. HARRIS. Correct; yes.

Another interesting aspect of this problem is—in general I have not been sympathetic with the dear-money policy either in 1953, 1955, 1956, and 1957; but it has been a dear-money policy and one wonders why if the Treasury and the Federal Reserve agree on a dear-money policy why all the Government credit agencies keep on expanding their total loans and guaranties during periods of both dear money and cheap money and there certainly is not an adequate amount of integration between all these credit agencies and the Federal Reserve and the Treasury.

I would hope very much when the Federal Reserve appeared here or the Treasury they would make some comments about this problem of integration of all these agencies; but they did not and I have been through all the hearings on this particular subject.

I have not seen Mr. Martin's evidence of yesterday except what was in the Wall Street Journal.

Now, one reason that the Federal Reserve failed in its policy, I believe, is that they have been unable to control the total supply of money or the total amount of spending in part because of the financial intermediaries.

The financial intermediary—of course, by financial intermediary we mean the Government credit agencies, the pension funds, the insurance companies, savings and loan associations, and so forth.

There is some relation between the total supply of money and the activity of the intermediaries but it is a very loose relationship and these intermediaries can operate with various amounts of cash and Government securities.

It is an interesting point, Senator Byrd, that though your committee was dealing with the problem of the financial condition of the United States, neither the Treasury nor the Federal Reserve in their evidence this summer had anything to say about controlling the intermediaries: Was there such a problem or should anything be done about it? I might remind you, Senator Byrd, that in 1927-29 there was a very serious problem of the intermediary, that is lending money on account of others, and ultimately congressional legislation took care of that situation in the early thirties.

But nothing has been done so far on this general problem.

I should like to point out, Senator Byrd, the great advance of loans and guaranties by Federal credit agencies. If you consider the top of page 7, there are some figures on loans and investments of the Federal agencies and guaranties and insurance, and you will note that loans and investments, since fiscal year 1958, have risen by 28 percent and guaranties and insurance by 182 percent.

Now nobody knows how much the Government is really involved in these guaranties or insurance or what the likelihood of losses is, and there have been some congressional committees that have raised this issue but have never had a satisfactory answer.

I think the rise of guaranties and of insurance could be justified in many ways but I do think that in part this shift over from loans and investments to guaranties and insurance is in part an attempt to give a viewpoint of the budget that is not justified by the actual facts, because the point is guaranties and insurance do not appear on the budget, and loans and investments do, and there has been an unfortunate tendency to try to balance the budget account rather than to balance the budget.

Another aspect of this failure of the Federal Reserve to control the situation is to be explained by the very large increase of housing and consumer credit. You will notice on page 7 near the top that mortgage loans and consumer credits have risen from 42 to 180 billion dollars from 1941 to 1957, but commercial banks which are the direct target of the Federal Reserve policies account for only 15 to 20 percent of this type of credit.

Senator KERR. Where does that show?

Mr. HARRIS. That is in the third paragraph on page 7.

To indicate what is happening to our financial institutions, from 1951 to 1957, whereas the earning assets of commercial banks rose by 21 percent, the assets of life insurance companies increased by 48 percent, of savings banks by 155 percent and of government credit agencies by 113 percent.

This I suggest is a matter for investigation, and does at least suggest to the Federal Reserve that they have a weakened position of control; and it is an interesting thing that in similar investigations in the United Kingdom there was a good deal said about the need of taking accounts of the financial intermediaries and what might be done about controlling them, if the monetary system is to be controlled.

Now another reason, of course, for the monetary failure is the high liquidity of the economy.

This is explained partly by the fact that corporations had large amounts of cash, which they could use up, and did not have to have recourse to the banks as much as they otherwise would; and they could sell securities to the public. There are some statistics on the top of page 8 about this tendency to cut down their cash and to increase their issues to the public.

Senator GORE. Would not another factor be the ability of an increasing number of concerns to administer price increases almost at will?

Mr. HARRIS. Yes, sir; Senator Gore. I will say a word about that a little later if you do not mind.

Senator GORE. All right.

Mr. HARRIS. Now one of the objectives, I might say of monetary policy, according to Mr. Martin, was that what you need in an inflationary situation is to increase the amount of savings and if you have more savings there would be less inflation.

But it is a well-known fact that what really determines savings is not the rate of interest although it has some influence.

The major factor is the rise of income, and the Federal Reserve in increasing the rate of interest cut down the total amount of income; and if you consider the latest figures on personal savings you will find there has been a substantial decline since the third quarter of 1957, so that they have not achieved their objective of increasing savings; but they have helped bring about a decline of income and with a decline of income there is a cut in the total amount of savings.

Senator CARLSON. Pardon me, the decline started when, you say?

Mr. HARRIS. Third quarter of 1957 to the second quarter of 1958.

Senator CARLSON. Thank you.

Senator GORE. You are referring to personal savings?

Mr. HARRIS. Personal savings, yes.

Senator GORE. Well, time deposits are showing a rapid rise?

Mr. HARRIS. That is one aspect, of course, if you do have an increase of personal savings you will find them in time savings to some extent. You will find them in additional holdings of cash but the total amount of personal savings as revealed by the Department of Commerce in figures just released about a week ago indicate a substantial decline in savings, personal savings.

If you like I could give you the figures in a little while, I can give you them. They are in my bag.

Senator KERR. I would like to have them for the record.

Senator CARLSON. I would like to discuss these just a little bit. Either my figures are incorrect or I have been misinformed. I want to make a statement here I think is from the Treasury from the first 3 months of 1958 savings deposits in commercial banks in the Nation's business cities were up 16 percent, more than triple the increase in the same period. Is that correct?

Mr. HARRIS. Senator, that is correct and my statement is also correct.

Senator CARLSON. All right. How do you reconcile that?

Mr. HARRIS. I think your statement is a more restricted part of total savings.

Department of Commerce gives you all personal savings, not merely those that are held in banks, you see.

Senator CARLSON. All right. Let's go a little further. In the first 2 months, funds in the savings banks and in the savings banks and loan associations jumped to an alltime high, and savings banks alone now have a peak total of more than $32 billion on deposit; is that correct?

Mr. HARRIS. I agree if you read that, I am sure it is correct.

Senator CARLSON. All right. For the first time since July 1956, sales of new United States savings bonds are exceeding cash-ins and in February savings bonds sales were up 13 percent over February of 1957, while redemptions were down 11 percent; is that correct?

Mr. HARRIS. Yes, sir.

Senator CARLSON. Sales of life insurance, talking about savings, are running 10 percent ahead of 1957; is that right?

Mr. HARRIS. I am sure that is correct. That is all from the Federal Reserve Bulletin; is it not?

Senator CARLSON. Yes, sir.

Mr. HARRIS. Yes, sir.

Senator KERR. If the Senator will yield a moment there?

Senator CARLSON. Yes, sir.

Senator KERR. I saw some publicity just shortly back that the sales of life insurance were on the decline.

Senator CARLSON. I am quoting some figures given to me.

Mr. HARRIS. Senator Carlson, may I quote some figures to show those figures are not all-inclusive?

Senator MARTIN. Could we just pause there for a moment?

I think that is so important that we ought to get the correct figures. There must be some place that there are correct figures on that.

Senator GORE. I had the same figures Senator Carlson had; if they are not correct I would like to know it.

Mr. HARRIS. They are not incorrect. They are only giving you a part of the picture. Let me give you total personal savings and this includes everything.

Senator KERR. What are you reading from, Doctor?

Mr. HARRIS. I am reading from the Economic Indicator.

Senator KERR. All right. What page?

Mr. HARRIS. Page 5.

Senator KERR. All right.

Do you have one of those for Senator Martin?

Senator MARTIN. I did have one.

Mr. HARRIS. Excuse me. If you look at the second quarter of 1957 you will find that personal savings in all are $21.4 billion.

The first quarter of 1956 they are down to $18.3 billion. That is a decline of about 15 percent, and that is a pretty large decline.

Senator CARLSON. I want to read you another statement.

For the first time since 1954 recession, consumers are borrowing less on the installment plans than they are repaying on old debts, and in February, installment debt repayments topped new borrowings by a huge $485 million, the biggest net repayment for a February since World War II.

Mr. HARRIS. I have read that, too, Senator. I agree with all of this. I think the Federal Reserve is presenting the facts as they are but they are not presenting all the facts.

Senator CARLSON. Then I have no quarrel with your figures.

Mr. HARRIS. The consumer credit, the repayment of consumer credit——

Senator KERR. Just a minute. Have you got the Economic Indicator there, Senator Carlson?

Senator CARLSON. Yes, sir.

Senator KERR. If you look at page 5 you get both the personal savings and the saving as percent of disposable income, and it went up from $10.5 billion in the first quarter of 1957 to $21.4 billion, back down to $19.7 billion, down to $19.8 billion in the fourth quarter, back to $18.3 billion in the first quarter of 1958.

Percentagewise it was at 7.1 in the second quarter of 1957, 6.5 in the third quarter, 6.6 in the fourth quarter, and 6.1 in the first quarter of 1958.

That is the figures you are referring to?

Mr. HARRIS. That is right.

Senator KERR. And that represents as I understand it——

Mr. HARRIS. Total.

Senator KERR. Total of all savings.

Senator BENNETT. But isn't it equally true this is the rate of savings so the total volume of savings are increasing?

Mr. HARRIS. No, sir; this is the total amount. This is the volume.

Senator BENNETT. But this is the share of savings out of income. It is not the total of all savings in terms of savings as they have accumulated, so savings are still increasing though they are not increasing at quite as great a rate as they were a year ago?

Mr. HARRIS. Well, yes, sir; Senator, that is absolutely true, but what Mr. Martin was saying is that the way to get the total amount of savings up is to raise the rate of increase, to increase the total amount of savings more than they have been increased. Indeed, in virtually every year and in every month savings increase because there are net savings, except during a great depression; but now we have a smaller increase in savings than in the middle of 1957.

Senator BENNETT. When did the rate of interest turn around?

Mr. HARRIS. I would say—this would be a rough guess—I would say about October.

I could give it to you in a minute if you want me to.

Senator BENNETT. So the rate of interest was less in the fourth quarter and the first quarter in this year?

Mr. HARRIS. Senator, you do not exactly get my point.

Senator BENNETT. I get it.

Mr. HARRIS. No; you do not. My point is that does not matter what the rate of interest is right now.

But my point is the high rate of interest brought down the income and the income brought down savings.

Senator BENNETT. While you are on that, how badly did the policies——

Mr. HARRIS. Do you want me to give you the exact percentage?

Senator BENNETT. No; I am just looking at this same chart on page 5. Total disposable income from the top is down about a billion dollars.

Mr. HARRIS. Look at your gross national product and you will find it is down $16 billion; I think it is the third quarter.

That will be on page—which is the most inclusive item—that is on page 2.

Senator BENNETT. But this is personal disposable income out of which these savings have come?

Mr. HARRIS. But that does not give you everything though.

Senator BENNETT. You have chosen to assume that this chart gives you everything with respect to savings?

Mr. HARRIS Personal savings.

Senator BENNETT. And you will not compare that?

Mr. HARRIS. Personal savings, I said. This chart gives you everything as regards personal savings and these are the figures that Senator Carlson was quoting.

Senator BENNETT. But actually personal disposable income is only down about three-tenths of 1 percent.

Mr. HARRIS. That is perfectly true, as far as we go, but gross national product is down by $16 billion and that is the——

Senator BENNETT. Then it is the corporations whose income has dropped.

Senator KERR. Where did you get that figure, Senator Bennett, if I may ask?

Senator BENNETT. If you look at page 5, the left-hand column, headed "Personal income," you find a high in that series in the third quarter.

I was looking at the second quarter. You are down about $4 billion which is about 1½ percent.

Senator KERR. It is a good deal more than one-third of 1 percent.

Senator BENNETT. Yes. I was looking at the second quarter, 343, which is the period of high savings to which you refer. But it is down about 1½ percent.

Mr. HARRIS. Yes; but if you allow for the expected growth, it is down more than that.

Senator BENNETT. As Senator Kerr said yesterday, that is speculation and we want to stay with the facts.

Senator LONG. Let me ask you this question:

How does the first quarter of this year compare to the first quarter of last year if you allow for the difference in the purchasing power of the dollar?

Have you undertaken to compute that, Mr. Harris?

Mr. HARRIS. Well, I would say—I took the peak in 1957, and then you have in two quarters; that is, in one-half year you have a decline in gross national product of $16 billion, you see, and in order to allow for the price increase you should have had an increase of about $12 billion, with 3 percent increase in prices or at least in a half year you ought to have an increase of $6 billion, that is $22 billion the country loses.

If you take 6 months, 6 months on 2 percent for the usual growth you have 8 more and we have lost $30 billion.

Allowing for inflation, allowing for usual growth and then allowing for the growth we lost $30 billion, $16 billion, and $6 billion, and $8 billion for not having achieved the growth we should have achieved. (Annual rate.)

Senator LONG. Some of that would be a loss to the Government; would it not?

Mr. HARRIS. In tax revenue; yes.

Senator LONG. About what percentage would you estimate that $30 billion?

Mr. HARRIS. Well, it is hard offhand to give an estimate, the Federal Government gets what, about $75 billion, that is roughly less than 20 percent, and if this corresponded to this particular decline they would lose 20 percent, my guess is they would lose a little more, because of their progressive type of taxation, so I would guess they might lose 3 or 4 billions and I think that is one reason why Senator Byrd some time ago said that the revenues are going to be considerably less than they have been estimated.

Senator LONG. Yes.

Senator CARLSON. Dr. Harris, while we are on this table, how are we going to justify—now, I think we are all agreed we have a few million more unemployed in the first quarter of 1958 than we had in 1957, yet the first quarter's personal income on this table 1957 is $338.3 billion, and the first quarter of income in 1958 is $342.3 billion and despite these 5 million or more unemployed the personal income is up.

Mr. HARRIS. Senator, would you give me the page from which you are reading—on page 5; is it?

Senator CARLSON. First quarter of 1957, first quarter of 1958, first quarter 1958 and personal income.

Mr. HARRIS. Yes, you have an increase here of $4 billion here in personal income.

Senator CARLSON. Yes.

Mr. HARRIS. Well, one explanation of course is that this is actually a decline, if you allow for the rise in prices.

Senator KERR. Rise in prices is about what, 3 percent?

Mr. HARRIS. More than 3 percent, but even say if it is 3 percent that is $10 billion right there.

Senator KERR. So if you had the same amount of purchasing power it would have to be up $10 billion; would it not?

Mr. HARRIS. That is right, Senator, and the other point is that, of course, the corporations have taken a good part of this loss and that is not indicated here.

Senator MARTIN. Mr. Chairman, the actual inflation is not 3 percent in a year; is it?

Mr. HARRIS. It has been in the last 2 years.

Senator MARTIN. But I mean the last year.

Senator KERR. Yes; it has been, Senator.

If you look at page 23 you see that?

Mr. HARRIS. It was seven-tenths of 1 percent the last month, which is at a rate of 8 percent.

That is eight and four-tenths for the year.

Senator KERR. As I see it, in January 1957 it was 118.2. On page 23, all items.

Mr. HARRIS. Yes.

Senator KERR. In January 1958 it was 112.3 or an increase of 3½ percent.

Mr. HARRIS. That is about 3½ percent.

Senator KERR. It is over 3 percent of what it was of January 1957.

Senator MARTIN. I realize it is a very serious proposition, this inflation, which is the thing that worries me a danged sight more than the Russian bomb.

Senator KERR. If you go to March here, Senator, you will find it was 123.3; the figure that came out yesterday was 118.9, which from March to March, what would that percentage of increase be, Doctor?

Mr. HARRIS. What was that? I went back to my page 5 here.

Senator KERR. It is on page——

Mr. HARRIS. If you add, March would make it about——

Senator KERR. 123.3?

Mr. HARRIS. 123.3—it is a little more than that because it is eight-tenths of 1 percent of 122; probably it would be 123.4, and that would be an increase from March of 4——

Senator LONG. It is almost a full 4 percent increase.

Mr. HARRIS. That is what it is—pretty close to 4 percent now, it is just about 4 percent, just a little under for a year.

Senator KERR. During a very sharp recession.

Mr. HARRIS. During a very sharp recession.

Senator KERR. Isn't that the first time in history that has occurred, Doctor?

Mr. HARRIS. So far as I know, it is. I am not an economic historian except sort of in a dilettante way.

But so far as I know, we have never had anything like that.

Senator KERR. As a unique accomplishment?

Mr. HARRIS. It is.

Senator WILLIAMS. Isn't that the usual aftermath in any country after inflation has been in effect for a few years, like France?

Mr. HARRIS. I think Senator Kerr's position is somewhat different. He said we had a recession and rise in prices.

What we generally have is a recession and a fall in prices. This is rather unique.

Senator WILLIAMS. It is unique but has it not been the historical background in other countries, where they have had inflation, that in the latter stages of it, at least, you can have a rise in prices and at the same time be in the midst of a recession?

Mr. HARRIS. I mean you take the classic case of Germany where they had a rise of prices of a billion times. You get into all kinds of economic difficulties, probably because you do not get raw materials and you cannot therefore keep your people working and there you get a recession that is related to what you might call a really advanced type of inflation. That is a somewhat different situation than the present.

Senator WILLIAMS. Well, to bring it down to the situation that happened in France or England in recent years, you have got a somewhat comparable situation, have you not?

Mr. HARRIS. You mean in recent years?

Senator WILLIAMS. Yes.

Mr. HARRIS. Well, in England so far as I know, you have had, at least in the postwar, very little unemployment, and you had very rapidly rising prices compared to our price rise.

I do not know any situation in modern times, anyway, that is like the one that was brought out in these hearings in the summer of this year.

Senator WILLIAMS. I am not suggesting that we should not be concerned about this because I think we are; as Senator Martin pointed out, it is one of the major problems confronting us but in my understanding of the historical background of inflation which has affected other countries, is that this is a customary result of an extended period of inflation or deficit spending.

It always ultimately ends up in such a situation.

Mr. HARRIS. You mean you get a collapse after a long period——

Senator WILLIAMS. Yes. And unless it is controlled it could develop into a serious collapse?

Mr. HARRIS. Well, Senator Williams, I simply say that, and I think this is the position that Mr. Martin tends to take and I do not want to be unfair to Mr. Martin, because he can take care of himself, but Mr. Martin and the Federal Reserve tend to do this, and I think you are to some extent saying the same thing, if you have a creeping inflation it is going to be a galloping inflation necessarily and I think this frightens people.

I do not agree that a creeping inflation necessarily brings a galloping inflation—consider our own postwar history.

But I think if you have a situation like the German situation or like the situation in Hungary which provided a world's record with prices going up to 10 to the 17th root, 10 plus 16 zeros, in that kind of situation I think you will have a collapse ultimately.

I do not think it necessarily follows we will have a collapse with our kind of inflation.

Senator WILLIAMS. I am not suggesting that it is inevitable but based on the historical lessons, whatever lessons you can gain from history, it has been the results in any country which has gone along the road where they have had so-called controlled inflation for a time and then lost control of it.

Senator KERR. Is the Senator suggesting that after 5 years and some months of this administration, we are approaching the situation that existed in Germany and France?

Senator WILLIAMS. No, but I am suggesting that inflation is still a major problem confronting this country.

Senator KERR. It seems to me he is trying to draw a parallel.

It would frighten me and I have such a high regard for his good sound judgment, if he would now be telling us that after 5 years and 4 months of Eisenhower that we inevitably are in the situation that destroyed the economy of Germany and is about to destroy that of France.

I had thought it was serious but nothing like that serious.

Senator MARTIN. Mr. Chairman, if the distinguished Senator from Delaware and the distinguished Senator from Okahoma would yield just for a short observation: Isn't it true that we have had inflation for the last quarter of a century?

Senator KERR. Mr. Martin, if you are asking me, sat there yesterday and told me that 1951, 1952, 1953, 1954, and 1955—told me we did not have.

Senator MARTIN. It almost——

Senator KERR. I do not want to say that by quoting him I am putting the stamp of my approval upon everything that he says, but his name is Martin, and what he has said thus far has been rather persuasive with my friend from Pennsylvania. [Laughter.]

Senator MARTIN. Which is pretty sound.

Senator KERR. Were you here when he made that statement?

Senator MARTIN. Yes.

Senator KERR. Would you say, in the light of that, that we had had inflation for the past 25 years?

Senator MARTIN. Bob, there was a period there that it almost leveled off, not quite, and we who believed in a sound currency, and were opposed to the erosion of the dollar, felt very good, although even then it went up just a little bit. But, as a general thing, we have had inflation since the early thirties when we started pump priming and deficit financing. We have had wars, and we have had crises, and

I am wondering, like Senator Williams, just how soon it might get out of control.

Senator BENNETT. Mr. Chairman, we adopted specific rules when this hearing started. This is the first time we have really broken over them.

Therefore, I respectfully ask for the regular order.

The CHAIRMAN. We will proceed.

Mr. HARRIS. Thank you very much. I have enjoyed this. It has given me a little rest, I might say.

Senator MARTIN. If the distinguished Senator from Utah would just yield, Senator Gore and Senator Carlson were talking about the amount of insurance that had been sold during the last quarter, and I think that is a rather important thing, that we get the exact figures, because the purchase of insurance shows a confidence that few things show.

The CHAIRMAN. The staff will be instructed to insert that information in the record.

(The information is as follows:)

New life insurance written

[In millions of dollars]

	Total	Ordinary		Total	Ordinary
1958—February	4,860	3,457	1957—May	6,224	3,970
January	5,402	3,420	April	5,907	3,828
1957—December	6,727	4,164	March	5,653	3,932
November	5,409	3,823	February	5,000	3,210
October	5,782	3,978	January	4,838	3,161
September	4,602	3,418	1956—December	7,188	3,846
August	4,968	3,689	1955—December	5,883	3,079
July	5,281	3,609	1954—December	4,137	2,468
June	5,545	3,659			

Source: U. S. Office of Business Economics, Department of Commerce, Survey of Current Business, publishing data of the Life Insurance Agency Management Association.

Senator GORE. It also shows the desire to avoid some taxes by using some existing loopholes.

Senator BENNETT. Mr. Chairman, I still call for the regular order. [Laughter.]

Mr. HARRIS. Senator, I would like to just say Senator Williams is one of my favorite Republicans, and I do not want to leave him out on a limb.

Senator WILLIAMS. I might say you have not left me out on a limb, even though the regular order has been called for, and I am perfectly able to interpret what I meant myself without anybody reading into my own mind or reading into their speeches what they think I meant. And I still say inflation is the No. 1 danger of this country, whether the Republican or Democratic Party is in control, and I do think it is something we should recognize and try to find a solution for, not on a political basis, but as American citizens. We must do it on that basis.

Senator GORE. Mr. Chairman.

Senator KERR. I ask for personal privilege since I was referred to here and I want just to say this: I have just as much respect for Senator Williams as you have, but I would suggest to you if he is out there on a limb he got there of his own free will and accord and you ought to let him get out the best way he can.

The CHAIRMAN. Proceed, please.

Mr. HARRIS. I was just going to say, of course, that this present recession is partly a cyclical phenomenon and I don't put the whole blame on the Federal Reserve.

I think that we might have had some reaction even if they had done nothing, but actually they helped to accelerate the process and so to that extent I hold them responsible.

The CHAIRMAN. Go ahead.

Mr. HARRIS. I can see, Senator Byrd, that it requires your consummate tact to handle this committee.

Most signs in April—now I am getting—let me just read one paragraph at the bottom of page 8 which pretty well summarizes this discussion on the recession——

Senator KERR. I would say—when did you leave the middle of the page?

Mr. HARRIS. Oh, yes, you are right, Senator; I got sort of put off by all these Senators talking.

Senator KERR. That deep regard you had for Senator Williams is all right.

Mr. HARRIS. But this is the point you are interested in. [Laughter.]

Of course, and this is the point I think Senator Gore was referring to earlier, one of the reasons for the difficulty of the Federal Reserve, and here I am very sympathetic with them when they do try to control an inflationary situation; they are confronted with a problem of rising wages and of rising prices and with the rising wages and rising prices they can only interrupt inflation by introducing pretty severe monetary restrictions, and if they do that, then, of course, they are jeopardizing the stability of the economy and they may bring about a recession.

I think it is true, as far as I know the economic history of this country, it has never been true when we introduced a high rate money policy that this has not been followed by a recession or a depression.

I do not want to go into the problem. I think in a general way what happens in a highly productive industry, wage rates tend to rise, sometimes even less than productivity but the other industries tend to take this up and so you get a national rise of wages, and then in many cases the businessman sends prices up much more than is justified by the rise in the wage level. I recall an editorial in the Herald Tribune some time ago—not very long ago—in which they pointed out that the iron and steel industry over a period of 10 years had an increase of wages of 30 percent, and that the increase in prices was in excess of a hundred percent and the increase in profits of 800 percent. I do not mean to say that is the usual case; but there are many cases where the businessman can administer his prices in such a way as to contribute to inflation, and I think that is one reason why we have inflation now, despite the recession.

I am bending backward to be fair on this issue.

I do not mean to say that labor is not partly responsible, but I think the businessman is also partly responsible.

I do not know how you can deal with this problem. I do not think exhortation does very much good.

It has not done very much good here even though the exhortation by the President of the United States.

Summarizing then, in short, a recession of fairly serious proportions followed an investment boom. A restrictive monetary policy which on the whole favored corporations against small business and local and State governments, and a turnover from fiscal expansionist to contractionist policies contributed to the reversal of business conditions.

Now about the present situation.

We have had about a year of—pretty close, 10 months of decline. According to the National Bureau of Economic Research, which is the outstanding statistical group in the country, the turning point was about the middle of 1957 and we have had now about 10 months of decline.

They claim that we never have had a decline that goes on for more than a year except the 1929-33 depression. If they are right, then the turning point should be in the middle of 1957. I am skeptical——

Senator KERR. 1958.

Mr. HARRIS. 1958. I am skeptical of this and I know many economists who are but this is a matter of judgment.

Now the unemployment situation is serious. We have had an increase of more than 2 millions over a year ago, a rise of about 60 percent.

If you convert the hourly decline, the decline in the hourly week of 4 percent, we have another increase of unemployment of 2½ million, so the total rise in this manner, defined in this manner, is from 3 millions to more than 7 millions, or a rise considerably more than 100 percent.

Now all or most of the active factors, I would say, point to a serious decline.

Business investment is down, plans are down 13 percent but investment itself was already down 20 percent on an annual basis.

And the situation is more serious because unlike the last two recessions there is a depression psychology abroad. I would argue——

Senator GORE. Abroad in this land or in the world?

Mr. HARRIS. In the land. I think the rest of the world is a little worried about this but I was thinking about what the situation is here.

I think it was Senator Carlson who pointed out there has been a decline in the amount of consumer credit in February 1958 for the first time in an awfully long time.

Now should this decline of consumer credit continue or accumulate, this would be a very serious depressive influence in the economy because this means that you are destroying part of your spending power in this way.

If you allow for the decline in the gross national product, inclusive of a decline of investment, inventories, the beginnings of a decline of consumption, and also a decline in the very large excess of exports, which was phenomenal in 1957 and is a stimulative factor—and if this is reduced, this tends to be another unfavorable factor—then if you allow for all of these you can easily see that we are going down at the rate of something like $15 billion a year, annual rate, and if you are going down at the rate of $15 billion a year you have to do something about it.

In order to offset this decline you have to stop this decline of $15 billion a year and I noticed in a statement recently that inventory has been going down at the rate of $7 billion a year which is a phenomenal rate of disinvestment.

In other words, much goods are being sold which are not produced because they are taken out of inventories and I point out in the table on page 10 the decline is fairly widespread and is not merely in automobiles and housing as many people say. Now, at the top of page 11 the therapy:

Monetary policy: I think the first thing we ought to try to do is to increase the total amount of purchasing power, because if we increase the total amount of purchasing power this tends to increase the goods in demand, to increase the demand for goods and to bring up the price of assets and therefore to bring down the rate of interest.

I am pretty critical of Federal Reserve policy not only before the recession but since, even more critical of the policy since the recession.

They did virtually nothing until November of 1957, and yet their own indexes of industrial production show that the economy had been moving sideways for about a year, which suggests that we were not advancing any more and that in itself is a sign that there should be caution in monetary policy but they continued their dear money policy until almost the end of the year.

We have had a turning point, according to the experts since June 1957, and they have all the statistical apparatus, a wonderful research staff, and on the basis of all this information they certainly should have taken action sooner.

What have they done so far and why have they acted so slowly?

I think they share with Senator Williams this great fear of inflation. This is, I am sure, the major explanation of their lack of activity. But not only are they excessively worried about inflation—and I think we ought to be worried about inflation when we really get it, not when we are still going downhill—but they have tied their own hands by an unwise policy, and this unwise policy, as many of you gentlemen know, is the policy of indulging in open market operations only by buying short-term securities and not buying long-term securities.

If you want to influence the long-term rate of interest, you ought to buy long-term securities.

There was a great debate, as you may recall, before the Joint Economic Committee between some of the Governors of the Federal Reserve banks and particularly by Mr. Sproul as against the Federal Reserve Board, and Mr. Sproul was very strong, and I believe still is, for the Federal going into the open market and buying Government securities.

Senator KERR. Long term?

Mr. HARRIS. Long term; that is right.

And if you would take a look at the—I will say nothing about the open market policy so far, and especially during the recession when they were restrictive, but if you take a look at the table on page 12, you find that this compares the situation a year ago and at the turning point of June 30, and what do you find?

You find that the reserves, which are the source of monetary expansion, are less than they were on June 30 and slightly above where they were a year ago.

Senator KERR. Now show that.

Mr. HARRIS. Well, you see the reserves, the first line on that table 4, February 27, 1957, $18.68 billion?

Senator KERR. That was—identify that again.

Mr. HARRIS. These are the member banks' reserves.

This is the basis upon which member banks create credit; in other words, manufacture money.

Senator KERR. Yes.

Mr. HARRIS. And they were $18.68 billion in 1957, February. They were $19.17 billion in June 30, 1957, and $18.91 billion in February 1958.

Just about exactly the same day, 1 day off.

The required reserves, you see, have changed very little also—1 percent or so. The excess reserves, which are supposed to be the best indication of how much is available, have scarcely changed in this period.

Discounts and advances are up as compared to a year ago and somewhat down since June 30, but I should add I have had more recent figures which show a very large decline of member-bank discount and advances with the Reserve.

The last is significant on the theory that if the member banks borrow less from the Federal Reserve they are more inclined to expand as they do not like to be in debt.

This is a theory the Federal Reserve has held for a long time.

I myself have had some doubts about its validity.

At any rate I would say the Federal Reserve has made the great mistake, has been making the great mistake of not going into the open market and not pouring out several billion dollars worth of cash to buy up Government securities.

If you look at the Federal Reserve in the great depression——

Senator LONG. Could you tell me whether that would tend to cause inflation?

Mr. HARRIS. I would be inclined to say this:

I think this is what worries the Federal Reserve; they are afraid if they do this, this will bring about inflation. I am inclined to take the situation when you are faced with a serious depression—I agree with what Senator Byrd said this is not going to be a 1930–31 affair, not for a minute, but I think it can be more serious than it is now and it is already more serious than our last two recessions, and in that situation I say you have to risk a little inflation, and when the times comes then you adopt whatever policies are necessary.

I would worry less about inflation——

Senator KERR. And worry more about deflation?

Mr. HARRIS. That is what I am worried about.

Senator KERR. Do you discuss in here the comparative results of the two, Doctor?

Mr. HARRIS. I do in a general way. I have said one word about this, and I will say a little more later on.

Senator KERR. All right.

Mr. HARRIS. The point I would like to make is in the early 1930's when we had a serious recession, if you look at the bottom paragraph, at page 11, in the years 1930 to 1932, the Federal Reserve increased its holdings of Government securities by $1.7 billion or by about 250 percent.

This was a tremendous open market operation which has never been equaled in the history of central banking, except during the war.

Now a corresponding relative increase in 1957–58 would involve an increase of about fifty-five or sixty billions of public securities held by the Federal Reserve banks; but of course such use would be absurd and all I am suggesting is that Federal Reserve ought to buy a few billion dollars' worth of additional securities.

I am not sure this is going to cure the situation.

There is no really great risk; whatever risk there is, is certainly worth taking.

In other words, the job of the Federal Reserve should be to greatly increase the reserves of the member banks so that they will have plenty of money in their pockets so they can go out and lend more freely and when there is danger of inflation that arises then that is the time to worry about that.

Now the next approach, which is, I am sure, an even more controversial issue——

Senator LONG. Might I ask one question at that point? It occurs to me that one of the things contributing to this inflation we are having a the moment is the possibility that some of these larger concerns, seeing their sales fall off, are perhaps attempting to raise their prices so as to maintain the same profit level against a smaller number of sales.

Mr. HARRIS. True.

Senator LONG. Do you have that impression, or not?

Mr. HARRIS. Well, it would be a purely impressionistic viewpoint.

All we can say is that the price level still is rising. It is true that you remember this breakdown of the fair-trade practice suggested that some large corporations are trying to bring their prices down.

I gather in the automobile industry now, both in the new and second-hand market, there is considerable evidence of price declines but whether it is evidence of a general picture, I don't know, but there are still many industries and firms tending to keep their prices up rather than to cut their prices. They are waiting.

If the situation gets more serious, they will cut their prices.

Senator BENNETT. Mr. Chairman, I have to call for a regular order again. It is difficult to follow the witness' testimony which is not the same as the material he gave us.

The CHAIRMAN. I think we will make greater progress——

Mr. HARRIS. I try to give you additional windfalls, Senator.

Senator BENNETT. If he proceeds, except for an inquiry as to a fact——

Mr. HARRIS. Now, as regards tax cuts:

When I wrote this paper 2 weeks ago I was not absolutely sure that I would want a tax cut right now.

As a result of additional information, particularly the first-quarter figures that have come out, I am much more inclined to favor a tax cut now.

As you all know, there was a reduction of taxes in 1954 and I am sure this contributed toward the emergence of a healthy economy. We were in a more favorable position at that time in part because the administration was prepared to cut taxes in such a way as to increase investment and was not too concerned about the issue of equity.

But now the situation is more serious, with less confidence, with a substantial decline in the stock market, and with total investment going down very much.

I, therefore, would like to see a tax cut which would be given primarily to consumers, because the real problem now is to increase investment by increasing consumption.

I would agree—I put together on pages 13 and 14 the various proposals for tax cuts and these, I might say, I cribbed from a report that was made for this committee.

There is nothing new in this table except that the proposal I would make would be No. 6, where you vary the rates of the first $2,000 of taxable income, 10 percent for the first thousand, 20 percent for the next thousand. I would propose that this be used for a period of 6 months.

It could even, I suppose, be used for 3 months, but for 6 months at any rate, and if necessary, to be renewed.

In other words, a commitment of $3½ billion for 6 months at the annual rate of $7 billion and if the situation improves by then sufficiently this could be revoked after 6 months.

It is even conceivable that might be done for 3 months. Under that kind of a program the incomes under $5,000 would gain 40 percent of the taxes remitted, the incomes under $10,000 would gain 50 percent, and the remainder roughly 10 percent.

I do want to say a word about the relative virtues of dealing with this kind of a situation, assuming you want to increase the total amount of spending by 10 to 15 billion dollars to offset the decline of spending of 10 to 15 billion dollars and therefore stop the decline.

Assume you want to do that. Is it better to increase spending or is it better to cut taxes?

Now, of course, as the Senators here know, this all goes back to Keynesian economics which has been, I think, widely accepted although not by everybody by a long shot.

When Mr. Keynes talked about this problem he was always talking about public works and increasing public expenditures.

Senator KERR. Who was this?

Mr. HARRIS. Keynes—the British economist.

Now at the present time the increase of spending is not nearly as attractive to most people as the cut in taxes.

Certainly this seems to be true in many circles at any rate.

The advantage of an increase of spending out of deficits is that it puts a great deal of money to work, and it has a secondary and a tertiary effect.

The people get the money, spend it, and so forth.

The weakness of this kind of a program is it takes a long time to get going and I will show that in a minute.

Another reason for it is the feeling that, in many areas, there has been underspending, for example, in education.

Now then, the case for a tax cut is that it works much more quickly. The case for the tax cut is that it also not only does it work more quickly, but on the whole it helps—it results in a considerable amount of additional spending.

I think, compared to the spending program, that is an increase of spending, a tax cut is less effective in this sense that a great many people will not spend the money they get as a result of remitting of taxes.

So dollar for dollar you probably get a greater effect out of an increase of spending than out of an equivalent amount of tax cut.

I think the case against the tax cut is on the whole, an ideological one, namely, that on the whole the people who pay taxes are richer than the people that do not, and therefore if you cut your taxes on the whole you favor people that have more income than you would if you increased spending.

Now at the present time we all know, and I think Senator Byrd has made a statement to this effect, or at least we have been told this by the Secretary of the Treasury also, that we may look forward to a deficit of about $8 billion in fiscal year 1959.

Now that is a substantial deficit.

The CHAIRMAN. Mr. Martin put it up to $10 billion.

Mr. HARRIS. Did he? I did not realize that.

And I think in making——

The CHAIRMAN. That is without tax reduction?

Mr. HARRIS. Without a tax reduction; yes, sir.

So you have an 8 to 10 billion dollar deficit in fiscal year 1959.

I was surprised myself, I think many people were surprised, at the administration's January 1958 budget for fiscal year 1959, because whenever you get a turning point like this, it almost invariably follows that your tax receipts go down, and history should have convinced the administration this was true, but they did not allow for it.

In fact, they anticipated a rise of income so their budget was altogether too optimistic.

Now then, in taking into account this estimate which has been made available recently, in fact after I wrote my paper, one might say this: That what you want, perhaps, is an increase of spending of $15 billion.

To some extent this proposed increase in deficit—or the coming increase in the deficit for fiscal 1959 will take care of this situation. But probably not enough. I don't think it is necessary that you get $15 billion of additional money into the spending stream in the first instance because there is a multiplier effect.

But it does seem to me that you do—you would have to have some tax cut and some rise of spending in order to bring about a healthy economy again.

I think it is also true and I know there is a difference of opinion on this, but I think it is also true if you had a tax cut and some increase in spending, this, in itself, would contribute toward higher income. Out of the higher incomes the Government would collect more money and therefore the net increase in deficit would be considerably less than the gross increase of the deficit.

I think at the present time we do have some programs and some estimates of how this money is getting out.

I think on the whole, the general idea is that the money is not being spent very rapidly.

In fact the Comptroller of the Defense Department told the joint committee not so very long ago that there would be no increase to speak of in defense spending in the calendar year 1958 over 1957, and he also said that there would be an increase in obligations for defense for procurement and construction at the annual rate of $4 billion a year but this is apparently not going to be reflected in any substantial increase of spending for defense according to Mr. McNeil, who is supposed to be the expert on this issue.

So that I do not think we can count on any very large increase of defense spending in the calendar year 1958, though we may get a substantial increase in the calendar year 1959. This may not be very good timing.

Now, a word on page 16 on expenditures and growth.

I think it is important—I might say I remember Senator Byrd has said a number of times that what worries him about this growth that we economists always talk about is that sometimes declines prevail and with declines a large deficit in the budget, and I think Senator Byrd was quite right in anticipating this kind of a situation, and I think, if I remember correctly, my memory is not too good—I remember he said, if you get a moderate decline in activity you are going to end up with a deficit of something like $10 billion or something of that sort.

I think this happens, but I think also you have to take into account the general picture and if you look at the second paragraph of page 16, indeed the rise is not likely to be steady.

Years of large rises, like those of 1942, 1948, 1951, and 1955 are likely to be mixed with gentle increases or possibly even declines like 1946, 1954, and 1958.

In some years these are likely to be deficits offset by surpluses in the other years.

Now the economists have been estimating that in 10 years we would have a gross national product not of 300 or 400 billion dollars but 550 to 600 billion dollars.

Dr. Burns' estimate was $600 billion.

Now the Rockefeller, mind you this is a group of businessmen, have come out and said that by 1967 if we continue the pace of the last generation or two we would have $580 billion. If we go up at the rate of the last 10 years we would have $640 billion, if we go up at the rate of 5 percent a year, these are all 3, 4, and 5 percent rates you say, $580 billion is at a 3 percent rate of interest—$700 billion is a 5 percent rate, if we go up at that rate we would have a $700 billion gross national product in 1967.

If that is the kind of growth we are going to have, and proper and appropriate monetary and fiscal policy can contribute to this, then we do not have to worry too much about this kind of a situation.

And when I make a few suggestions on spending, and I put these down with great trepidation, fearing that Senator Byrd would disapprove, I was consoled a little to look at the Rockefeller estimates which are way beyond anything that I ever put on paper, and so my suggestion from an academic man are much more modest than are those of the Rockefeller businessmen's committee.

So I am beginning to get old and conservative in these issues. [Laughter.]

Now, if you do have a spending program, what kind of a priority should you establish?

Now priorities, on page 16, should be determined on basis of contributions to American life, to the treatment of recession, and to the cost to the Federal budget. There are indeed other and related criteria.

For example, the choice of fields of expenditures favors certain regions against others.

Development, natural resources helps the west especially; roads help sparsely settled areas especially; social security programs, the industrial areas; education helps most States, though a Federal Government program tends to favor low-income States.

The other day I was advising our own Governor on some of these issues, and he asked what I thought he ought to present as a program for Massachusetts.

I said "Well, if you are looking at the problem from the viewpoint of Massachusetts, come out strongly for an unemployment compensation program, and area redevelopment, and health and education."

I said, "However, if you come from—say Senator Kerr's State, you probably would be more inclined to come out for a program of roads and public works and so forth."

Senator KERR. You sure were reading my mind. [Laughter.]

Mr. HARRIS. Then I realized that there are political issues involved here, and I thought you might be interested—I do not expect you to look at this table on page 18, but it is a rather interesting table which gives you some indication on how much you would gain should you be in favor of a tax-cut program or a spending program and this gives you some idea of how much money each region puts into the Treasury coffers and how much it takes out, and obviously, say a governor from Massachusetts, on the whole would be inclined to favor a tax cut, because they contribute a larger part of the Federal Treasury than they take out.

I am not in any sense implying that Massachusetts should take out exactly what it puts in but I think if you are looking at the problem from the viewpoint of your own region this is a relevant reason although as an economist I think we should look at this in terms of the national economy.

I also suggest, I would weigh education, perhaps unlike Senator Kerr, more heavily relatively than roads. This is a value judgment and is not primarily economics.

I would be inclined to say despite what I said about guaranties above, I would be inclined to put much more weight on guaranties. For example, guaranties of State and local governments issues for school construction and other services because this costs the Federal Government the least.

There is a good deal of discussion at the present time in the House and Senate about helping college students.

The general programs proposed are scholarships or loans. I think as a matter of fact the Federal Government would come off much better to guarantee loans of college students which would cost them less, and there is no reason why a college student should be subsidized by the Federal Government except through loans because on the whole the college student is a rich man in American society once he gets out of college.

He has a lifetime income of a quarter of a million dollars more on the average than the noncollege graduate.

Now, on Federal loans, I would be inclined to—I rather like the community facilities program. This puts a much smaller burden on the Federal Government than a public works program of its own.

This program could be extended much more to colleges, for example. The colleges of the country need a billion dollars a year for new investment and they can raise a half billion dollars.

Here is a way in which the Government with virtually no cost to itself can get an awful lot of spending done with a great stimulus to the economy.

Now, then, turning to page 19, I myself would weight heavily the importance of a good unemployment compensation program.

In a way I like unemployment compensation and an area redevelopment program more than I do, say, public works programs, because it affects the people who are really in distress directly, whereas the public works program depends upon a spillover ultimately to help the people who need the help most.

Senator GORE. I did not understand that word.

Mr. HARRIS. Spillover.

Senator GORE. Yes.

Mr. HARRIS. That is the money that is spent say for public roads gradually gets spread all over the economy, it spills over.

Senator BENNETT. Trickle down?

Mr. HARRIS. "Trickledown" is another term.

So what I am suggesting here is that——

Senator KERR. I ask for the regular order.

[Laughter.]

Mr. HARRIS. What I am suggesting here, Senator Byrd, is that given—supposing you want to spend $4 billion and I am not supposing, Senator Byrd, you want to spend $4 billion more, but assuming that you did. [Laughter.]

The CHAIRMAN. Your supposition is very correct.

Senator KERR. You are reading somebody else's mind also. [Laughter.]

Mr. HARRIS. If we are going to spend $4 billion additional I think it is important to take a good look at the different kinds of programs. We should not look at this problem purely merely in terms of the anti-recessionary effects but also in terms of what kind of a long-range program we would want and also in terms of having the kind of programs that will put the smallest burden on the Federal budget.

I think you also in that respect ought to consider the fact that State and local governments are in plenty of trouble. I would also, despite all I have said about natural resources, say we ought to develop our natural resources further than we have so far and I think the President made a great mistake in suggesting in his budget address that no new projects should be started; but he has had to abandon that particular position under the growing recession.

Now here on page 20 are the outlines—I am almost through, the outlines of the compensatory program.

We seem to be moving to a point where according to CED we may be operating at a level of 7 percent below that of public capacity and that is roughly at a rate of $30 billion a year, and that is roughly about where my own estimate came out.

Mr. Keyserling has a larger estimate of a loss of something like $55 billion. His estimate is based on the assumption that even in 1957 we were producing below capacity and I think this is a relevant issue. I should point out that in general this is what we have to keep in mind if we decide on any compensatory program, that it is a program to cut taxes or a program to increase public spending.

On page 21 I propose, and I must say, and I am terribly disappointed, Senator Byrd, we do not get estimates from the Federal Government about just exactly where we stand on tax cuts and Federal spending and prices and the amount of money that the Federal Reserve is pouring out and all that sort of thing.

I get a lot of my information just from what good reporters of the New York Times put into the New York Times.

It seems to me, and I was going to say this at some point or other, that the Council of Economic Advisers, in a period like the present, especially, ought to come out with a report once a month which ought to be made available to the public and all congressional committees saying just how much they are spending and when the money is going to be spent and how much taxes are going down and when and what is being done on monetary policy, at what rates of interest is the money being lent and all that sort of thing.

I think a report of 100 pages or so once a month would be of tremendous use, certainly, to economists and I would think it would be of tremendous use to the Congress.

Senator ANDERSON. Doctor, can I stop you right there to ask if you have seen all of the publications the Department of Agriculture puts out? They publish a cotton report once a month; they put out a price situation pamphlet once a month. The farmers are only a small percentage of the total economy.

Don't you think the other segments of the economy should know as much about their economic health as the small percentage does about the farm situation?

Mr. HARRIS. I agree with you, Senator Anderson.

I think the Department does an awfully good job in this field and I get an awful lot of information from what they put out.

We set up a Council of Economic Advisers and their job was to look at the whole economy.

What they do is they give us 1 report and sometimes 2 reports and they do come in and testify before congressional committees, but I think you read the New York Times every day, a few columns on the recession, but most of the guesswork about how much money is being spent, how much each program is going to yield the next month or a year, are worked up by fairly young bright reporters, but it is not being given by the Government, as a rule, and what we ought to have is a systematic statement once a month, particularly in a period like this, taking into account all the factors relating to the economic state of the Nation, which is an important thing.

I disagree with Senator Martin, if I may, I think this is not as important as the bomb but it is a pretty important thing nevertheless.

Senator ANDERSON. May I come back to my question. When Secretary Humphrey was testifying, I asked him about the National Security Council, and I asked him what he would think of the establishment of a national economic council. It is just about as important to bolster our economy at home as to watch our security, and a national economic council could publish these thorough, systematic economic reports. Is that the type of action you are recommending?

Mr. HARRIS. Yes, Senator Anderson. I was simply talking in terms of information and I remember Mr. Bell before this committee on the interest rate increase made a suggestion for that kind of a council, too.

Senator ANDERSON. That is where I took my suggestion from, frankly.

Mr. HARRIS. I think that was a good idea.

The Federal Reserve did not like it because they felt it might impinge on their independence and whatnot, but I think some central organization that would speak for the Government and present these overall statistical pictures would be a great help to everybody who is interested in the present situation.

Senator ANDERSON. You are trained to look for this statistical information and you have students that can help you pick it out.

Can you imagine the task of an individual Member of the Congress who wants to try to find it and has to go hunting through these magazines by himself?

Mr. HARRIS. You are absolutely right, Senator.

I know the Members of the Congress have about 15 or 20 different problems they have got to be interested in at the same time.

I had to spend a whole week working this paper up and I was really annoyed I could not find anywhere any estimate of just exactly how much we expect to spend the next 6 months, and I worked up some wild estimates of my own which I would not have any faith in, but I think the Government should have a better possibility of knowing the range within which they would expect this sort of thing to happen.

Now I have on pages 22 and 23 a listing of different programs that are already passed or on their way to be passed, and some of which I suppose will not be passed and these altogether yield a few billion dollars, I think it is $4 billion.

Actually of course only a small part of this money will be spent in calendar 1958, and I have also suggested because of the slow rate at which expenditures go out, that we might conceivably expect an increase of spending along other lines.

For example, I would be inclined to think that we should have perhaps $2 billion additional for security although little of this will get out in 1958.

I suggest a few other items here. I would like to see an educational construction bill although I realize there is not much chance of getting it, and I have suggested a few other increases all of which altogether add up to a couple of billion dollars.

My own guess is that with all these programs we are not likely to get much more than $2 billion of additional spending in 1956 and this includes some programs not on the congressional agenda.

And then, if I may just take 3 minutes to summarize——

The CHAIRMAN. You mean 1958 or calendar year 1958?

Mr. HARRIS. I am talking about calendar. I think in calendar 1959 a substantial amount of this money may get out. It may be we will be out of the recession and hence some of these expenditures may be unfortunate except so far as the program may be justified on other ground.

I simply end up then by saying that the restrictive monetary policy contributed to the decline.

The monetary policy has not reversed itself quickly enough; that one of the factors in the situation is excess capacity, but that is related to the total supply of money and spending.

The Federal Government in its changeover from a deficit to a surplus position has also contributed to the decline.

The recession, I think, is moderately serious, worse than the last two, not anywhere near as serious as 1929-32, and I don't for a minute think it will ever get anywhere near that.

I think we have learned a great deal on how to deal with this kind of a situation and I am sure the Congress will do a great deal to neutralize the effect of declining demand.

I need not go into the problem again why I think the Federal Reserve policy has been unsatisfactory; but I do want to stress the point they have a very tough problem to deal with.

So far as a therapy goes I would suggest an aggressive monetary policy, an increase in spending, a reduction of taxes.

As far as expenditures go, I have indicated the lines of my proposal, and I would say the present deficit would make some contribution and that we do not have to offset the full $15 billion dollars because of the multiplier effect, except that so much of this spending is very slow in getting going.

I want to emphasize the point that there is some real danger in waiting, and I wonder if it is worth taking the risk.

Thank you very much, Senator.

The CHAIRMAN. Dr. Harris, we certainly thank you, sir. You have made a very interesting statement, a very sincere one, and it will be valuable in our consideration of this great problem.

I am only going to ask a few questions because you have already answered a good many in your very clear statement.

Did I understand you to say that the reduced purchasing power was one of the factors in the recession?

Mr. HARRIS. Yes. Well, there really was not a reduction. It was a reduction in the rate of increase, because even in 1957 we had a rise of 1 percent in the total supply of money. I would say that the failure to expand the total supply of money more rapidly since the turning point——

The CHAIRMAN. I am speaking of the personal consumption expenditures.

Mr. HARRIS. Yes, I would say, Senator, that the personal consumption expenditure just did not rise fast enough, given our capacity to produce, and this, of course, caused a certain amount of difficulty and it did not rise fast enough partly because of monetary and fiscal policy.

Senator KERR. I believe the Senator asked you if you thought that appreciating value of the consumer's dollar contributed to the recession, wasn't that what you had asked?

The CHAIRMAN. That was one part of the question. In the past several years there has been no substantial reduction except in 1957, as I recall the situation.

Mr. HARRIS. You mean in the total supply of money?

The CHAIRMAN. In the reduced purchasing power of the dollar. What interests me is that in 1957 disposable personal income was $300.6 billion.

Mr. HARRIS. For the year 1957.

The CHAIRMAN. Yes.

Mr. HARRIS. $300.6 billion.

The CHAIRMAN. After taxes?

Mr. HARRIS. Yes.

The CHAIRMAN. While, in the first quarter of 1958 the rate is $299.3 billion.

Mr. HARRIS. Yes.

The CHAIRMAN. Very slight difference.

Mr. HARRIS. That is perfectly true, but if you look at the quarterly figures though, Senator, take the third quarter of 1957, the figure is $303 billion and we are now down to $299 billion. That, of course, does not take into account the rise in prices since that period, so you have a decline.

The CHAIRMAN. As compared to the first quarter of 1957 and first quarter of 1958, is $2 billion more.

Mr. HARRIS. That is right. That in real dollars is less. But I am willing to grant you your point, Senator, that the decline of disposable income has been surprisingly small. I agree with you.

The CHAIRMAN. You mentioned that it was necessary to increase the purchasing power?

Mr. HARRIS. Yes.

The CHAIRMAN. These figures are less taxes?

Mr. HARRIS. Yes.

The CHAIRMAN. And available for expenditure?

Mr. HARRIS. That is correct.

The CHAIRMAN. And in the second quarter of 1957 there was a saving of $21.4 billion, and that was reduced in the first quarter of 1959 to $18.8 billion.

Mr. HARRIS. Yes.

The CHAIRMAN. Money available for expenditure by all the people of the country did increase but your argument is it did not increase in proportion to the so-called boom we had.

Mr. HARRIS. That is correct.

The CHAIRMAN. Do you think a country can have a constant boom?

Mr. HARRIS. Well, Senator, I do not think so. I think you are going to have some reactions of some kind, and we cannot manage the economy in such a precise way that we can always go up every single year, and I think we are going to have some——

The CHAIRMAN. We have been going up for how many years?

Mr. HARRIS. Of course, we had a setback in 1949 and we had a setback in 1953–54.

My only criticism of the authorities is that not only did we have the decline, the reaction, and we were investing at a fairly rapid rate, but they helped to make it a little worse and helped to bring it on.

The CHAIRMAN. As a matter of fact, we can say we have been in a boom period for at least 10 years, since 1948.

We had a recession in 1953 or 1954, yet the disposable personal income increased.

Mr. HARRIS. Well, I would say, Senator, we have done remarkably well, taking the whole period from 1946—even from 1941—right on.

The CHAIRMAN. The trouble has not been in a reduced purchasing power on the part of the people, and during that period the loss of the dollar value was not very much.

I think it was stationary in 1952, 1953, and maybe 1954; was it not?

It started to lose its value about 18 months ago again at about the rate of 2 cents a year; is that right?

Mr. HARRIS. Yes. You mean the value of the dollar? It went down.

The CHAIRMAN. Yes.

Mr. HARRIS. Well, Senator, in many respects I agree with your statements and the implications, but I do want to say for the record that the thing that of course troubles a good many of the economists is that, you see, you have, say, 750,000 new workers getting on the labor market every year and you have this rise of productivity which has averaged 2.2 percent over a period of 50 years.

In that kind of a situation you have to have a substantial rise of income of something like $15 billion a year, year after year, and if you do not, to that extent you have more unemployment.

The CHAIRMAN. But you just said you do not think a country can have a continuous boom.

Mr. HARRIS. No. You will have some declines, I am sure.

The CHAIRMAN. That is what we are having now?

Mr. HARRIS. Yes, that is perfectly true.

The CHAIRMAN. It is a readjustment of the economy?

Mr. HARRIS. My point of view is I am not sure we had to have it so soon or so great and I am sure it was not brought on by natural forces only.

It was brought on partly by governmental policy.

The CHAIRMAN. But you do say there cannot be a constant rise over a period of time?

Mr. HARRIS. I would not say you cannot but I will say it is improbable you would have things going up every year for 20 years.

The CHAIRMAN. It has not been doing that, has it, in all the history of the country?

Mr. HARRIS. Not that I know of.

The CHAIRMAN. Let's get down to the tax reduction.

As I understand your figures here, you recommend a tax reduction on a yearly basis of $11,491 million.

If we recommend that——

Mr. HARRIS. That is not right, Senator.

The CHAIRMAN. Was that not on the page I was reading here?

Mr. HARRIS. Unless there is a misprint here.

The CHAIRMAN. I think some of this document—I mean the document you prepared is a little out of date; is it not?

Mr. HARRIS. You know Senator, I prepared this 2 weeks ago.

The CHAIRMAN. You say at the bottom of page 20, the outlay, meaning the additional expenditures, tend to multiply and I agree with that, every word of it.

You cannot turn these things off and on like water through a spigot, but you have got a computation somewhere—what page is it?

Mr. HARRIS. I said the economy is going down at a rate of $10 billion to $15 billion a year.

The CHAIRMAN. Page 14, you said that the full effect of your recommendation for tax reduction is $11 billion——

Mr. HARRIS. No, these are eight alternative programs for tax cuts, and the one that I suggested was No. 6.

These are the ones that the Joint Committee on Taxation presented to your committee and I took some of those out.

The CHAIRMAN. What confused me was that you added them all up.

Mr. HARRIS. No, I did not. This is only the program No. 8, which says you reduce individual rates from a top of 91 percent to 42 percent.

The CHAIRMAN. You only recommend one?

Mr. HARRIS. I recommended No. 6.

The CHAIRMAN. No. 6?

Mr. HARRIS. Yes; and that is for only 6 months so it was only $3.5 billion.

The CHAIRMAN. I see. I misunderstood you.

Mr. HARRIS. I guess I went too fast and did not make it too clear.

The CHAIRMAN. In any event, it would result in a deficit of around $14 billion to $15 billion.

Of course, as you very correctly stated, Doctor, one of the reasons for this deficit is the overestimation of the revenue.

Mr. HARRIS. Yes.

The CHAIRMAN. Which, as I calculate it, amounts to about $4 billion.

Mr. HARRIS. Yes.

The CHAIRMAN. Is that in accordance with your thinking?

Mr. HARRIS. I got most of my information on that from you.

The CHAIRMAN. It has not been publicly admitted by the Treasury but I think it will be.

Just a little while back they talked about having a surplus in this fiscal year.

Senator KERR. Next fiscal year?

Mr. HARRIS. No, 1958.

Senator KERR. I thought when they came out January 12 they estimated a $400 million deficit.

The CHAIRMAN. I am speaking of this fiscal year. And in the next fiscal year I think we start with a $2 billion overestimate of revenue this year.

Then for next year the budget estimated revenue at $2 billion more than the original estimate for this year.

Mr. HARRIS. Yes.

The CHAIRMAN. That makes it a loss of $4 billion?

Mr. HARRIS. That is right.

The CHAIRMAN. To start with, I don't share your feeling that in the next 15 months this spending is not going to reach a very high level.

Mr. HARRIS. I was talking about calendar 1958 primarily.

The CHAIRMAN. In view of the way things are going in Washington now, I think expenditures in fiscal year 1959 will exceed budget estimates by up to $6 billion and I think Mr. Martin expressed the same view yesterday.

A month or more ago I put the deficit next year at $8 billion, and yesterday he calculated it at $10 billion.

Certainly it will be in that neighborhood.

If you add $4 billion or $5 billion or $6 billion in tax reduction, you have got by far the biggest peacetime deficit we ever had in the history of our country. Now I think you and I differ, sir. Where you think deficits, excessive spending, and taxes can be stopped at will.

But I have been in the Senate 25 years, and I can say to you, sir, that from my experience of 25 years they cannot be turned off and on like a water through a spigot.

For instance, we still have Korean war taxes. We have been continuing them every year and the same thing would apply to tax reductions even if you were to put an expiration date on them.

There can be no doubt about the fact that entrenched public spending is the most difficult thing that Congress has to do to reduce. When I came to the Senate 25 years ago we had a $4 billion budget. Now it is $80 billion.

I think one of the most unfortunate things this present administration did was to bring in the largest peacetime budget in the history of the country for 1957 when there was no emergency even such as we have now. That set a level of spending which will not be substantially reduced for many years.

For that reason I am opposed to a tax reduction when it has to be financed by deficit financing.

Just one more question.

You spoke of a creeping inflation and as I understood it you accepted the principle of a gradual inflation.

What percent of that would you accept, 2 percent a year?

Mr. HARRIS. Well, Senator, I did not mean to imply that I accepted a creeping inflation. I think we would all be better off without inflation. It is just a question of estimating one risk against another, and as I said in my paper, I would be very happy with a 1-percent rise of prices and a 5-percent rise in output, and I would be very unhappy with the reverse.

I think my colleague, Professor Slichter—who I understand was here; I read his paper—I know he feels quite strongly that he is ready to risk a 2-percent rise of prices in order not to bring on a recession and this is a matter of judgment, of course, and there are matters of equity involved and so forth.

The CHAIRMAN. How could you hold it down to 2 percent?

Mr. HARRIS. On the whole, Senator, I think if you take the end of 1947, which you might say is the end of the war aftermath and go on to 1957, the situation really has not been too bad.

You get an average, what, of maybe 2 percent per year, and look at the tremendous prosperity we have had taking the whole 10-year period.

The CHAIRMAN. I believe we have lost more than that since 1947, and 1948.

Mr. HARRIS. I beg your pardon?

The CHAIRMAN. I think we lost more than 2 percent in 1947, 1948.

Mr. HARRIS. I think it was something like that.

The CHAIRMAN. As a matter of fact, as you know, from 1940 to 1958, we lost 51, nearly 52 cents of the purchasing power of the dollar.

Mr. HARRIS. From 1948 to 1958 we have lost just less than 20 percent.

The CHAIRMAN. I mean from the beginning in 1940 or 1939.

Mr. HARRIS. Yes.

The CHAIRMAN. We lost 52 cents.

Mr. HARRIS. That is true, Senator, but I want to make two comments on that. One is it was largely war, and secondly, I do not think it is fair to compare 1938, 1939, or 1933 and I notice Secretary Humphrey did that.

I think you ought to go back and compare it to 1929, because from 1929 to 1932 you had a 32-percent drop in prices and part of the increase later offset this decrease.

The CHAIRMAN. What would you call small inflation, 2 percent?

Mr. HARRIS. I would hate to see prices go up on the average more than 2 percent a year.

I mean you begin to get into pretty bad adjustments.

The CHAIRMAN. As an economist, do you regard increased cost of living as a standard of inflation?

Mr. HARRIS. Yes, although there can be other definitions, of course. Almost everybody uses the cost of living index because it affects so many people.

The CHAIRMAN. Is that the main factor, in your opinion?

Mr. HARRIS. Well, I think——

The CHAIRMAN. When I speak of inflation, I am talking about what occurs to the purchasing power of the dollar?

Mr. HARRIS. Yes. That is right.

The CHAIRMAN. And you think that the increase in cost of living would—is the main factor in inflation.

Mr. HARRIS. It is about as good an index—there are other indexes.

The CHAIRMAN. In other words, does the dollar lose its purchasing power in proportion to the increased cost of living?

Mr. HARRIS. Well, the way a technical economist would say that, Senator Byrd, is simply that the cost of living measures the change in the purchasing power of the dollar.

The CHAIRMAN. That is right.

Mr. HARRIS. In other words, if the cost of living rises that means the value of the dollar has gone down.

The CHAIRMAN. It went up seven-tenths of 1 percent this last month?

Mr. HARRIS. That is right.

The CHAIRMAN. And we lost seven-tenths of 1 cent; is that it?

Mr. HARRIS. Well, roughly, that is correct, yes.

The CHAIRMAN. Thank you very much, Doctor.

Senator Kerr?

Mr. HARRIS. Senator, may I make one other comment?

I know your views on the budget and I do not want to risk your displeasure, but I do want to make one point——

The CHAIRMAN. There are plenty of people who differ with me on my views on the budget.

Mr. HARRIS. I want to raise one point with reference to the point you made.

I remember way back in the 1930's I used to say a good deal about the need of spending more money in order to get us out of a depression and I can remember when people were very unhappy about a $3 billion deficit and they said this was the end of the American economic system, and so forth.

Yet this has gone on for an awfully long time and I think most of the debt and borrowing and inflation has been the result of the war, but the interesting thing is even if we have and I hope we can avoid having a $15 billion deficit, I hope we can get out of this with less, substantially less, but supposing we had a $15 billion deficit. This is the equivalent in terms of the size of our economy with a $3 billion deficit.

The CHAIRMAN. I will ask you another question.

Suppose we had another $15 billion deficit for next year, $12 billion the next, $10 billion the next, and so on, would that be a good thing for the country?

You do not contend this $15 billion assuming it does occur is going to end in 1 year, do you?

Mr. HARRIS. Senator, I would like to see the debt cut down in a period when we have inflation.

The CHAIRMAN. Answer the question. Do you think it is a 1-year proposition or not?

Mr. HARRIS. No; I do not but my answer to you is the following: If the debt rises $15 billion in the midst of a recession, I do not think we ought to be too unhappy about it.

I would not like to see it happen year after year and I hope for example in 1960 when and if we have a highly inflationary picture we pay off a substantial part of the debt. I agree with you, Senator, that it is very difficult to do that and I realize that and that is one reason why the economist does not have the final word.

The CHAIRMAN. Do you consider it is harmful to pay more than 11 percent of the total income from taxation for interest on the debt.

Is that a good thing of not?

Mr. HARRIS. We do not pay that much, Senator.

The CHAIRMAN. It will come to that.

Mr. HARRIS. I see.

The CHAIRMAN. We pay about 7 or 8 now; don't we?

Mr. HARRIS. I would say that this is a tough problem if you get up to 7 percent.

No; the present debt is what, $6 billion or $7 billion interest? That is only 2 percent of our national income.

The CHAIRMAN. I am speaking of the tax revenue.

Senator KERR. He is speaking of percentage of the Federal budget.

The CHAIRMAN. Seven percent of the taxes we collect.

In other words, when we pay our tax bill, more than 10 cents of every dollar paid goes for interest on money we have spent in the past.

Mr. HARRIS. Well, I could—this is the sort of thing you could argue about for days and days, but if you look at our economy of 1933 with an $80 billion income and today $430 billion, there was a charge for the national debt then of a half billion dollars, and $7 billion today, we have a rise of $6½ billion of debt charge and a rise of what $350 billion of income, so it is only an increase of, say, even at the most, of $7 billion against $350 billion.

I do not mean to say, Senator, this does not raise problems.

You have a large rentier class and people like that.

Senator JENNER. You have got a 48-cent dollar.

The CHAIRMAN. You will live longer than I will, but I want to say this $300 billion Federal debt is going to be one of the most difficult things to meet and finance in the years to come.

It is going to $300 billion, as I see it now.

Where you and other economists and I disagree, as I said before, is that you think you can turn these expenditures and these taxes off or on as you please.

I say to you with 25 years on this committee and as a Member of this Senate, that cannot be done.

Mr. HARRIS. Senator, it is a matter of degree, and if the thing— you have to relate it to the economy and if it goes up too fast in relation to the economy——

The CHAIRMAN. How are you going to do that?

You have 435 Congressmen and 96 Senators. How are you going to get all of them to agree to cut the taxes, put the taxes back or stop these public works or stop this, that and the other, that is being done?

Mr. HARRIS. I agree there are difficulties of cutting back. There are difficulties in repaying the debt and difficulties of raising taxes when you should raise taxes, when you have an inflation and these are political issues which of course the economists have to take into account, and I am perfectly willing to say to you the problem is much more complicated than the academic economist makes it out to be.

The CHAIRMAN. But you do agree deficits started in a so-called emergency such as now may continue before it is stopped for a good while to come?

Mr. HARRIS. Yes, I think that is possible.

The CHAIRMAN. Senator Kerr?

Senator KERR. Doctor, I shall be brief in my questions.

I would enjoy an elongated period, but I know Senator Anderson is going to ask you a number of questions, and I am tremendously interested in them and the answers so I will be very limited in what I have to ask.

You were talking about Government guaranteeing liabilities of Government agencies and maintaining dear money at the same time, as being evidence of a lack of coordination on the part of various elements of the same Government. I was glad to refer to it because it is a matter that I have referred to many times and the only answer that I can give as to why that is done is that there is an attitude on the part of many men in powerful positions in this Government to increase the take of those who lend money.

Because certainly as Government agencies are borrowing money with the Government guaranty they have to pay more interest than the Government itself would on its own indebtedness, and when Government is borrowing money either directly or through its agencies and another branch of Government is making the available amount of credit less or money more dear, I can see but one compelling reason and that is that there is a joint effort there to increase the interest rate.

Would that sound logical to you?

Mr. HARRIS. I suppose so, Senator.

Senator KERR. It certainly has that result; does it not?

Mr. HARRIS. Yes.

Senator KERR. Any time that branch of Government which controls the money supply makes it more dear at the time the Government itself and its agencies are borrowing more money—one is the direct obligation of the Government and the other is a Government guaranty—they are contributing to a situation of an increasing interest rate level.

Mr. HARRIS. Yes; I would certainly say the dear money policy increased the rate of interest and therefore made the business of life insurance and banking and so forth more profitable. And that is——

Senator KERR. The interest rate is higher?

Mr. HARRIS. The interest rate is higher; yes.

Senator KERR. Now you were talking about a situation of a Government agency making forecasts or making reports on the status of the economy and forecasts of the economy and also providing information currently as to Government spending and operations of the Federal Reserve bank in the open market, and in the making of additional credit more available or less available and other pertinent information about the economy did it ever occur to you that if that were done that the corner on information now enjoyed by those who have access to that information might be broken and that their opportunity to profit by having information not available to all the people in this country would be impaired if what you suggested would be done?

Mr. HARRIS. Well, Senator, that is an interesting idea that never had occurred to me and I think there is something in it.

I did not mean to imply, Senator, that I would have the Government forecast—of course when they make up their budget they do forecast.

Senator KERR. Under the Full Employment Act, aren't they given——

Mr. HARRIS. Yes, within those limits they are supposed——

Senator KERR. Aren't they directed to make a forecast?

They have not been doing it, have they?

Mr. HARRIS. Not in any vigorous way I would say.

I go through that report each year and I always say——

Senator KERR. With your facilities of getting information, has any of it gotten in your way as you were searching for it?

Mr. HARRIS. I don't think they do very much in this direction. I agree they have some responsibilities here.

Of course the budget director does have to make some guesses and as Senator Byrd pointed out——

Senator KERR. But there is no law or no penalty if he is in error, is there?

Mr. HARRIS. No, and I think it would be too bad if there were.

I think it is rather dangerous to do too much forecasting on the part of the Government but they ought to give us the information and I think your point that this information be made available for everybody might be good for society because some get access to this limited information and others should get it.

Senator KERR. The Governors of the Federal Reserve Board have access to it?

Mr. HARRIS. And they have their own research staffs.

Senator KERR. And the directors have access to it?

Mr. HARRIS. I think so.

Senator KERR. And since 6 out of the 9 directors are elected by the member banks, it is just possible they have access to it?

Mr. HARRIS. Yes.

Senator KERR. Do you suppose it is just possible that might account for the situation that occurred in the latter part of 1956 when banks, commercial banks, and other owners of long-term Government bonds, saved tens of millions of dollars in taxes by selling their long terms and then immediately rebuying other similar ones and saving 50 percent of the loss that they took on their paper there in the form of taxes saved? Then in December of 1957, after a change of policy in the Federal Reserve bank had made money easier and long-term Government had gone up 10 or 11 points, they sold them, paid 25 percent capital gains tax, and immediately repurchased similar ones. They had the same situation on their balance sheet December 31, but in the meantime they had been enriched by that operation in long-term Governments.

Mr. HARRIS. Well, Senator——

Senator KERR. Does it just occur to you that, with the situation the way it is handled now, there are substantial numbers profiting by it but that that opportunity might be lost to them and shared by others if the information that they use in thus handling their portfolios was compelled to be made public information?

Mr. HARRIS. Well, Senator, I think there is a lot in what you say. I think it is true this is a very difficult problem. You have an open market committee considering whether they should increase the rate in buying of securities or reduce the buying of securities or something of this sort—this is going to have an effect on the rate of interest or an effect on the economy.

Quite a number of people know this, and I think probably most of the people that operate in this field are pretty honest and do not go around and tell their friends that the thing to do is buy or sell Government bonds or something of this sort.

As you know, there was a great scandal in England on this issue recently. They had an expert committee look into it, and they finally found the directors of the Bank of England had not violated their trust.

But this is a matter of high trust and keeping their information. I do not know how you can deal with this problem, of dealing with it, where there is a long list of people knowing what is going on.

Senator KERR. If your suggestion was carried out, that would, in part, handle it?

Mr. HARRIS. That would help it——

Senator KERR. If information as to their operations and so forth were compelled to be made public once a month?

Mr. HARRIS. Yes.

Senator KERR. That would be better than it is now?

Mr. HARRIS. It would be an improvement certainly as far as the general picture goes, and it would make this information much more widely available.

Senator KERR. Now, in your statement you said, "Whereas the earnings assets of the commercial banks rose about 21 percent from 1951 to 1957, assets of life insurance companies increased 48 percent, and savings banks 155 percent, Government credit agencies guaranteed investments by 113 percent—you understand what was the principal contributing factor to that situation, don't you?

Mr. HARRIS. The high-money rate.

Senator KERR. No. It was the tax advantages in the 1951 law.

Mr. HARRIS. I suppose that was a factor.

Senator KERR. When that matter was before the committee and on the floor of the Senate, the Senator from Oklahoma predicted just this thing would happen under the tax advantages in that law, to insurance companies and building and loan associations and savings banks.

I predicted at the time that the rate of growth of the various financial institutions, commercial banks, insurance companies, Government loan associations, mutual savings banks would be materially affected by that tax structure. I will say to you now you might just as well be prepared for the commercial banks in this country to be in fourth place among those groups of financial institutions if the present tax structure is continued because they pay 52 percent of their earnings in taxes.

Mr. HARRIS. Yes.

Senator KERR. And these other institutions pay either nothing or very little comparatively?

Mr. HARRIS. Yes.

Senator KERR. As long as that exists, isn't this disproportionate rate of growth going to continue?

Mr. HARRIS. Yes. Well, Senator, I realize there has been a lot of discussion about the taxation of life insurance companies. I do not feel I am an expert in that particular area and I should certainly think if they are treated favorably vis-a-vis the other financial institutions they would tend to grow more.

I am not prepared to say this is the only explanation of this rate of growth.

This is worldwide and certainly it is true in Great Britain, too. I do not know just exactly what the explanation is except these outfits are growing.

Maybe they have better managers than banks; maybe they have a better job to do and maybe the assets they buy tend to become more important; for example, consumer and housing credit tend to become more important in the economy.

This would also tend to explain——

Senator KERR. Well, you know a good racehorse makes the racehorse owner pretty smart at times.

One time in Madison Square Garden a follow hired the lion tamer from a circus and paid him a big bonus and he said, "I want you to get us the same crowds you got at the circus." He said, "If you depend on me to do it consistently you will have to get the lions, too."

Now, you give the managers of a building and loan association and savings banks and insurance companies the advantage of having to pay little or no taxes, that gives them a pretty good running start in a competitive position with commercial banks that have to pay 52 percent of their earnings; does it not?

Mr. HARRIS. I had not thought of that point, Senator.

There certainly must be something to it. It must be one of the factors and I certainly have been aware of the fact there has been this long struggle about how life-insurance companies should be taxed, but I want to take your word for it.

Senator KERR. This is not insurance companies; they are taxed some.

Mr. HARRIS. Yes.

Senator KERR. But I cannot find where the mutual savings banks or the savings and loan associations are taxed at all.

Mr. HARRIS. Except on real estate and so forth, but not on income.

Senator KERR. Yes, but their earnings are not on real estate. Their earnings are on lending money.

Mr. HARRIS. Yes.

Senator KERR. Well, thank you very much, Dr. Harris.

Mr. HARRIS. Thank you, Senator.

The CHAIRMAN. Senator Martin.

Senator MARTIN. Mr. Chairman, I was very much impressed with the discussion between you and Dr. Harris relating to taxes, deflation, debt, deficit financing, and so forth. They are very serious problems, and I was very much impressed, Dr. Harris, with your suggestion that you hoped we would decrease the public debt during times of great prosperity.

Mr. HARRIS. Yes.

Senator MARTIN. That is very sound, and what the distinguished chairman of this committee stated a moment ago, it is awfully hard to get those things done.

Over 50 years ago I was a burgess of a small town; over 40 years ago I was the solicitor for a growing county in Pennsylvania; then I was Governor of the Commonwealth of Pennsylvania. And the debt level of government has continually increased over those years.

There has been seemingly no attempt, except on very few occasions, to reduce the debt. I had the debt of Pennsylvania down to $44 million when I retired as Governor. It is now a billion, and it has gotten the State in a great deal of trouble so far as inviting industry to the Commonwealth.

I would like to get back to what we discussed just a little bit ago, about inflation. We have had inflation since the early thirties, and at some periods much more than others; and in that time the value of the dollar has decreased; we have lost 52 cents in the value of the dollar.

And then you suggest that probably a couple of percent increase each year would not be too damaging to the economy. But when can we stop it?

Mr. HARRIS. Well, Senator, may I just say a word about debt repayment first.

We have repaid some of our debt right after the war, and I think enough was not repaid and I agree with what both you and Senator Byrd say, it is not easy to get debt repayment when it should be repaid.

I agree a hundred percent with what you say about State and local debt, because the situation there is much more serious than with the Federal Government, probably because they have no way of creating money the way the Federal Government does indirectly, and their debt has been going up at the rate of 200 percent during the last 10 years.

So we are in substantial agreement on this.

Now, on inflation, it may well be that, given our institutional setup, we just cannot stop a certain amount of inflation unless you want to risk a serious recession, because you have the workers well organized demanding wages often in excess of their productivity; you have semimonopolistic——

Senator MARTIN. I think we all appreciate what you are saying very much, but your mentioning there that wages have increased——

Mr. HARRIS. Yes.

Senator MARTIN. Way beyond productivity——

Mr. HARRIS. Yes.

Senator MARTIN. Is that not a great reason for inflation?

Mr. HARRIS. That contributes to inflation, and I want to be fair——

Senator MARTIN. Is it not one of the largest contributors to inflation?

Mr. HARRIS. Well, I don't want to make a value judgment. I would say that where wages rise more than productivity, taking the whole Nation, then to that extent labor is responsible for the inflation, and insofar as the businessman passes on in prices more than his costs are that are involved, then to that extent the businessman is responsible, and I don't want to say that the laborer is more responsible——

Senator MARTIN. Doctor, let us be fair. Is it not a combined responsibility, and is it not most unfair to the general population in the United States?

Right now, to my mind, one of the greatest reasons for this recession that we have is a buyer's strike. People think prices are too high.

Yesterday we discussed increased costs and prices. The big proportion of these additional increases went to labor. I want to see labor receive good wages and I want to see them have fine living conditions.

The great majority of Americans are really savers. They have deposits in saving banks, they have life insurance, and they buy Government bonds.

Now, in our economy, do you not think it is necessary for us to give a lot of consideration to that fine group, because they are the ones we really depend upon in great emergencies.

Mr. HARRIS. Senator, I agree, and I think that inflation is a serious thing for the savers, and if it is too large and too long continued it has a detrimental effect on savings, and it is just a matter of degree. To some extent you do injustice to the savers in order to get a higher gross national product.

If you have too much inflation in those terms, then to that extent you are not operating a very good economy; and you can inflict some losses on savers, but if you do it year after year at a rapid rate, then of course people just stop saving, and the result is that their savings are used up and consumed by inflation.

I wouldn't be unhappy about a 1 percent inflation, even if it does, say over 40 years, wipe out 50 percent of your savings, as it would. But if you had a steady rise of 5 percent a year, there would be a disastrous thing for savings.

Senator MARTIN. Well, Doctor, have we not, since 1939, seen the value of the dollar decrease 52 cents, and that cut in half the savings of the people of our country?

Mr. HARRIS. It certainly did.

Senator ANDERSON. Did it cut in half the national debt, also?

Mr. HARRIS. It had that effect, of course. And, of course, the other point is, one must not consider this thing outside of the fact that the factors that were contributing to higher prices also to some extent were contributing to a rise of output, so you have to put the loss of savings due to higher prices—the rise of savings due to the rise of income which accompanied the inflationary policy.

Now I agree with you this is a matter of degree, and I would not like to see a rapid rate of inflation. But I think one should not talk about inflation unless one talks about the other effects of these policies that brought on the inflation.

If it is a large amount of inflation, I believe it is going to do a great deal of harm, both in terms of justice and in terms of the effect on output.

Senator MARTIN. The distinguished Senator from New Mexico stated that cut our debt in half, but 40 million Americans that owned Government bonds also had the buying power of their bonds cut in half.

We have at the present time what you would call a managed economy and a managed currency. Do you not agree with the statement of Senator Byrd that we just cannot turn these things off and on like we do a spigot which supplies water?

Mr. HARRIS. It is difficult. There is no doubt about it.

I think the economists know much more about what is to be done. I think the Congress has a much better idea of what is to be done, but I think there are great political obstacles in doing what is right, and we do not have precise control of these matters.

The CHAIRMAN. I deeply regret I have to go to cast my vote in the Armed Services Committee, and I will ask Senator Kerr to take the chair.

Dr. Abbott, would it suit you to testify tomorrow morning?

Dr. ABBOTT. Yes.

The CHAIRMAN. I am afraid we will have to vote this evening, so when we adjourn this session, we will not reconvene until tomorrow morning at 10 o'clock.

Senator KERR (presiding). Senator Frear.

Senator FREAR. Doctor, in your recommendations for tax relief, I think you suggested No. 6 on page 13.

Mr. HARRIS. Yes.

Senator FREAR. With split rates of the first $2,000 taxable income.

I wondered how you would feel about a tax reduction by increasing the personal exemption $100, which would have not quite the same cost but perhaps the same effect.

Mr. HARRIS. Well, I would not object to the other. I think there is a strong feeling in the country if you do that, you will get an awful lot of people off the tax rolls.

Senator FREAR. Well, I agree with you, and I think it costs the Government less to collect it if they were off the tax rolls.

Mr. HARRIS. Yes.

Senator FREAR. So you would have more net from that than you would have in a less complicated return.

Mr. HARRIS. I really do not have any strong preferences between these. I think politically there are a great many people who object to the change in the system that would take, say, 5 million or 6 million taxpayers off the rolls, the theory being if you are on the rolls you are more interested in Government, and that sort of thing.

Senator FREAR. I agree with you, and there is something to that. I think a person who pays taxes has a more stimulated interest than he would otherwise.

Mr. HARRIS. Yes.

Senator FREAR. That is all.
Senator KERR. Senator Williams.
Senator WILLIAMS. No questions.
Senator KERR. Senator Anderson.

Senator ANDERSON. You mentioned earlier that this recession was not as bad or as severe, of course, as the one in 1929 or 1932, but you thought it was severe. Who do you think is primarily responsible for the recession?

Mr. HARRIS. Well, I do not want, you know, to be mean to the Federal Reserve, but I think there are some forces in the economy—this great increase in capacity had something to do with it, certainly, and many economists believe this is sort of a capital goods recession. We turned out too many capital goods, and we do not have the buying power to take the goods off the market.

But always I tried to imply I think the Federal Reserve has some responsibility for it. They were trying to stop an inflation; this is what concerned them. I think they were excessively concerned with inflation, and to that extent I would say that it is partly their responsibility.

Senator ANDERSON. They put on the brakes, but they put on too many of them?

Mr. HARRIS. They put on brakes and didn't even stop the inflation. I mean we got both the inflation and recession, although some people say we would have had more inflation if the Federal Reserve had not cut down the supply of money.

Senator ANDERSON. As you watch it, do you think the Government has any integrated plan for controlling this recession?

Mr. HARRIS. I don't believe the Government has an integrated plan. What they do is, about every third day they send something up to the Hill or they make a comment on some bill being put through by Congress.

I would like to see the administration, the White House, if not the Council of Economic Advisors, come out and tell us once a month what their plan is, and what progress they are making, and so forth.

Senator ANDERSON. That is why I asked the question a while ago when you proposed this report, which I had never heard before. It seems to me if you had to report once a month, you would have to know what kind of an integrated plan there was, if you had to report on it.

Mr. HARRIS. Yes.

Senator ANDERSON. You feel there is need for completely integrated planning?

Mr. HARRIS. Yes. What we get now is a weekly statement by the President off the cuff, but there is no plan and he does not tell us really where we are going.

Senator ANDERSON. You felt the Federal Reserve did put on too many brakes. Do you believe that it reversed its policy quickly enough and actively enough when it did reverse it?

Mr. HARRIS. No, I don't think they did. I think they still haven't moved into high gear, and I just wonder what they are afraid of.

I think they are still excessively concerned about inflation. I would like to see them pour a couple of billion dollars into the market. I don't think it will have a great effect, but at least it will make the banks feel instead of having $500 million in excess reserves they will have $3 billion, and they may be willing to take some more risks.

Senator ANDERSON. I will not go through the long list of things which Mr. Martin indicated the Federal Reserve had been doing. However, there is listed on his sheet, I think, seven steps they have taken since February 1958, but they were all sort of mild ones.

Mr. HARRIS. Mr. Martin ought to take a look at what was done in the 1930's when we did not know as much about this problem as we do now, and I think to compare it with the 1930's, we have not done very much.

It is true the depression was much more serious then.

Senator ANDERSON. But we moved very vigorously when the time came.

Mr. HARRIS. The Federal Reserve moved vigorously. We did not get very far. We may not now, but it is a risk worth taking.

Senator ANDERSON. Do you believe the Federal Reserve has brought down money rates fast enough?

Mr. HARRIS. No, I do not; because actually if you look at the money rates, you will find except for the Government bond market where there have been special factors, the Federal Government bond market, we are still far away from the low rates in 1954 and 1955, so we have only come back a small way in the long-term market from the low rates.

We had a high about August or September of 1957, and we have moved in a small way toward lower rates, but not nearly enough, and that is partly because there has not been enough money put out, and partly because the Federal Reserve has refused to buy the long-term securities.

Senator ANDERSON. When we were having some hearings last fall, the 90-day bills were up to 3.8 percent, and now they are down to 1¼. I do not know what the sales were, but they are down to that point.

Certainly it would be fair to say that the general bond market has not described anything like the proportionate amount the 90-day bills did. It followed the 90-day bill rate pretty rapidly when it went up, but when the other started down it did not follow it.

Mr. HARRIS. That is right.

Senator ANDERSON. How do you account for this failure to bring the money rates down?

Mr. HARRIS. As I say, they have not manufactured enough money, I think, and they have not operated on the right market. It is quite clear, as you said, the short-term rate has gone down quite a bit. But the local and State bond market, as I recall, has only gone down 10 percent, and that is only corporation Aa bonds, that is the rate on them, and that is a small decline considering how much they went up before.

Senator ANDERSON. I think we both would agree properly that the drop in the 90-day rate is not a mixed blessing, because it sort of tempts people to say, "Let's live from hand to mouth" instead of the long-range financing that the Government ought to have.

Mr. HARRIS. Of course, I said before, one of the difficulties why the rate has not gone down more is this unwise policy—and I think it is putting it mildly—of right in the middle of a business recession, pouring out $9 billion more of intermediate and long-term securities which compete with private enterprise in this market and keeps the interest rate up.

This is the time when they should be issuing short-term securities and take advantage of these low rates.

Senator ANDERSON. What do you feel the economic objective of the policy of this Government should be?

Mr. HARRIS. I wish I knew. But I think the most likely guess, if you take the whole period since 1952—and I watch very carefully the statements of the President and the Council and all of their representatives—I think their primary fear is inflation. They want to stop inflation.

I think this is a laudable objective, but I think they carry it too far and forget there are other objectives, for example the objective of growth and the objective of equity in their economic policies.

And so I think that insofar as I can see any well-conceived objective, it is stability of the currency. And if you remember, Secretary Humphrey evidenced when he was here during this summer that he was highly concerned with the problem of how badly the Democrats had operated the economy by raising prices and unstabilizing the dollar, and you remember in the 1952 campaign the major emphasis was put on the business of the inflation.

But the Republicans have kept that in mind right along, and they stress this tremendously. But I think it is way out of proportion to its importance, and they have forgotten about the other objectives.

Senator ANDERSON. I asked this in essence a moment ago, but do you think these Government policies are integrated effectively?

Mr. HARRIS. Well, I would say they are not. I think the best example is the Federal Reserve and the Treasury.

In the recession when the Treasury should have been—in the inflationary period, so-called, when they should have been selling long-term to match the Federal Reserve policy, they were selling short term. In other words, if you sell long term at that time, you tend to increase the rate of interest—this is what they wanted.

And in the present situation, when they should be issuing short term, they are issuing long term.

Senator ANDERSON. Would you not say that the monetary policy had failed?

Mr. HARRIS. I think the monetary policy has failed. As a matter of fact, Senator, I think over the years from 1914 on, that monetary policy has not been a great success. I think it has a place in our society. But I think the Federal Reserve has an exaggerated viewpoint as to how important monetary policy is. They do not have an adequate idea of their own limitations.

I was very much interested to read the other day, or maybe it was a year ago, that the head of the Bank of England got up and said:

> I want to say right off, we just don't control the monetary situation the way we used to. In the first place, there is the problem of fiscal policy. In the second place—

he said—

> there are all these intermediaries and people over whom we have no control.

I would like to see Mr. Martin get up and make a statement like that sometime; namely, that he has some idea that the monetary machine is not quite so powerful as is generally believed.

Senator ANDERSON. Well, he does know that we do not control the intermediaries; does he not? I questioned Secretary Humphrey and I questioned Mr. Burgess about the growth of these intermediaries. Certainly, Mr. Martin—I will not ask you to testify about what he would testify to, but you recognize we do not have control of them; do you not?

Mr. HARRIS. I certainly do. I read those hearings, and I must say that I was impressed by the fact that no member of the Government—there were 3 important witnesses, and I think there may have been 1,200 pages of their evidence—not one of them said anything of the responsibility of the intermediaries of what suggestions they would make to control the intermediaries.

I remember you did ask some questions on this, and I do not think you got any very satisfactory answers, and I think Secretary Humphrey said, "Well, what do you suggest?"

Senator ANDERSON. Well, I even went so far as to suggest, rash as that was, that I would have brought them under some sort of control. It seems to me when I was in the Department of Agriculture, I discovered that the intermediaries just the Department controlled had a tremendous effect on the market.

Do you think the debt policy has been effective?

Mr. HARRIS. I think—I can understand his feeling. I think many people have it, and this is one of the unfortunate aspects of it. But you could look at the Federal debt policy in various ways. You can look at it in terms of the famous Morningside interview, when Senator Taft and President Eisenhower said, "We will cut down the debt. We will cut our expenditures down to $60 billion."

Now they are getting up to a cash outlay of pretty close to $90 billion in 1959.

Now, I don't say this is necessarily bad or not. It is only bad in terms of the promises they made in 1952. The debt policy has been weak for another reason. They had some idea that the thing to do was to redistribute securities so that the Treasury has much more long-term securities, and then they brought about the debacle of 1953 by issuing a 3¼-percent bond when the going rate was about 2½. They reversed that policy, and if you will take a fair definition of short and long—and sometimes the definitions given by the Treasury are not of the best—you will find they have not at all achieved the objective of lengthening the maturity of the national debt and, of course, I could suggest that their policy of selling short-term issues in the inflation period and long-term in the recession was a wrong move.

Senator ANDERSON. Well, the Senator from Oklahoma has pointed out several times this issuing of 3¼ bonds when the market was about 1½ did not hurt the banks any, but it was pretty expensive to the Treasury and to private business.

Mr. HARRIS. It was not a very wise policy, I think, from anybody's viewpoint, especially from the Government's.

Senator ANDERSON. I read an editorial or article or something this morning or yesterday—these things get away from me—in which the writer referred to a man who was against inflation and against deflation, but still in favor of "flation." How do you weigh the dangers of inflation in comparison with the dangers of deflation?

Mr. HARRIS. Well, of course, Senator, it is a matter of degree. I think you can have serious inflation. There has been a good deal of talk about the dollar being a 48-cent dollar. I think this is unfair, because, in the first place, we had the largest war we have ever had, and the inflation was largely the result of the war.

I once made an estimate. I took the years of the New Deal-Fair Deal period and eliminated the war and immediate postwar period, and you had an average inflation of one-half of 1 percent, and that is better than has been done around here the last few years.

So that the inflation is serious in wartimes, and it is awfully difficult to avoid inflation in wartimes. I thought on the whole we had a pretty good financing program in World War II, at least nobody has had a better program than we had in World War II. If we continue to have an inflation of 3 or 4 percent, as we have been having lately, I think this is a fairly serious matter.

On the other hand, I think our present job and the most serious matter, as serious as this inflation is, and Mr. Clague says the next few months are going to be better, our major problem now is to stop this recession, and this is what we ought to concentrate on, and worry about the inflation when we get it.

Senator ANDERSON. When I was a member of the Appropriations Committee of the House of Representatives, we had a budget in 1948, I think it was, of $109 billion. A prominent New York banker came down to testify that this was going to throw your national debt all out of proportion; that if we went past $50 billion—I do not want to misquote him—I think he said there would not be a life insurance company that could survive, and the banks would be in trouble, and so forth. I have lived to see all the life insurance companies survive and prosper, and that is why I asked the question when Senator Martin brought up the question about the reduction in savings.

I grant all those things, too, but the byproduct of the drop of 52 cents is that we paid off a part of our national debt that way; relatively it is not as important as it was when the national product was way down and when the national income was way down, and when our whole——

Mr. HARRIS. Senator Anderson, that is a tough issue, and, of course, I myself hold, for me, quite a few Government bonds, and I certainly was not happy watching these bonds depreciate, and I think the bondholder has a right to be unhappy about this.

But I think, as I said to Senator Martin, you want to look at the whole picture, and I think in terms of what the expansion of output has done for the national policy as well, and from that viewpoint it is not so bad.

Another thing that happens if we do have a fair amount of inflation, a large amount of people get wise to this and they finally begin to seek insurance against this, and I think in a general way the tendency of people to put more money into common stock and real estate and all that sort of thing we have seen in the last 10 years, reflects this.

Senator ANDERSON. Even insurance companies have started buying common stocks.

Mr. HARRIS. Universities now have 50–55 percent of their money in common stocks, and it is going up ultimately.

Senator ANDERSON. There was a time when I think the Central Life Insurance Co. of Canada spent its time buying common stocks. Now they are all doing it.

Mr. HARRIS. Yes.

Senator ANDERSON. Does a creeping inflation bring on galloping inflation, as Governor Martin said the other day?

Mr. HARRIS. Of course, it is conceivable that it might. But I think Mr. Martin, throughout the evidence during the summer—I do not know whether he intended this—always sort of raised this issue that a 2-percent inflation may develop into a 5-percent inflation and a 10-percent inflation. He did not say it in exactly those ways, but the general idea was to leave you with the thought that you could not stop it at 1 or 2 percent.

Along the same lines, one of the OPA administrators during the OPA said you can't be partly pregnant. You are either pregnant, in which case you produce a baby, or you are not. In other words, you cannot have a little inflation.

It is the same sort of argument Mr. Martin uses now, although he does not use it quite so vigorously.

Senator ANDERSON. Does the high-money rate do any good for the economy and, if so, what?

Mr. HARRIS. I think in a general way, and I do not think there is universal agreement among economists, but I think a large proportion of them believe that one of the objectives of economic life is to get the rate of interest down, because any businessman who borrows money compares the rate of interest that he pays with what he expects to earn with this money, and obviously if you get the rate of interest above what he expects to earn, he does not borrow.

And so it is, it seems to me, a fundamental objective of economic life on the part of the Government to get the interest rate down, and this is one of the reasons I am critical of the Federal Reserve Board for not having reversed itself.

I think it is generally true if you have a recession and want a recovery to follow, you bring the interest rates down.

Senator ANDERSON. Do these higher money rates bring about any compensation by having more savings?

Mr. HARRIS. As I suggested a while ago, the figure on savings suggest that they are going down rather than up right now, despite the attempt of the Federal Reserve to bring about more savings by higher rates of interest.

The Federal Reserve has a fairly antiquated theory of economics, that the rate of interest determines savings. The thing that determines it more is the amount of income, because savings is a function of income. They depend on income.

Senator ANDERSON. Who is responsible for these higher rates?

Mr. HARRIS. Well, many people, and I think if you will recall its early evidence, I remember following Mr. Martin once on the hearings on bond interest rates. Mr. Martin made a point, and a number of other Government people said, "We just follow the market." I recall this evidence during the summer. This line was first taken by Secretary Humphrey, but he finally yielded to some extent, and Secretary

Burgess and Governor Martin had to yield to some extent, the general line had been the rise in the rate of interest results from the supply of and demand for capital.

That is true, but it is also true that the Government influences this relationship. If the Federal Government comes out and issues a 3¼ rate bond, they influence the rate. And if they cut down on the amount of money which determines the demand for bonds, this also brings the rate of interest up. So you cannot argue it is merely supply and demand.

It is supply and demand, but supply and demand is also determined by governmental policy.

Senator ANDERSON. If you had been here the other day when—I missed a great deal, I regret to say—the Senator from Oklahoma asked a few questions of Secretary Humphrey, then of Randolph Burgess. Then when Marriner Eccles was here, he asked some more questions. Later he tried to pin Governor Martin down on this question of 7 directors and 128, or 127 people. Do you think the Federal Reserve is independent?

Mr. HARRIS. No.

Senator ANDERSON. Is it supposed to be independent?

Mr. HARRIS. I am glad you raised that question, Senator. I have strong views on that.

I think it is perfectly absurd, the idea that the Federal Reserve is supposed to be independent. It is not true in other countries, and——

Senator KERR. I do not believe I understand. I do not want to interrupt the questioning.

Senator ANDERSON. I am glad you have, because this was your question, and you were the one who got me interested in it. I am going out to make a little talk to a banker group, and I thought before I got out there I had better know something about the Federal Reserve. I read the testimony of Mr. Humphrey, and I understood him to think it was 127 or 128 men that ran it. Then I read Mr. Eccles' testimony, and he was sure that 7 men ran it. Then Mr. Martin's answer was, yes, a little, but not much, and he left me confused.

Senator KERR. I want to understand the answer of the witness. He thinks it is perfectly absurd that somebody would believe the Federal Reserve is independent, or that somebody in the Federal Reserve would believe that it should be entirely independent?

Mr. HARRIS. Well, what I was trying to say, Senator, was that I do not believe for a minute that the Federal Reserve should be independent, if it is.

Senator KERR. I thoroughly agree with that. It is a creature——

Mr. HARRIS. Sure.

Senator KERR. There is no divine right to the Federal Reserve bank.

Mr. HARRIS. Absolutely. The 1951 accord which has been so often misinterpreted an agreement of the Treasury and Federal Reserve, after a long debate, that the Federal Reserve would not have to maintain the 2 percent rate on Government bonds and pour out money. You could defend that as an agreement because you were getting too much money out and there was too much inflation, and so forth.

But from that to draw the idea that the Federal Reserve could do anything they please is absurd, because we are running a very complicated economy. The Treasury has some influence, the Social Security Board has some influence, the Government credit agencies do, and there are all kinds of other departments that do besides the private economy, and it seems to me the Federal Reserve must integrate its program with those various organizations.

I just do not understand how the President can go out and make a statement in his press release that he has no control over the Federal Reserve. It seems to me the Federal Reserve is part of the Government.

Just because the Federal Reserve thinks high money rates are what we need, it does not seem to me because of this the other agencies therefore have to accept this.

There should be some agreement worked out, and of course in an indirect way the Federal Reserve knows awfully well if they trespass to much on their independence the Congress might do something about restricting their independence in various areas.

I think it is good for them to have a limited amount of discretion, but on the other hand I do not think they should be free, for example, to bring about a recession if they think this is a smaller evil than inflation, if the rest of the Government agencies and the public think otherwise.

Senator ANDERSON. You said, I believe, that the present recession—I had better not quote it. Do you think it is serious or more serious than the preceding recession?

Mr. HARRIS. I think it is more serious than the last two, and my own view is that it is more serious because of the depression psychology.

Senator ANDERSON. Do you not believe you had better identify the last two? You mean 1949 and 1953?

Mr. HARRIS. 1949 and 1953–54, yes, and already the substantial indexes have gone down more than those in those other two depressions.

On the other hand, we also have now, you might say, a capital saturation point that we did not have in 1953–54, although I must emphasize again that capital saturation depends also upon how much money there is around, how much spending. That, in turn, depends upon monetary and fiscal policy, and monetary and fiscal policy, of course, have tended to cut down the amount of demand and spending.

Senator ANDERSON. Doctor, I get one line of mail that says, "You have to do something right away; cut all the taxes." I get another batch which says, "You have to do something right away; create public works."

In the Congressional Record of yesterday, or the day or two before there was an excellent summation of the Rockefeller Bros. Fund in which they recommend—I only picked out those things which happened to put water on my own wheel—recommended certain types of public works.

All of these voices say do this and do that, and the tendency I have is to say, "Well, since there is so much difference of opinion, maybe we should let it alone for awhile."

Do you think delay is dangerous?

Mr. HARRIS. Well, I think delay is dangerous. I thought you probably would get a lot of satisfaction out of that Rockefeller report.

Senator ANDERSON. I did. It is a wonderful thing. All these places that are marked with red ink on this sheet here are things which just delight the chairman of the Irrigation and Reclamation Subcommittee of the Committee on Interior and Insular Affairs.

Mr. HARRIS. But the amazing thing was that the chairman of the committee was an ex-Governor of the Reserve Board, Mr. McCabe, but that a businessmen's group would make a report like this, it is a very good group, it is really amazing, and I think on the whole it was a very good report and I, as an economist, would not have dared to go as far, but that they do so is certainly something. And——

Senator ANDERSON. Well, the reason I take it to my heart, Doctor, is that when I go home and talk about spending this money, there is a group of somewhat conservative individuals who say, "He is trying to spend us into bankruptcy," and I say, "No, I just want to do what the Rockefellers want done."

Mr. HARRIS. I was trying to make this point, and have done it a number of times with Senator Byrd, you have to estimate these things against the size of the economy, and that is what the Rockefeller people do. They are looking in terms of a $500 billion to $700 billion economy 10 years from now, and in terms of that situation. With all these programs, the Government is not going to demand any more relatively than they are demanding now.

Senator ANDERSON. To that extent, has there been a tendency of budget accounting to change with somewhat confusing——

Mr. HARRIS. This is one of my grievances against the present administration. They have been sincere, I think, in wanting to cut the budget, and I think they have been worried about the size of the budget, and I think they think that a larger budget contributes to inflation and they want to get the Government out of economic life as much as possible.

There may be ideological differences as to their objectives, and I think they have a right to these objectives. But the thing that troubles me is the extent to which there has been, I wouldn't say manipulation, but there has been a certain amount of budgetary practices that I do not like, and I will give you a few examples.

In the first place, I mentioned the growth of guaranties. Now there are other reasons for guaranties. One reason is, the Government wants to get out of the insurance or mortgage business so they guarantee rather than lend, and you can say this is all right in terms of their general objectives. But if you look at their whole policy since 1953–54, and you may recall that in the hearings this summer—I think it was Senator Frear, or was it Senator Smathers, I think, got into a long discussion with Secretary Humphrey about the civil service retirement fund, and it was made very clear that the civil service retirement fund had been deprived of a couple of hundred million dollars of its funds. In other words, the Treasury had not diverted to the civil service retirement fund a couple of hundred million dollars that was due the civil service retirement fund.

This, of course, made the budget look much better, but there was some question as to whether this improvement of the budget really means the budget was better.

They also generally have undertaken the position of selling everything they could get their hands on that they owned, and this, of course, could be explained in their policy of being against anything getting the Government involved.

Let's get the Government out of everything, but it also makes the budget look much better.

If they get rid of all kinds of CCC paper and mortgage paper, and so forth, it makes it look much better.

They also accepted this program of leasing post offices instead of building them. We are delighted to find this year the Congress has reversed them on that.

Senator ANDERSON. I must put in this year, not last year because we got the Albuquerque Federal Building started on that program. From here on out, I can be very enthusiastic about the position taken by the House.

Mr. HARRIS. And I think the explanation of this, Senator, is simply they do not want to tie their money up in building post offices because it makes the budget look worse. Because if they rent, each year instead of paying out $10 million, they pay out $500,000, or something of that sort.

Senator ANDERSON. But the eventual cost to the Treasury is——

Mr. HARRIS. Is much higher. That is the point. In other words, they are merely measuring their present position, and say they do not care about the future.

I will give you another example. I was very much surprised and pleased to see that the Government in 1953 or 1954 liberalized the old age insurance program. This is something you might not expect of the administration in view of their ideology, and so forth, but they did.

But then what did they do? And why did they do it? Well, the idea was that what they were actually doing was, they were building up a large benefit, you see, and therefore building up a large deficit in the old age insurance fund; because what this means is, you pay out so much more to people compared to what they pay in, and have to reverse that process later on.

But that is something they will have to worry about in 1970 or or 1980, and maybe the Democrats will be in power then. But anyhow, they are not worried about 1970 or 1980.

My own theory is, this liberalization of the old age insurance program, not wholly determined by this, was a factor.

I might give you an example of this kind of bookkeeping.

So I think the budget is more serious than it seems to be in terms of their objectives, and there are all kinds of ways of playing around with this budget so that you spend in such a way and you finance in such a way that it shows up in the budget a minimum.

They have done that in a rather brilliant manner, I think.

Senator ANDERSON. I am——

Mr. HARRIS. And that has been done in a number of different ways.

Senator ANDERSON. I am pleased to have you say that because I do think the change they made in agricultural accounting was bad.

The sale of Commodity Credit assets in order to show an improved position, did not help either the farmer or the people.

Now, just 2 or 3 more questions, then I will stop.

Have you got an explanation for the inflation that has taken place? How do you account for it?

Mr. HARRIS. Well, I think it is possibly what you might call an excess of demand in the usual sense, that is, purchasing power chases more goods around, and this tends to send prices up.

I might say in the summer hearings it seemed to me that Senator Kerr brought out this issue of the unique kind of a depression where, or the unique kind of a situation where, you are having unemployment and, at the same time, you have rising prices, and I think a part of the explanation of this fact is the fact that costs are going up partly through trade union activities, but also partly through businessmen who had semimonopolistic positions, and even underemployment and with excess capacity. They keep on raising their prices, and raising their prices more than is justified by costs.

I think this is a good part of the explanation of why you have inflation even in the midst of a recession.

Senator ANDERSON. Does the present steel situation perplex you?

Mr. HARRIS. I think a good many people feel that the steel pricing policy has contributed to the recession, although I think steel does reflect also what happens to the whole economy, and when the economy goes down steel goes down very much—but the economy went down, I think, in some part as a result of the steel pricing policies.

They allowed their prices to go up too much.

Senator ANDERSON. Is our present monetary policy taking into account the actual needs and responsibilities of the economy?

Mr. HARRIS. I do not think so. I mean, I have a feeling that monetary policies should take into account the needs of the economy and that, of course, also includes the Government, and I think it is important in a situation like the present that the Government have good credit, have plenty of cash around to buy up their assets, their debts, and that this particular aspect of monetary policy over the last few years has not been given adequate attention.

Senator ANDERSON. I have just one last final question. It is one that I have raised several times.

How do you explain the failure of the Government to talk about these problems of these financial intermediaries? Why do they not talk about them? They are a very important part of our whole credit structure.

Mr. HARRIS. I do not know. I see the CED is going to do a big study of the monetary situation. The CED is a pretty good outfit, and they have a good many really able people behind it, and I hope very much that they will spend much of their $1 million or so to look into this problem.

I think, I am sure, that the Federal Reserve must realize the position of the intermediaries.

They must certainly realize their lack of potency in dealing with these intermediaries.

It may be that they are scared to step on somebody's toes.

After all, as you said, or Senator Kerr said, life insurance companies have a lot of authority, and they have had relatively low taxes.

I have had this impression myself, and you know they have a certain amount of support of the public because we are all policyholders, and we want our insurance companies to be protected.

I do not know whether life insurance companies would resent this control. They probably would. But if you are going to have real, honest control of the monetary system, I do not see how you can do it by putting all the pressure on the commercial banks and letting all the others do as they please, or else let us do away with monetary control. That would be my answer.

Senator ANDERSON. I think particularly as you watch the rate of growth of all those institutions and realize the change that has come about, there has been a terrific increase in the assets of the life insurance companies and the savings and loan institutions.

The life insurance companies did not hesitate to go into the loaning of $100 million, which was really a commercial bank loan.

Mr. HARRIS. What happened to the so-called dear money policy when the life insurance companies just dumped their bonds on the market, as they have since 1946, and they proceeded to put their money into circulation in the rest of the economy, and this was inflating the rest of the economy and deflating the Government bond market.

Senator ANDERSON. That was the point I made to Secretary Humphrey. I thought that was a most important situation, the life insurance companies dumping Government bonds.

I have gone too far, and I apologize to the Senator from Utah.

Senator KERR (presiding). Senator Bennett?

Senator BENNETT. Mr. Chairman, I just have the typical one question that will expand into four or five as we go along.

Dr. Harris, you begin your formal statement by saying:

> In the last 75 years the Democrats have generally been associated with policies of monetary expansion and inflation, the Republicans with sound monetary policies.

Mr. HARRIS. I am sorry, Senator, but I did not hear you.

Senator BENNETT. I was reading the first sentence in your statement:

> In the last 75 years the Democrats have generally been associated with policies of monetary expansion and inflation, the Republicans with sound monetary policies.

Mr. HARRIS. Yes.

Senator BENNETT (reading):

> But in the last few years it has been the Democrats who have criticized the Republicans for support of inflationary policies.

As I understand it, you currently are the chief economic consultant for the National Democratic Advisory Committee?

Mr. HARRIS. I am not the chief; I am one of them.

Senator BENNETT. All right. You certainly are one of them.

I had assumed you were the chief.

On the theory that you and the members of that committee have formed a kind of a shadow cabinet, we now find ourselves in a position—let me say something else, first.

As I understood your exchange with the chairman, it was to the effect that you were not particularly worried about a 1 percent inflation as long as there was a larger increase in economic activity, and you were not too much worried about a 2-percent inflation.

A little later on, in answer to questions, I think, by Senator Anderson, you said there were people who believed that the 2 percent would become a 5 and that it would go on to creeping inflation.

Mr. HARRIS. Go on to galloping inflation.

Senator BENNETT. Go on to galloping inflation.

We now have a 4-percent increase this year over last year, which is only 1 less than 5, and you made the point earlier that, measured at last month's rate, we have an 8.4-percent increase.

If you had to come out of your shadow and were in the position to face that problem, what means would you use to reduce the present rates of inflation back to your concept of a safe rate of 2 percent rise?

Mr. HARRIS. Well, Senator, of course, I wouldn't—I was distressed to read the seven-tenths of 1 percent.

I think the signs were beginning to be evident that the inflation was pretty well licked until I saw this seven-tenths of 1 percent.

Things have been a little better the last few months, and the Bureau of Labor Statistics in a nonpolitical release, suggested that this was temporary because of the bad weather and increase in price of oranges and what not, and that this would not be repeated.

I would certainly not go to the point of saying that now we had inflation for 1 month at the rate of seven-tenths of 1 percent per month or that this was 8 percent a year.

If it continued for 6 months, I would be worried about it.

Senator BENNETT. We had 4 percent a year, and 3 percent the year before that. It has left the 2 percent, and has moved to 3 and 4 percent.

Mr. HARRIS. Yes.

Senator BENNETT. You had criticized—which is your privilege—you criticized the program by which the present men in responsible positions have moved against that problem, criticized their program and its failure.

Now, for the benefit of this committee, I would like to know what kind of a program specifically you could recommend to us in the present situation, with an annual 4-percent rate, and evidence that that is pressing upward rather than downward?

Mr. HARRIS. Well, Senator, let me answer this in the following way:

In the first place, since 1946, as I suggested, or 1948, as I suggested to Senator Byrd, the average inflation has only been 2 percent.

In the second place, half of that was the Korean war, so that I think our record, on the whole, as far as inflation goes——

Senator BENNETT. I am not criticizing your record. I say, if there is a situation——

Mr. HARRIS. I am taking your record, as well. I am taking both the Democrats and Republicans, from both 1948 to 1958, where there has been an average inflation of 2 percent, and a half of that was the Korean war and I, therefore, say that inflation is not very serious.

I do not think we are going to have an inflation of 4 percent a year over the years, and if it is proved to be so, then measures should be taken.

But I say that today the crucial issue is what you are going to do about this recession which is not getting better.

Senator BENNETT. Well, then, am I to understand you are not concerned with the currently increasing rate of inflation on the theory that it will wear itself out pretty soon?

You have no program, specific program, with which to attack this particular problem at this particular time?

Mr. HARRIS. I have a program. I would not attack it at the present time.

You can, and President Eisenhower also, will say, "Let's be moderate in our demands to labor and capital."

But this, as you know, is nonsense. I mean, I do not mean to be disrespectful of the President. I just simply mean the idea is nonsense, because each businessman and each trade-union leader tries to get the maximum he can get, and this is the way a capitalist system operates, and should operate, and any businessman or labor leader who listens to exhortations is doing his firm or his workers a disservice. So I do not think that is the approach.

I simply say that what we do now is take the measures necessary to stop this recession, and one of them is to get more money outstanding.

Then, having done that, we then take a look at the price level and see what is happening, and if we get an increase of 4 percent or 3 percent and, say, only 4 percent unemployment, then I say I would be ready to consider necessary measures, including a tax increase.

Senator BENNETT. Then you would propose a tax increase, as Mr. Baruch did, and I assume you would apply that at a time when we had no recession, if I understand your statement.

You are saying the patient is too sick to cure now, we have just got to kind of give him some relief, and then we will come around to his basic problems later.

Mr. HARRIS. I do. I think Mr. Baruch's statement was entirely different from mine. He wanted a tax increase right now.

Senator BENNETT. That is right.

Mr. HARRIS. This is not my statement.

Senator BENNETT. When is the time in the pattern of the economic cycle to deal with the problem of inflation?

Mr. HARRIS. Well, I think one of the difficulties, and I am sympathetic with the Federal Reserve, and I would not want to have their job, but the thing that troubles me about the Federal Reserve is that their policies are based on a theory of precision of controls which does not exist.

So I say you are going to get into a certain amount of trouble no matter what policies you introduce because there are lags.

But in a broad general way we do know when you have a recession we increase our spending, and we cut our taxes, and I know there are difficulties in timing the thing correctly.

Senator BENNETT. Then can we say, can we turn that coin over and say, that in time of rising economic activity we should increase our taxes?

Mr. HARRIS. In times of rising activity, when you have—not rising activity, but when you have a real inflation on your hands, by all means, increase your taxes.

Senator BENNETT. And you think monetary policy has no particular effect in curbing inflation if applied in times of high activity or rising activity?

Mr. HARRIS. I would say, on the basis of the economic history of this country, I would say that would be my position. I would not say "no effect." I would want to give Mr. Martin, who, in the face of all hostile criticism has stuck to his guns, credit for his courage; and that is more than the Federal Reserve has done in similar periods. He deserves great credit for that.

On the other hand, I do not think that monetary policy is going to play a terribly important part in controlling inflation unless there are considerable changes in the regulation of these financial intermediaries.

Senator BENNETT. Can you conceive of any time when the Federal Reserve should move definitely and specifically to restrain the supply of money and thus to make it more dear, as you say, to use your words?

Mr. HARRIS. Yes. I would have said that, for example, that they could have done considerably more in 1928 and 1929 than they did. There was, as you know, a confusion and a conflict of views on this, but on the whole, it was—I think if Mr. Martin had been governor in 1928 and 1929, and had been in control, we probably would have had a less serious inflation of the stock market.

Senator BENNETT. You think there is no time within the last 5 years in which they should have moved to restrain the supply of money?

Mr. HARRIS. Well, 1955 was a fairly inflationary year in the sense of a very large rise in consumption and what not.

It is quite conceivable they might have restricted a little there, but I certainly would have gone very cautiously.

In other words, my suggestion is that you are awfully careful when you introduce monetary policy in order to stop an expansion, because you do not know how much damage you are going to do in the other direction, and I would be more inclined to risk no activity than to risk a recession.

Senator BENNETT. What would you have done in 1955, if you had not recommended monetary restraint?

Mr. HARRIS. Well, I would certainly—you must not forget, in a sense, our system works beautifully now in many ways, because when you get an expansion like 1955, with a very large rise in gross national product, you automatically get a very large rise in tax receipts. This is something you ought to thank the Democrats for because they introduced that tax structure.

Senator BENNETT. Yes; but you also set a new level which you then accept as normal, and when things drop off, as they have done since, you assume that we are in a recession.

Mr. HARRIS. We are in a recession, and one reason we are not in a worse recession is that we have a good tax system which immediately responds to a fall of income and, therefore, leaves more money in the hands of the people, but it does not respond sufficiently.

Senator BENNETT. Is it fair to say then that you feel that money should more or less always be easy, there should be very few times when there should be any restraint on the supply of money?

Mr. HARRIS. Well, in a general way, I prefer easy money to dear money, but I would not go quite so far as that.

Lord Keynes, who had a lot to do with the spread of this idea of easy money, I think, goes that far. I would be inclined to be a little more restrained.

Senator BENNETT. We now have a recession and a rise in prices, neither of which is desirable.

You feel the one should be cured, the recession should be cured first, even at the expense of a further or greater rise in prices?

Mr. HARRIS. I do not agree with the second part of your question. But it is quite conceivable you would have a cure of the recession without bringing about a further rise in prices.

Senator BENNETT. Is it not a fairly accurate statement to say that we now have a recession and a continuously rising price level?

Mr. HARRIS. We have a recession, but I am not at all sure that if we poured a couple of billion dollars or more into the money market through open market operations that this would aggravate the inflation, and if it did aggravate the inflation to the extent of 1 percent, I would still take my risk.

Senator BENNETT. But 1 percent on top of the 4 we have already stated.

Mr. HARRIS. I think the 4 percent is a temporary situation, and I think the long-term trend is less than that.

Senator BENNETT. But here we are today at 4 percent, and you say you will take the risk of adding 1 percent to it which, in my simple arithmetic, makes it 5, and——

Mr. HARRIS. Yes, I am ready to take the risk of another 1 percent in order to stop the recession.

Senator BENNETT. I think I will not pursue this any further. I am getting hungry, as I know the witness is, Mr. Chairman.

I have some other questions, but I will desist.

Senator KERR (presiding). That is very good, Senator.

I would be glad to stay here if the witness cares to stay.

Senator BENNETT. No, I do not desire to ask any further questions.

Senator KERR. Very well. I am going to ask him one final question, and we will recess until 10 o'clock in the morning.

You can oppose a drought of credit or money supply without automatically being in favor of a flood, can you not, Doctor?

Mr. HARRIS. You said it much better than I did, Senator.

Senator KERR. That is the position of the Senator from Oklahoma. I am bitterly opposed to this drought that has been imposed upon us, and I would be just as much opposed to a flood.

Mr. HARRIS. Yes; I agree with you.

Senator KERR. We will recess until 10 o'clock in the morning.

(Whereupon, at 1 p. m., the hearing recessed, to reconvene at 10 a. m., Friday, April 25, 1958.)

INVESTIGATION OF THE FINANCIAL CONDITION OF THE UNITED STATES

FRIDAY, APRIL 25, 1958

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 (chairman), Kerr, Frear, Martin, Carlson, Bennett, and Jenner.

Also present: Elizabeth B. Springer, chief clerk, and Samuel D. McIlwain, special counsel.

The CHAIRMAN. The committee will come to order.

It gives the Chair a great deal of pleasure this morning to present the witness, Dean Charles C. Abbott.

Dr. Abbott is dean of the Graduate School of Business Administration of the University of Virginia.

Before coming to the University of Virginia in 1954 he was for a number of years converse profesor of banking and finance in the Graduate School of Business Administration of Harvard University.

Dean Abbott has written several books, including one entitled "Management of the Federal Debt."

He has made a number of studies of the Federal public debt and is considered one of the Nation's leading authorities on the subject.

We are very happy, sir, to have you and we should be pleased if you would proceed in your own way.

Dr. ABBOTT. Thank you, sir.

STATEMENT OF CHARLES C. ABBOTT, DEAN OF GRADUATE SCHOOL OF BUSINESS ADMINISTRATION, UNIVERSITY OF VIRGINIA

Dr. ABBOTT. I would like to say, first, that I am very gratified at having been asked to make such contribution as I can to the important matters before this distinguished committee.

The range of subject matter before this committee is very wide, and there are a good many ways to approach it.

My prepared statement, which I would like to read in a moment, approaches the topic by emphasizing the things that the Government, the Federal Government, could do now in checking the recession, that would not cost public money.

This is certainly not the only way to approach the range of subject matter before your committee, and I am not even sure that it is necessarily the best way, Senator.

But my reason for taking this approach is quite simple. It has seemed to me that the American people the last year or two have almost instinctively tended to reach for spending whenever confronted with a problem, irrespective of the problem.

Whether it is juvenile delinquency, a shortage of scientists, a 2- or 3-point drop in the Federal Reserve index, a weakening of some of our foreign allies, traffic problems—the cure has always been the same, as I have observed it.

And certainly, all problems are not going to be cured by spending money.

Consequently, it has seemed to me that it might be useful in approaching the matters before your committee to see if we could take some other road and develop some other method of approaching these very serious problems.

My remarks deal broadly with the 17 questions included with Senator Byrd's letter of last February 17.

These questions and the Senator's letter raised two general questions in my mind, to which I address myself.

1. Is our banking system—and I include both commercial banks and the Federal Reserve banks—are our procedures for investing the people's savings in industry, are our methods for controlling costs, adequate to provide for and foster the economic growth that is necessary to give our country a rising standard of living and—more important—insure the economic and military safety of the Republic?

2. What part should the Federal Government play in checking the current recession in business activity?

The most recent figures I have seen suggest that national output has thus far declined only about 4 percent from its alltime peak, that employment is only 2 or 3 percent less than it was a year ago and that personal income may be 2 percent below the peak of last August.

Unemployment, which we all greatly regret, is largely concentrated in the heavy goods industries.

At this point I think it might be interesting to mention some figures that I say the other day which I thought were extremely illuminating. These figures have to do with the distribution of employment in the United States, and I believe the data are correct in a general way.

These figures are as follows: 60 percent of the jobs are in the service trades; 25 percent of the jobs are in manufacturing; 10 percent in agriculture; and 5 percent in construction and the extractive industries combined.

Now I think the significance of these figures is that the service trades are very stable in terms of employment, and so is agriculture. This gives us 70 percent of the jobs in the stable part of the economy.

The unstable areas are in the extractive industries, construction and manufacturing, and the construction trades are doing pretty well.

Senator MARTIN. By extraction you mean——

Dr. ABBOTT. Mining, oil production, lumbering, and so forth.

Senator BENNETT. Mining?

Senator MARTIN. All right. Thank you.

Dr. ABBOTT. I think this pattern of employment is one of the reasons for feeling this recession may not be very severe.

One of the great trends in the postwar period has been the rise of the employment in the service trades.

Included in the service trades are Government employees, of course, and I see no prospect whatever, looking ahead, that employment in the service trades will diminish over the next few years.

The current check on economic expansion should not be seized on as an excuse for creating deficits and spending the public's money on projects of doubtful value. I say this for several reasons.

First, if I read Secretary Anderson's remarks last week correctly, we are going to have deficits anyway. There will be plenty of deficit spending, without deliberately creating it.

Second, larger Government spending, irrespective of whether it helps some of our present problems, will certainly make others worse. It is not a cure-all for every ailment of the body politic.

Third, the timelags involved in setting large public works in motion are typically such that these expenditures do not come quickly enough to accomplish their purpose.

Fourth, public works expenditures on any practicable scale would probably not cure the recession. The great public works expenditures of the 1930's did not cure the great depression of that decade and there were still 9 to 10 million persons unemployed at the time of Pearl Harbor.

In communities where unemployment brings hardship to individuals the hardship should be alleviated at the local level as a matter of relief. But relief, in the form of public works, should not be disguised as a cure for declining business activity, since it won't cure it.

I am not entirely sure that this paragraph I have just read makes my meaning wholly clear and I would like to supplement it.

As I see it, public works are at best an indirect rather than a direct way for dealing with unemployment and in that sense are an inefficient way.

Typically public works cannot be put in motion at the right time and place to absorb unemployed men and typically they do not require the skills that are most common among the unemployed, and hence they will, generally speaking, not go very far in doing the job of curing unemployment.

Now unemployed persons who are covered by insurance have to be dealt with for administrative purposes at the local level, as I said in the first paragraph I read, and unemployed persons who are not covered by insurance obviously have to be dealt with where they are situated, anyway.

I think this perhaps spells out my meaning a little more clearly.

The current check to economic expansion ought to be used as an opportunity for enacting reforms that will make the economy work better. It ought not to be used just as an excuse for spending money. It ought to be the occasion for instituting reforms that deserve enactment on their own merit and which, if enacted, will not only provide jobs but will also strengthen the bases for increased production in the future, on which our national security and welfare depend.

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Senator KERR. I do not want to interrupt for questioning at this time but I just wonder if somewhere in the course of your paper you got specific.

Dr. ABBOTT. Yes, Senator, I make 2 or 3 specific suggestions.

Senator KERR. As to reforms which will provide jobs and strengthen the bases for increased production?

Dr. ABBOTT. Yes, I do, Senator.

Senator KERR. Fine.

Dr. ABBOTT. Public policy should be directed toward stimulating the kinds of private spending that are needed, not toward using public money in place of private money.

In particular, public policy should seek to encourage the kinds of business expenditure on plant and equipment that will reduce costs and increase productivity.

I make this last point for three reasons:

First, the reduction in business expenditure since the fourth quarter of 1957 has been one of the chief causes of the decline in business activity.

Second, we do not need business expenditure just to increase capacity—in several lines of business we now have too much capacity—but we do need investment of the type that will improve efficiency and cut costs.

Third, persons better informed than I tell me there are reasons to believe spending—business spending—of a cost-reducing type, stemming from technological advance, may begin on a considerable scale in 1960 and 1961. If that is so, it would make sense to try to move some of this type of spending forward.

Courageous and imaginative leadership could initiate several measures of the type I have in mind, that would be aimed at making the economy work better.

Most of them would not require the expenditure of public funds. Presently I shall make 2 or 3 specific suggestions. But my essential point is that the Government ought, now, to take the steps that it and it alone can take to encourage the types of private spending that will end the recession and reinforce the foundations for future expansion, and the Government ought not to use the recession as an excuse for attempting to do the things that private initiative, free markets, and the private section of the economy can do better than it can.

Currently the economy suffers from 2—perhaps 3—major ailments.

First, since at least as far back as 1939 there has been a steady and persistent tendency for prices to rise.

There have been 3 postwar waves of advancing prices—1946–48, 1950, and 1955 to date.

The dollar is now worth less than half of what it was in 1939. This disaster is partly attributable to war, partly to an inadequate governmental process. It cannot be blamed on the mistakes or selfishness of individual persons or business concerns, whatever their faults may be.

Second, we are currently suffering a modest decline in business activity. A slackening of demand began to show up during the summer of 1957. This was followed by a reduction in inventories that began in the final quarter of last year and by a cutback in business expenditures in this current year, as compared with the very high levels of 1955, 1956, and 1957.

These are the immediate causes for the rise in unemployment, not a decline in consumer spending—which has held up very well—nor an inability on the part of the consumer to spend.

So-called recession measures designed to bolster consumer spending are like prescribing a weight-gaining diet for a man already as heavy as he should be.

Notwithstanding a little price softening here and there, the business decline has not been accompanied by any general or appreciable fall in prices. My impression is that the Consumer Price Index has just made a new alltime high.

This last consideration suggests what may be a third ailment of the economy—a growing inflexibility in cost-price relationships and an increasing inability to bring costs into line with changing consumer demands and business conditions.

This inflexibility stems from the great expansion of contractual commitments in our economy that increase the proportion of fixed costs involved in doing business.

Let me cite as just three examples the growth of taxes at the Federal, State, and local levels, governmentally supported raw material prices, and the increasingly rigid labor costs that stem from the monopoly power of labor unions.

If the current recession deepens, I would raise a question whether economic historians may not label it the first union-made depression in our history.

Let me tell you why I put the matter this way. To the course in industrial relations in the Graduate School of Business Administration at Virginia we have, this spring, invited as speakers a series of the most distinguished economic analysts to be found in our universities.

Ten of these guest lecturers have thus far appeared. I have been impressed by the extent to which they ascribe many of our present economic difficulties to the exercise of monopolistic powers by trade unions. There is general agreement on the process through which these difficulties are generated.

Under threat of strike, unions extract wage increases and other benefits from the economy that are in excess of increases in productivity. These wage increases inevitably push up prices when, as is the case in this country, there is a flexible money supply. That is why the kind of inflation we have today is increasingly referred to as a wage-push inflation and—incidentally—this type of inflation cannot be solved through monetary and fiscal policies alone.

There are, of course, many other elements that have contributed to the increase in prices that has taken place since the 1930's. Federal deficits, the increased national debt, and the expanded credit base thereby provided, have played their part. The rise in the turnover of bank deposits since 1945 has been a factor. So has the incredibly wasteful policy of the Government in supporting agricultural prices, and so has the increasing volume of services bought by the average family—at a rising dollar cost.

One cause of inflation to which I give weight in my own thinking is the appreciable fraction of the national output that has been absorbed by the military services or sent abroad under foreign-aid programs. During the postwar period at least 12 percent of all our production can be accounted for in this way.

The production of military goods and of goods bought in foreign-aid programs places purchasing power in the hands of persons and companies making these goods. But this purchasing power is not matched by goods flowing back into domestic civilian consumption. Military items and foreign-aid goods are, as you might say, shot away or sent abroad. They are not available for purchase or consumption here. The purchasing power generated in their production, however, stays at home and conpetes in the domestic market for the remaining portion of production—and bids up prices.

Let me now turn to some of the things the Federal Government might do to increase jobs, hasten resumption of economic expansion, and improve the outlook for the future.

None of these measures I shall mention require an outlay of public funds. I should say also that they are essentially meant to be illustrative—they do not in any sense constitute a program.

First, consider the relationship of full employment and price stability. The Employment Act of 1946 made pursuit of full employment a national policy, but it did not make price stability a national objective. General price stability, leaving individual prices to fluctuate in accord with the dictates of free markets, is at least as much in the public interest as is full employment.

In view of the decline in the value of the dollar, it seems clear that both these objectives will not be achieved so long as one has the blessing of the Federal Government and other does not.

Amendment of the Employment Act so as to make price stability an explicit goal of public policy would greatly strengthen the basis of an expanding economy, and it would require no outlay of public money.

Let me give a second example. The measures already taken by the Federal Reserve Board, under the present statute, to reduce reserve requirements of member banks and make credit more generally available, are aimed at hastening recovery.

In addition, bills now before the Congress looking to a change in reserve requirements are a further step in this direction.

These measures are designed both to hasten recovery and to serve as long-term reforms—and they will not cost the taxpayer a dime.

Let me make a third suggestion of this same general nature. One of the chief causes of the recession, as it was of the preceding boom, has been the behavior of business expenditures for plant equipment. Such expenditures were very large in 1955, 1956, and 1957. It is currently estimated that they may be 13 percent less in 1958 than they were last year. Until such expenditures turn upward I do not expect to see a renewed expansion in the economy.

If the Treasury were to do away, immediately, with its regulations defining the amounts of depreciation on buildings and equipment that may be charged off for tax purposes and let business management use its own judgment—so long as practice was consistent from year to year—a great stimulus would be given to business investment, one of the major keys to increased employment.

This step would not require any public expenditure nor, in the long run, do I think the Treasury would lose any revenue. On the contrary, if it stimulated business spending as much as I think it might, the Treasury would probably gain.

If we look for particular industries that need additional capital investment at the present time, and not all industries do, let me suggest as a fourth point that we look carefully at the transport industry. In the phrase "transport industry" I include all forms of transportation—railroads, trucks, airlines, transit systems in metropolitan areas. It is a basic industry and one essential for national defense.

Generally speaking, the industry is in very poor shape as regards equipment, facilities, and finances.

Enormous capital expenditures in this essential industry are necessary if it is to carry the foreseeable burden during the next 10 to 20 years.

As a means of encouraging this industry to rebuild, I suggest that the Federal Government immediately suspend all the regulatory powers of the Federal agencies regulating the transport industry except those having to do with safety. I suggest this step be taken in addition to, or perhaps in place of, the various aids now being considered in the Congress.

This suggestion is advanced on several grounds. First, the regulatory powers of these agencies, generally speaking, were originally enacted on the assumption that transportation companies were monopolies and could practice discrimination in ratemaking. For the most part, this broad assumption is no longer valid.

Second, this step would encourage capital investment in an essential industry, and capital investment must increase if economic expansion is to be renewed.

Third, the intent of the suggestion is not that the transportation industry should get more revenue for providing just the services it now provides. Rather, the intent is that through permitting more flexibility in its operations the industry should be allowed to earn more revenue through providing more and better services, so that the consumer as well as the industry will benefit. As things are going now, both the consumer and the industry are suffering. Finally, this proposal is advanced on the grounds that it would provide jobs, and that it would entail no expenditure by the Treasury.

As a fifth type of undertaking that could stimulate the economy and which would not require the outlay of the public's money, let me say that, despite improvements in the tax structure made by the Revenue Act of 1954, it is generally admitted that tax reform is urgently needed.

Revision of the tax structure offers enormous opportunities for encouraging the initiative and enterprise of individuals, and in the last analysis termination of the present recession and the stimulation of a new upswing must depend on the initiative and enterprise of individual persons. Time does not permit discussion of particular proposals, but generally speaking, tax reform should be directed toward encouraging saving and capital accumulation and toward enhancing flexibility in the economy. Nor should we forget that tax reform, if it really stimulated the economy, might very well lead to increased revenues even if tax rates were reduced.

In closing, I should like, in accordance with the request in Senator Byrd's memorandum, to say something regarding the relationships of fiscal policy and monetary policy. By fiscal policy, I mean the tax structure of the Federal Government, the collection of its revenues, the management of its cash balances, the expenditure of its funds and the management of its debt. By monetary policy, I mean those operations of the Federal Reserve System that influence the quantity and availability of credit.

Except, perhaps, in times of extreme crisis fiscal policy should primarily endeavor to do three things:

(1) Protect the Government's credit; (2) provide, through debt management, the type of credit base and the forms of investment (i. e., the several types of Treasury obligations) needed by the economy; and (3) so far as possible, minimize the effect of Federal financial operations on the private sector of the economy, particularly the price level and the level of employment. Monetary policy should serve as a balance wheel to counteract excessive expansionary or depressive tendencies, whether these arise from the private or from the public sector of the economy, whether they stem from fluctuations in public spending or in private spending.

With the national debt in the neighborhood of $275 billion and governmental expenditure close to one-quarter of national income, the impact of Federal financial operations is inevitably large and the administrative problems involved in managing the Government's affairs exceedingly severe.

If we are to look forward to an economy based on free markets and individual liberties it is an illusion to think that—except in times of extreme crisis—Federal financial operations can in some way be manipulated to serve ends more socially useful than the economical and efficient management of the Government's affairs. It is also a mistake to think that fiscal policy can be directed toward accomplishing the goals of monetary policy without in some measure failing to fulfill its own special responsibilities.

It is the task of the central bank, the Federal Reserve System, to act as a counterpoise in economic fluctuations. The executive branch of the Government—through the handling of its financial arrangements or through debt management—should not attempt to usurp this responsibility.

The often-repeated policy of the Federal Reserve "to lean against the wind," is its proper function. Part of the "wind" against which the Reserve System must lean is the effect of the financial operations of the Government itself.

Deficit financing creates inflationary pressures. So does inept debt management. It is the job of the Federal Reserve to counteract pressures that arise from these directions just as much as it is to offset the consequences of overspending or speculation by private persons and business concerns.

During the last 10 years or more the effectiveness of monetary policy has been handicapped by two major changes in our situation. The first, which time prevents discussing here, has been the rise of important financing institutions, often governmentally sponsored, not subject to the credit policies or influence of the Reserve System.

The second has been the increase in the Federal debt and the lodgment of a large segment of it in the banking system.

One of the great needs, in order to get part of the debt out of the banking system, both of Treasury debt management and of reserve system monetary policy, is the development of markets for Treasury obligations outside the banking system.

Considerable progress has been made in this direction. I think it is worth considering, however, whether it might not be desirable to make a modest amount of the estates of all decedents—say $10,000—free of estate taxes to the legatees if $10,000 of the assets of an estate were in the form of Government securities that had been held a minimum of 7 years.

Such an arrangement might provide a substantial new market for long-term Treasury securities, and I doubt if the Government would lose any sizable revenue through such an arrangement.

The CHAIRMAN. Thank you very much, Dean. It is a very interesting statement, and I agree with most of it.

You have made such a clear statement that I have questions only on 1 or 2 points.

As I understand it, except in times of great emergency such as war, you do not favor deficit spending?

Dr. ABBOTT. I think deficit spending is inevitable in times of war, and it may be necessary at other times. But I do not favor it as a matter of principle.

The CHAIRMAN. Take the present situation. We are headed for a deficit of $3 billion this year and Chairman Martin of the Federal Reserve Board estimates a deficit of $10 billion next year. I think the present situation confirms his view.

Do you see how that deficit could have been avoided?

Dr. ABBOTT. It depends on the point in time with which you wish me to start, Senator—6 months or 6 years ago?

The CHAIRMAN. I am speaking of this fiscal year.

Dr. ABBOTT. As of the starting of this present fiscal year?

The CHAIRMAN. For the current fiscal year ending June 30 the deficit is estimated at $3 billion. For the next fiscal year beginning July 1 the deficit is estimated at $10 billion without tax reduction?

Dr. ABBOTT. I think the deficits we are faced with in this current fiscal year and the next fiscal year are very largely the consequences of past mistakes over the last 10 years.

The CHAIRMAN. They are due in large measure to appropriations that have been passed for public works, things of that kind.

Dr. ABBOTT. And the military and the farm program.

The CHAIRMAN. Military program has not been passed yet and I gathered from your statement that you thought public works should be undertaken only when they have a real merit, independent of combatting recession.

Dr. ABBOTT. That is correct. I think they are not an efficient means of dealing with a decline in business activity.

The CHAIRMAN. Well, on the basis of what has already been done and not considering further action, we are faced with a deficit of $10 billion.

I assume you regard deficits as inflationary.

Dr. ABBOTT. Potentially inflationary. Sometimes immediately inflationary—always potentially inflationary.

It depends in part on how the debt is managed.

The CHAIRMAN. In the period from 1939 to date we have lost 52 cents of the purchasing power of the dollar and have increased our debt very heavily.

Do you think deficits have been one of the main factors in bringing about that loss of the purchasing value of the dollar?

Dr. ABBOTT. Yes, I do. Of course, some of the deficits were accumulated as a result of war.

The CHAIRMAN. Yes. I understand that. In some years we had deficits running up to more than 50 billion?

Dr. ABBOTT. Surely.

The CHAIRMAN. I did not clearly understand your suggestion about tax reductions or adjustments.

Do I understand that you believe businessmen or corporations should have the right to charge off—this is new construction you speak of, if they choose?

Dr. ABBOTT. New construction, new purchases of equipment.

The CHAIRMAN. In other words, things that would be in existence? It would not be change?

Dr. ABBOTT. That is right.

The CHAIRMAN. In other words, a corporation could have a new construction program and charge all of it off in 1 year?

Dr. ABBOTT. In an extreme case. I do not think that would happen.

The CHAIRMAN. I know, but as I read your statement I understood you to say corporations should be allowed, to say when they are going to charge off new plant and how.

Dr. ABBOTT. And if it did that, it would then pay taxes on the earning power of the building subsequently.

The CHAIRMAN. I understand that.

Dr. ABBOTT. Yes.

The CHAIRMAN. But under your recommendation it would be possible for a corporation or any business, to charge off the entire cost of the construction in 1 year?

Dr. ABBOTT. Yes.

The CHAIRMAN. Don't you think that would create inequities? That is to say, that a particular corporation might have great advantage over other corporation which must, pay off in 30 years or 40 years as many of them do. And would it not encourage corporations and other businesses to construct new plants in excess of need for reasonable additional production?

Dr. ABBOTT. I think businessmen are not likely to construct plants greatly in excess of need for this reason: They do construct plants in excess of need at times through mistaken judgment, and at other times they make less expenditure than is ultimately required through mistakes in judgment. You can never correct mistakes in judgment.

The CHAIRMAN. I assume you are familiar with the rapid depreciation provisions.

Dr. ABBOTT. Yes.

The CHAIRMAN. They were largely repealed. It was testified that they did encourage creation of plants in excess of need. I agree that you can only depreciate the amount of your investment, the Treasury takes a loss in interest.

Dr. ABBOTT. That would be a constant.

The CHAIRMAN. Secretary of the Treasury Humphrey testified that the Government had actually lost $3 billion in interest as the result of the rapid depreciation provisions.

Dr. ABBOTT. If the companies had borrowed an equal amount even without certificates of necessity, the Government would have lost the revenue through the tax deduction in any event, I would think.

This would seem to me a somewhat illegitimate argument, begging the pardon of the Secretary.

The CHAIRMAN. I introduced the amendment, and this committee adopted it unanimously, restricting application of the rapid depreciation provisions to industries involved with new weapons such as those in the atomic and guided missile fields.

Congress has gone on record practically unanimously, against accelerated depreciation except in fields where exploration and experimental work is urgent.

Dr. ABBOTT. If I may say so, Senator, I think the Treasury regulations regarding depreciation were a mistake in the first place, and consequently monkeying with accelerated depreciation, if you like, stems from the original mistake.

It would seem to me that a recession, where you need business expenditure, would be an ideal time to correct the initial error. This is in very summary form, my view.

The CHAIRMAN. The 1954 act, as you know, liberalized it very substantially, but it liberalized it generally applicable to all businesses.

It occurs to me that your suggestion would have a great defect in the inequalities or inequities which might result.

Once the decision was made it could not be changed. Some would take half of it off, some would take a third off. I can see how it would be disadvantageous for some companies to take it all off at once.

In my own business, I have never used the accelerated depreciation because I wanted to keep it in a reserve so to speak, for future years, in order to reduce my taxes in the future years, rather than at once. It would not occur to me that there would be objections to that.

Dr. ABBOTT. But, Senator, is it not the functions of businessmen to make this kind of calculation in their minds, and this kind of decision?

The CHAIRMAN. The point I am getting at is that there ought to be, I should think, a uniform law applicable to all businesses. There would be many businesses in which construction or expansion has been completed for some time. They would be shut off from this new advantage.

Some new business could compete with an old business established and take depreciation off 1, 2, 3, or 4 years.

Senator JENNER. Mr. Chairman, could I interrupt?

Don't you also have this proposition in this situation you are talking about some of your large corporations for example, would have such an enormous amount of their business in military and defense contracts so what they do, they will go ahead and expand to take care of the military contracts, and they have more or less a guaranteed profit in that particular field, and then they will take their other development and go out here and beat to death little people who are trying to compete in some other field.

Take General Electric, for example. They have a big military contract and then they will go out here and expand for that purpose. Then they use the development of their electrical appliances and so forth to drive any other competitors out and they can do it.

So where would you make that separation because so much of our expenditures is going into military defense which is a guaranteed profit for certain corporations.

Dr. ABBOTT. It seems to me, Senator, that you are raising the question of the terms on which competition is carried on in an economy where you have big business units and small business units.

The CHAIRMAN. Yes; I am.

Dr. ABBOTT. And that you have the difficulty of this kind of competition, that you mention now.

The CHAIRMAN. That is right.

Dr. ABBOTT. I do not see offhand that my suggestion would make this difficulty any worse.

The CHAIRMAN. Well, the benefits of fast tax writeoff quickly put them into keen competition, and the companies with which they are competing did not have the fast tax writeoff advantage.

Dr. ABBOTT. But my suggestion would give the possibility of a fast tax writeoff to the little business also.

The CHAIRMAN. Well, it is an interesting point certainly. Your proposal would apply to the purchase of equipment as well as construction?

Dr. ABBOTT. Yes. You, of course, might hedge this in one respect by saying that depreciation, as taken on a firm's own books, should be the same as depreciation taken for tax purposes, which would place the burden strictly on business judgment.

The CHAIRMAN. Well, there is an element of the loss to the Government in interest which would be very substantial.

You mentioned other tax reforms that you said would not cost the Treasury anything. You specifically referred to the depreciation. What else did you have in mind?

Dr. ABBOTT. Well, Senator, taking this question of the whole tax structure is pretty hard. You have the question of a level of rates, you have the question of forms of taxation, you have the matter of the way in which business decisions are influenced by tax considerations, the consequences of tax considerations on the motivations of individual people, and I think the question of reform in the tax structure has to be examined on a step-by-step basis.

I made one small suggestion with reference to Government bonds held in an estate which would be tax free to the legatee.

I am hesitant to try to get into a long, technical, step by step discussion.

The CHAIRMAN. But you have nothing specific beyond the depreciation?

Dr. ABBOTT. Not at this time.

The CHAIRMAN. In regard to depreciation: Another objection occurs to me. Assume a business concern would take off $50 million in 1 year for a new plant, and that would give them a loss of $25 million. Now assume the business had made a profit in 1 of the 2 preceding years. This business could then get a cash refund from the Treasury to the extent that loss could be claimed by this process.

Dr. ABBOTT. And the following year, Senator?

The CHAIRMAN. The 2 preceding years.

Dr. ABBOTT. Yes.

The CHAIRMAN. You can carry your losses back 2 years.

If you would take all the depreciation off in 1 year and, assuming you had a loss thereby, you could get a cash refund from the Treasury.

I think it is——

Dr. ABBOTT. Companies do not like to show losses on their books, Senator.

The CHAIRMAN. Unless they are very profitable companies, they would show losses if they took all of it off in 1 year. Suppose a company making $10 million a year built a plant that cost $20 million; by taking depreciation off as an expense, the company then would show a loss of $10 million, and become entitled to a tax refund, if it made a profit in the preceding 2 years?

Dr. ABBOTT. Yes; if they took it all off in 1 year.

As I say, you could hedge this somewhat by saying that the amount they charged off for tax purposes should be the same as the amount they charged off for dividend purposes.

The CHAIRMAN. But your proposal as stated does not have any limitation on it.

Dr. ABBOTT. Not as stated, but there are many variations of this.

The CHAIRMAN. It seems to me, Senator Jenner has made a point relative to big corporations with military contracts which is worthy of consideration. I think you will agree, Dr. Abbott, that many smaller businesses today are finding it difficult to survive in the kind of competition the big corporations are giving them.

I am not sure but offhand it would seem that your proposal would make it more difficult for them to survive.

But this depreciation proposal is just one part of your statement. I want to compliment you, sir, on the balance of it.

I want to ask just one further question: Do you think the Federal Reserve System acted wisely in the various actions it took before and after the recession started?

Dr. ABBOTT. You are speaking of the period 1956, 1957, 1958?

The CHAIRMAN. Yes, I think you said the recession started in the middle of 1957 or the spring of 1957.

Dr. ABBOTT. The first signs, yes.

The CHAIRMAN. The first antirecession action taken by the Federal Reserve was November 15, 1957.

Do you think that action was taken in time; should it have been sooner; was it adequate or not?

Dr. ABBOTT. I think in this last 24-month period, plus or minus, the Federal Reserve policy has been pretty good. I think the Federal Reserve has been a little slow on tightening credit as the boom mounted. I think it has been a little slow on relaxing.

But the direction of policy, I think, has been in accord with the needs of the economy, and it is awfully hard to make your timing perfect.

I am generally sympathetic with the way the reserve policy has operated, but I think it was a little slow on tightening things to hold the boom down and a little slow on loosening things up.

The CHAIRMAN. You referred to the plant construction as being one of the things that brought about this present recession. The Economic Indicator for April 1958, shows new construction in 1957 was at an average of $47.3 billion, as compared with $48.1 billion in March 1958.

So that is actually an increase.

Senator BENNETT. What page, Mr. Chairman?

The CHAIRMAN. Page 19.

In 1956 the figure was 46.1. Now we are running at $2 billion more than 1956 and nearly $1 billion more than 1957.

Dr. ABBOTT. Well, Senator, the figures that I was referring to are expenditure for plant and equipment on the part of business concerns, which is not quite the same as the figures here.

The CHAIRMAN. These are for all construction, the total, I think.

Dr. ABBOTT. These are total. These include farm and residential.

Now, my memory is that business expenditure for plant and equipment for all of 1957 was in the neighborhood of $36 billion or $37 billion.

It has been very high, in that range for 1955, 1956, 1957. It began to slack off in the fourth quarter of 1957, and it is generally expected, according to the forecasts, that this kind of expenditure will be down some 18 percent in 1958.

So this kind of expenditure——

The CHAIRMAN. You are speaking of manufacturing plant construction; is that it?

Dr. ABBOTT. All business, utilities, rails, distributive trades, all businesses.

The CHAIRMAN. Some people contend there was an overexpansion of plants in the period since 1955, and that this has been a factor in the temporary overproduction we are experiencing. Mr. Martin thought it had some bearing on the present situation. Do you hold this view?

Dr. ABBOTT. Yes; I think the fact that some lines of business perhaps overexpanded too quickly, has led to a decline in employment.

But I want to say two other things in this connection: First, in capital expenditures by business, it is almost inevitable that large expenditures be made at one time so that a steel mill or a paper mill builds somewhat ahead of demand.

It is in the nature of the problem. You cannot build a steel mill to manufacture only 1 ton.

Therefore, if business concerns are going to build in order to meet demand it is almost inevitable that periodically they build ahead and overexpand, waiting for demand to catch up.

I think it is also true that while we have at the moment some overcapacity in certain lines, steel and paper manufacturing, for example, we are very much in need of additional expenditure in other lines of business.

The overcapacity is not general throughout all lines of business. We need, as I mentioned, in the transport industry additional capital expenditure. We need additional expenditure in utilities, in the distributive trades.

I am under the impression that the manufacturers of drugs, and food processors, are also somewhat short of capacity, and I think there are probably other lines of businesses.

The CHAIRMAN. I now find on page 10 of the Economic Indicator that you are correct in the fact there was a reduction in new plant and equipment. But total construction apparently has not declined. In fact it has gone up.

Now the public utilities seem to have been somewhat stationary.

Dr. ABBOTT. Their construction tends to increase at a pretty steady rate.

The CHAIRMAN. Do you have page 10?

Dr. ABBOTT. I have the page, but I do not seem to see the figure you refer to.

The CHAIRMAN. Do you find the utilities there?

Dr. ABBOTT. Yes, I have it.

The CHAIRMAN. Utilities have not declined substantially?

Dr. ABBOTT. No.

The CHAIRMAN. There is some decline?

Dr. ABBOTT. Yes.

The CHAIRMAN. There is apparently a more substantial decline in manufacturing construction?

Dr. ABBOTT. If I read this correctly, the manufacturing total for the first quarter of 1958 and the second quarter of 1958 both are below the amounts of the first and second quarters of 1957.

The CHAIRMAN. About a billion and a half?

Dr. ABBOTT. Yes.

The CHAIRMAN. Do you think that is a factor in the present situation we have?

Dr. ABBOTT. Yes; I do.

The CHAIRMAN. Thank you very much, Dr. Abbott.

Senator Frear?

Senator FREAR. I was interested in this rapid amortization discussion, Dean Abbott, between you and the chairman.

I know the conservative approach of our beloved chairman here and I have a great deal of sympathy for it.

I am wondering if it were possible to take complete depreciation within 1 year, and we recognize that which seems to be practically inevitable that if inflation is going to continue it would be poor business judgment not to take advantage of the 100 percent depreciation because that would be the only way that you could get your 48 cents dollar repaid to you because as the years went on you would be getting a 44 and 40 and 32-cent dollar for which you had made a 48-cent dollar investment.

I am not completely in agreement with your thinking but nevertheless, I think it gives us something to wonder about in trying to protect those in industry or where capital depreciation is a part of their system which they have to take into account year by year as to where we should take rapid amortization or carry a reserve, as Senator Byrd has said.

Dr. ABBOTT. I think the point you make is a most interesting one, Senator. I am not sure that I would be quite so pessimistic as saying that inflation will inevitably continue. But if you did say that, then rapid amortization does give some chance of protecting the capital value of the capital investment. This is from my point of view an ancillary advantage.

I believe that capital should not be dissipated through inflation.

Seantor FREAR. That is all, Senator.

The CHAIRMAN. There has been a considerable agitation for reappraisement of the existing plant facilities, capital investments.

Dr. ABBOTT. Existing facilities?

The CHAIRMAN. Reappraisement of the present value of plants built 10 years ago when the dollar was worth more than it is now.

I am somewhat sympathetic with the general idea of giving some aid on this basis but it seems to me if you aid only new plants, injustice is going to be done to the plants previously built and the basis of depreciation over a period of 30 or 40 years.

Senator BENNETT. Mr. Chairman, I wonder if Mr. Abbott's idea would not be to allow owners of existing plants to have the same choice with the rest of their depreciation that you give to the builder of a new plant.

They could choose to charge off the rest of their depreciation in a single year if they wish.

Dr. ABBOTT. This is a possible variation, Senator.

I would not—there are so many variations that I would not at this point try to pick one and say this is the one that is best. But as I say, my thinking is, if you need business expenditure and capital accumulation, this is one way of stimulating it.

The CHAIRMAN. That would lead to the possibility of a colossal loss in revenue if all existing plants were allowed to be depreciated at the will of the taxpayer.

Dr. ABBOTT. Not over the long run, Senator, I think.

The CHAIRMAN. I think there would be the possibility of a staggering loss in tax income.

Senator BENNETT. It is an interesting question, Mr. Chairman, if I may interrupt again.

We are facing a loss of $10 billion in revenue. If by this device we stimulated the economy to the point that we did not have a $10 billion loss in revenue, it might offset it.

The CHAIRMAN. I think the whole question is a serious one, and that is the reason I am asking these questions. To replace these plants now with dollars of present value is a matter for careful consideration.

I am deeply interested in your proposal, Dr. Abbott but I cannot see a practical way to put it into effect. If you have any further ideas about this we will be glad to have them for the record.

Dr. ABBOTT. Thank you, sir.

The CHAIRMAN. Mr. Colin Stam, Chief of Staff of the Joint Committee on Internal Revenue Taxation is here. He has been giving some consideration to this subject, so if you care to elaborate on what you have said today we would be glad to have it in the record.

Dr. ABBOTT. Thank you very much, Senator.

The CHAIRMAN. Senator Martin?

Senator MARTIN. Mr. Chairman, if I may come back to this matter of depreciation a little later, but I have got 2 or 3 questions, Mr. Chairman, I would like to ask now.

Dean Abbott, on page 1 you say, "Larger Government spending, if it helps some of our problems, will certainly make others worse."

Dr. ABBOTT. Well, Senator, I think that is a most interesting question. I think there are a number of problems confronting the country that will be made worse by spending.

I would say in the first place that deficit spending will make more difficult the control of inflation.

Insofar as deficits result in Government debt, and they do, it will make Government debt management considerably more difficult. I think the larger the debt the more difficult the management of the debt, generally speaking.

If spending does have an inflationary effect through an increase in the money supply, and forces up the cost of living, this will raise wages in a good many industries through the cost of living proviso in wage contracts.

To take a more specific area or an individual area, I think the spending in agricultural price supports has consistently made the surplus problem worse.

And I think, with some thought, we could find some other areas. But here are 4 or 5 pretty serious ones that will certainly be made more difficult by an increase in spending.

Senator MARTIN. And probably the most serious of the ones you have mentioned, is the one that it will add to inflation.

Dr. ABBOTT. Yes, many stem from that one.

Senator MARTIN. On page 5 you discuss amending the Employment Act so as to make price stability a national objective.

What do you think is the relative importance of price stabiiity as compared to full employment?

Dr. ABBOTT. Well, that is again I think a most interesting and a rather difficult question, Senator.

I am inclined to think, to give a short answer first, that price stability is fully as much in the public interest as is full employment.

Senator MARTIN. For example, it would take care of the situation just called to our attention by the chairman and Senator Bennett and Senator Frear, the matter of replacing plants.

Probably in many cases the man started to lay aside depreciation 20 years ago, and those dollars now are only worth half the amount they were at that time.

So it enters into his situation.

Dr. ABBOTT. It enters into his situation. And it enters into the situation of people who save money over their lifetime. It enters into the situation of people who live on salaries and fixed incomes. It enters into the situation of companies which are paying people in accordance with a sliding scale of living-wage index.

It seems to me proper that price stability should be looked on as a desirable national objective, and given some explicit recognition somewhere in the governmental process.

And so far as I know it is not given any such recognition.

Senator MARTIN. Mr. Chairman, the reason I am referring to this again, I think the dean discussed it very well in his paper, but it does seem to me that these are things that ought to be given a lot of consideration by the American people, just the same as the American people ought to give consideration to the danger of inflation, the danger of wage increases and then of price increases. I am repeating the question in order to bring out how important it is to the man who is saving money, one who has a savings account, the man who has bought a Government bond, the man who bought life insurance, and then the widows and orphans and men with pensions that live on a fixed income.

It means so much to all that group.

Dr. ABBOTT. I am also inclined to think, Senator, that if we have emphasis on full employment, and if this is narrowly conceived of as, again in quotation marks, "a hundred percent full employment," which is difficult to define in a workable way, that this situation almost inevitably leads to price inflation. If you are to have any chance of checking inflation you not only need to give recognition to the importance of price stability, but you probably need to develop some kind of concept of "workable full employment" or "reasonably full employment," so that there can be some flexibility in the economy.

Senator MARTIN. Dean, isn't it probably true that it is impossible for Government to sustain full employment just like when we talk about a minimum wage? Government cannot do it, unless we have the facilities for employment out over the Nation, minimum wage does not mean anything or full employment does not mean anything?

Dr. ABBOTT. Well, I can give you an answer perhaps that will be distasteful, Senator. It is very distasteful to me, and so I hope you will share my distaste.

I think you can maintain "full employment" if you have continuous and progressive inflation, but not at a too rapid rate, so that it does not become runaway inflation.

I think the only way of maintaining a hundred percent "full employment" is through a pretty rapid rise in prices.

Senator BENNETT. Will the Senator yield?

Senator MARTIN. Yes.

Senator BENNETT. Yesterday, Mr. Harris, on page three of his statement, made this statement, which I would like to read:

"Actually in the first 10 years of the postwar—actually in the first 10 years of the postwar period, unemployment in the United Kingdom averaged less than 2 percent compared with 4 percent in this country, but prices rose 3 times as high in the United Kingdom as they did here."

The British had what might conceivably be full employment but they had paid a price for it in inflation that was three times as fast as our own.

I would like to say 2 or 3 things, Senator, if I may.

Senator MARTIN. Go right ahead.

Senator BENNETT. Mr. Chairman, I hate to take the time but I do think this is an important thing for the people of the United States to discuss, because we are the Government in the United States.

Dr. ABBOTT. First, I personally take strong objection to arguments which are quite common among some economists using Great Britain as a measuring stick for this country. I do this not because of any dislike for our English cousins but because the situations of Great Britain and this country are so utterly and totally different so that I think any argument based on British experience is suspect to begin with.

In the second place, the British not only had full employment but as was generally said by a great many Englishmen and by the economists and other reputable commentators and analysts, they had "overemployment." They not only had full employment, they had something more. Whatever the more was, they had it. The consequence was or, one of the consequences was, that they had a very rapid price increase, and I think the British experience very much substantiates the point that I was making.

If you are going to have full employment defined as no more than 2 percent of unemployment, which is generally described as overemployment, this means inflation.

Senator BENNETT. And no other way?

Dr. ABBOTT. That is my opinion.

Senator MARTIN. Now I would like to ask you this question:

Can you have both full employment and price stability over a long pull?

Dr. ABBOTT. I think Senator Bennett and I have just concluded between ourselves that you cannot.

Senator BENNETT. And Dr. Harris agrees with us.

Dr. ABBOTT. And Dr. Harris agrees.

Senator BENNETT. Yes.

Dr. ABBOTT. If you define full employment in terms of 2 percent unemployment or less, I think——

Senator MARTIN. Right there.

Dr. ABBOTT. Yes.

Senator MARTIN. Does that though bring price stability?

The inflation keeps the prices going up, but that is not price stability?

Dr. ABBOTT. That is not price stability, no.

I think what Senator Bennett and I were agreeing on was this: If you create a situation where you have such full employment that you have only 2 percent unemployed or less, this will inevitably produce rising prices.

I would like to add one other point——

Senator MARTIN. Would you say then, in order to have full employment, you must have a little inflation every year, which means you do not have price stability?

Dr. ABBOTT. That is generally what we were saying, I think, Senator.

Senator MARTIN. Yes.

Dr. ABBOTT. But I would like to put this in: I think the two objectives of price stability and full employment are compatible if you use not the concept of full employment but something like "workable full employment" or "reasonably full employment."

If you permit some——

Senator BENNETT. Maximum practical full employment?

Dr. ABBOTT. Something less than what the British had in any event. And if at the same time you define the concept of price stability as "workable price stability" or "reasonable price stability," permitting the general level to fluctuate within a 5 percent range or something like that.

Senator MARTIN. That is what President Truman meant 7 or 8 years ago when he made the statement that it was sound to have 2 or 2½ million unemployed in our country, because they are moving from one industry to another, and they were moving from one locality to another, trying to improve their conditions.

I think that is probably what the President meant at that time.

Dr. ABBOTT. I think that is part of what President Truman may have meant.

Senator MARTIN. Yes.

Now at various places in your statement you lay great weight on maintenance of business expenditures on plant and equipment.

Do you consider the level of these expenditures as important as consumer expenditures?

Dr. ABBOTT. Well, it is a little hard to define "as important." But let me answer it this way: I think consumer expenditures are very important and I think business expenditures are very important, but I think in different respects.

Consumer expenditures tend to be relatively stable from year to year. They are what the housewife spends when she is buying bread and butter. They conform in some measure to the standard of living. They represent purchases of essential items and some comforts and luxuries.

Business expenditure, on the other hand, is necessary if you are to have an expanding base for new production, if new technology is to be implemented and put to work, and if overall production is to expand. So consumption expenditures and business expenditures have a somewhat different significance.

But I think the real point of your question is something like this: There is very close conformity between the cycles of business expenditure and the business cycle.

If you can stabilize business expenditure from year to year, you will, I believe, pretty well stabilize the business cycle and employment. I think there are good reasons for arguing this, both on theoretical grounds and on pragmatic grounds from history.

Therefore, from the point of view of stabilizing the cycle and stabilizing employment, I would say that stabilization of business expenditure is perhaps more important.

We come back to our discussion on depreciation, Senator Byrd.

Senator BENNETT. On the theory partly too that consumer expenditure tends to be self-stabilizing.

Dr. ABBOTT. It does. I think that is a very good way to put it, Senator.

Senator MARTIN. It must not be misunderstood when we are talking about the importance of price stability, along with full employment, all of us on this committee, and you, we all want it as near full employment as is possible as long as it does not produce inflation and devaluation of the dollar.

Dr. ABBOTT. What you want is a reasonable balance?

Senator MARTIN. That is right.

Dr. ABBOTT. Among employment prices, savings, capital formation. So that the whole economy goes forward rather steadily with no element bulging out too far, and if you have too much capital investment or too full employment or too much of anything, you will get what might have been a balanced progress out of balance.

This I think is one of the dangers of defining full employment too narrowly and at the same time neglecting price stability.

Senator MARTIN. And the matter of savings not only of the individual but of the corporation is extremely important because that can be a cushion when there is a recession.

Dr. ABBOTT. Certainly.

Senator MARTIN. Just, for example, in the depression of the late twenties and early thirties, it was surprising the few corporations, big corporations that were forced into bankruptcy because they had accumulated adequate savings as a cushion.

A good many of them had very large cash balances, but it was a cushion to tide them over the depression.

Dr. ABBOTT. I would like to put in a footnote to that observation and come to the defense of the consumer.

Senator MARTIN. All right.

Dr. ABBOTT. It is my impression in the thirties that the consumers of this country, to their great credit, paid their debts somewhat better than the great corporations did. There was less default in consumer credit than there was in corporate credit.

Senator MARTIN. Dean, last summer Mr. Humphrey cited the optimism of business and consumers as to the future and that this contributed to the continuation of the inflationary boom.

Do you believe that the attention and public discussion in recent months tends likewise to prolong and intensify the current recession?

Dr. ABBOTT. Well, Senator, I think in the movement of the cycle up and down there is always a very strong psychological element. Some economic theorists base their whole analysis of cycles on psychology, not on monetary factors.

It has been my impression since last fall that business sentiment was appreciably worse than the business statistics. This of course is not susceptible to exact measurement. People have become, I think, somewhat obsessed with this recession.

It has been played up enormously in the public press. I have sometimes thought, going one step further in answering your question, that it is almost true to say the recession has been seized on as an alibi for not looking at various questions which I think in the long run are more serious and more difficult for this country.

It has seemed to me, as a citizen reading the newspapers and talking with businessmen and hearing a few speeches, that discussion of the depression and whether this index went off a tenth of 1 percent or that index went up two-tenths of 1 percent, has been almost a godsend for diverting attention away from various problems that I think in the long run are likely to be of much greater consequence to this country.

Senator MARTIN. You have already discussed, and very intelligently, the danger of inflation and how it comes about and so forth.

When we have, let us say, 2 percent inflation per year, how can it be stopped?

Dr. ABBOTT. Well, I think there are various ways that it could be stopped, but it is stopped at some cost in other areas.

I would say that it could be stopped if the American public were willing to pay the price in higher interest rates, tighter credit, and more unemployed, to give a very short and unwelcome answer.

Senator MARTIN. Dean, if we do not stop it won't it eventually spiral until it blows out at the top?

Dr. ABBOTT. Well, you know and I know, Senator, that this is a matter under great discussion: whether you can control a creeping inflation indefinitely.

The views differ. I do not know what I think because I think, in my opinion, you have to hedge your answer so carefully as regards the other conditions that are assumed: the attitude of the public mind, war or peace, drought, elections, all kinds of things impinge on that answer.

I do think it is extremely important for people to realize that if inflation, as you say, blows out at the top or does become extreme that that condition in our experience is always accompanied by all of the manifestations of extreme depression, by which I mean very heavy unemployment, a great amount of idle factories, low savings, low volume of output, probably an unfavorable balance of trade. So that if you look on inflation as a way of avoiding deflation, you may be filled with consternation when looking at the end of the road because you end up with all of the conditions that make deflation so extremely unwelcome.

Senator MARTIN. Deflation, of course, is most unwelcome. But since 1939 the dollar has been eroded until it now has a value of about 48 cents. That is not very many years.

Suppose it continues at the same rate for a similar number of years in the future.

Have you ever given any thought as to what the dollar will be worth then?

Dr. ABBOTT. Well, if that continued for the same number of years in the future it would clearly be worth a good deal less, Senator. What the consequences of that by itself would be is very hard to say because I think you have to assume other attending circumstances. I think it is impossible to say whether continued erosion such as this would necessarily bring unemployment, idle capacity, lack of capital formation.

You have to make so many assumptions as to the other attending conditions.

Senator MARTIN. Thank you very much.

The CHAIRMAN. Senator Carlson?

Senator CARLSON. Dr. Abbott, I should have interjected when they had this discussion on accelerated depreciation, because I think those of us who have heard all this testimony have noticed that the personal income has been holding up quite well, the consumer spending is pretty steady, and the big decline, of course, has been in the heavy goods industries, and in the construction field of new industry or new facilities and plants and equipment.

Dr. ABBOTT. Industrial construction.

Senator CARLSON. That is where our real problem seems to be. We have one phase that we could get some—if we had accelerated construction in this field again, and that is in the construction of grain storage facilities.

Dr. ABBOTT. Of grain storage?

Senator CARLSON. Grain storage facilities.

Dr. ABBOTT. Yes.

Senator CARLSON. For several years this Congress permitted accelerated depreciation for the construction of grain storage facilities.

The law expired last year, as I remember it, and there is pending before this committee at least one bill that I know of, maybe more, urging the reenactment of that phase of it.

Now if that phase or that type of legislation were again approved, and if we had accelerated depreciation for the construction of grain storage we would build facilities on the coasts and in the interior sections of this country for at least a billion bushels of grain which are badly needed and will be needed for harvests. I mention that because it is one way and I think it is a very important point in this picture, and one I am glad you stressed. If we want immediate action, early action in this field, we should again take a look at reenactment of accelerated depreciation.

I appreciate your mention of it this morning. It is one thing that, as the chairman has well stated, has some problems and I think we should reenact it again, and if we do, we ought to put some restriction on it but here as a field where we are dropping this year at least $4 billion based on the Economic Indicator here before us, in a field that is badly needed in every phase of our production expansion.

Senator MARTIN. Would the Senator yield?

Of course, if the man takes all of his depreciation in one year then the next year, of course, his taxes are greatly increased.

Dr. ABBOTT. That is correct.

Senator CARLSON. I just want to say this: That I did appreciate your statement very much, and Senator Bennett, I think, has some questions. He is going to get into a field I think I probably would have gotten into in time and I know where you get into the unemployment is largely concentrated in these heavy industries.

I just wanted one item on that. We are handling our programs for bringing about a lessening of this recession by what seems to me to be short of a shotgun method.

I mean we have large national programs when if there was some way that we could pinpoint these programs into areas where they are badly needed, and I say that because I live in a State where we have some problems but really not serious problems like I know there are in other places and if you have got any suggestions as to how we could get into communities, into areas, I mean some very large ones, in large fields, I would like to have them.

Dr. ABBOTT. Well, Senator, I would answer that question this way. This is probably an unwelcome answer in view of the nature of the question.

I think, generally speaking, there are some exceptions, but I think generally speaking programs designed to heal unemployment in particular areas are the wrong approach and I will tell you why.

The very fact that you have unemployment in a given area means that you have got too many people there and too few business opportunities.

The natural course would be to move the excess people to where there are business opportunities. This is what happens in a flexible economy.

Insofar as you put in "an artificial program" in an area where there is unemployment, you remove the motivation for anybody moving and perpetuate the situation of too many people and too few business opportunities.

You do not get anywhere.

Senator CARLSON. Doctor, that is a very practical answer and it is just about as politically feasible or possible as to say, "Well, let's move a lot of farmers off the farm."

Dr. ABBOTT. Quite. I recognize that.

Senator CARLSON. Yes.

Dr. ABBOTT. I am speaking as an economist and not as a politician this morning.

Senator CARLSON. Thank you very much.

The CHAIRMAN. Senator Bennett?

Senator BENNETT. Doctor, I have a number of questions.

On page 7 of your statement you list a number of aspects of fiscal policy and I wonder if you would consider amending it to include Government spending as a manifestation of fiscal policy.

You mention the tax structure, the collection of revenues, the management of car balance, the expenditure of its funds, management of its debts.

In the phrase "expenditure of its funds," do you include the concept of the balanced budget?

Dr. ABBOTT. Yes.

By "fiscal policy," I mean to include expenditure of funds, whether under conditions of a balanced budget or not. This is part of policy.

Senator BENNETT. Yes.

On page 8 you mention a problem which has been brought up many times earlier in these hearings and discussed at some length more or less without any resolution. And that is the problem created because there are financial institutions which are beyond the immediate reach of the Federal Reserve credit policy.

Do you have any suggestions that could be made now or later to the committee which might be translated into law, which might reach this particular type of problem?

Dr. ABBOTT. Senator, I think this is an exceedingly important problem among the range of materials before this committee, as I conceive its mission.

Now, of these institutions that are beyond the influence of the Federal Reserve, some of them are governmentally sponsored, some are private.

Suggestions would have to be different in each case, obviously. It would seem to me in the case of governmentally sponsored lending agencies, it would be terribly difficult to so change the statutes as to make the governmentally sponsored lending agencies susceptible to Federal Reserve policy.

Senator BENNETT. Then your approach in that case would be to expand the power of the Federal Reserve policy to have some influence on them, rather than to set up a new source of influence.

Dr. ABBOTT. That is correct.

The suggestions that I have heard before, looking toward setting up a new agency—and perhaps the suggestions I have heard are not the things you have heard or have in mind—but the suggestions that I have heard look to a procedure by which the Federal Reserve is covered into some supercouncil or agency, which would include the other governmentally sponsored lending institutions, and the top of that agency would presumably be centered in the executive branch of the Government.

In that event the Federal Reserve would lose its independence.

Senator BENNETT. That is right.

Dr. ABBOTT. The essential thing, if you are to have an effective central bank, is that it shall be independent.

Now, the Bank of France has lost its independence; the Bank of England has lost its independence; other central banks have.

And I think the test of whether you have an independent central bank is whether the central bank can lean against the wind that is generated from the Treasury. And if it is covered into an agency headed in the executive branch of the Government it obviously cannot.

Senator BENNETT. Well, this is a serious problem, and would probably be before another committee rather than this committee, and since I am a member of both, I would personally be grateful for any suggestions over the next few months or at a convenient time.

Mr. Chairman, the next few questions I have to ask are generated by the statement which we listened to yesterday. I do not know whether you have a copy of Dr. Harris' statement.

Dr. ABBOTT. Not in front of me, Senator; no.

Senator BENNETT. On page 3 of his formal statement Dr. Harris infers that as long as the gross national product increases at a faster rate than prices increase we're all right. Is it necessary to have rising prices in order to stimulate growth of the gross national product?

Dr. ABBOTT. Let me take this step by step, if I may, Senator.

Senator BENNETT. All right.

Dr. ABBOTT. If I understood you properly, you said that Professor Harris said that if——

Senator BENNETT. It is on page 3 of his statement.

Dr. ABBOTT. Which line, sir?

Senator BENNETT. He infers it on page 3. However, he has a statement on page 1. He says:

> We would not be unhappy with a rise of prices of 1 percent a year and a gain of output of 5 percent per year; but we would be unhappy with an increase in prices of 5 percent accompanied by a gain of but 1 percent in output.

The inference there is that you have to have the two of them together. You cannot have one without the other. That is the way I read it.

Dr. ABBOTT. I think there is much more to it than that. If you had a gain of prices of 5 percent and a gain of gross national output of 1 percent your productivity would obviously be falling. I should think we would be unhappy.

Senator BENNETT. To come to my question——

Dr. ABBOTT. Yes.

Senator BENNETT. Do you believe that it is necessary to have a continually rising price level in order to stimulate growth in gross national product?

Dr. ABBOTT. I think the record shows that it is not necessary, Senator. I cannot quote the figures for gross national production between 1920 and 1929 but the growth was substantial and if my memory is correct there was a continually falling Wholesale Price Index during that decade.

Senator BENNETT. That is correct.

In some situations, isn't it true that reduction in price level would promote an increase in the gross national product? To be specific, if I am correct in my analysis of the present automobile situation, don't you believe that many consumers are waiting for a lower price before they return to the automobile market?

Dr. ABBOTT. Senator, I think you have two questions here: One, you mentioned a general price level and, second, you mentioned the prices of automobiles which is one item.

Might I take these individually?

Senator BENNETT. Yes.

Dr. ABBOTT. I am not sure whether I would say that a fall in the general price level might promote a growth in gross national product, because I think other things than price behavior are important. But it is certainly true that a fall in the price level is compatible with a growth in gross national product, as witness the decade of the twenties which I mentioned a moment ago.

It is certainly true, to take the kind of an example that I mentioned to Senator Byrd, that one of the manifestations of extreme inflation is very rapidly rising prices and a very rapidly falling volume of output. And to take postwar German experience, when you stabilize prices you got a very rapid advance in gross national product.

So under that kind of situation perhaps it is fair to say that a stable price level or a reduction in prices, would promote gross national product. But this is, of course, an exceptional situation.

Senator BENNETT. That is right.

Dr. ABBOTT. Now as regards individual commodities, generally speaking, and with a number of qualifications, falling prices do promote demand. It depends on the nature and character of the demand.

Senator BENNETT. But in the so-called mass-production industries certainly the people who plan the sales and production programs for those industries assumed that the advantage of mass production is a lower price per unit, and that mass demand is created because of the existence of that relationship.

If we still had automobiles handmade, we would be in a completely different situation than we are today.

So presumably over a long period of time that falling prices in automobiles would stimulate a demand.

Dr. ABBOTT. For automobiles?

Senator BENNETT. For automobiles.

Dr. ABBOTT. I would say falling prices was one of the things. Building of the road network helped a good deal.

Senator BENNETT. Yes.

Dr. ABBOTT. A change in social habits helped a good deal.

Senator BENNETT. But some of those followed a realization on the part of the public they were going to have that opportunity to get their transportation at presumably equal or lower prices.

Dr. ABBOTT. Yes.

Senator BENNETT. Dr. Harris said on page 11 that the main therapy that we need is increasing purchasing power.

Aren't there two aspects of purchasing power:

(a) Income; and (b) Prices; and isn't it possible that inflationary deficit programs may cause rising prices to cancel out the benefit of increased income?

Dr. ABBOTT. I would disagree with Dr. Harris that the main thing that we need is increased purchasing power in the hands of consumers. I said as much in my piece.

Senator BENNETT. Yes.

Dr. ABBOTT. A reduction in consumption expenditures has virtually not taken place. Retail sales have held up very well. Savings in the hands of consumers are high, and I believe rising.

They have the money to spend, so far.

My analysis is that what we need is greater business expenditures on plant and equipment, not an increase in consumer purchasing power.

Senator BENNETT. It is true, however, that even though consumers have the money, for reasons of their own they have chosen not to spend it in certain areas. This creates a spotty situation. I am very conscious of that personally, because I am connected with two businesses back home.

One of them is going along at a very satisfactory rate; the other, which is an automobile agency, is having a lot of trouble. So that the situation is not a general lowering of business indexes, it is a very selective lowering.

Dr. ABBOTT. That is right.

Senator BENNETT. Then I would like to turn to an area that has intrigued me very much.

Can we have a continuous rise in national production based on debt rather than on saving?

Maybe the phrase "national product" is not the right one.

Can we have a continuous rise in the general level of the economy, based largely on debt rather than savings?

Dr. ABBOTT. Well, now, I think we have a problem of semantics here.

If we have savings that are put to work debt is created. The borrower borrows the savings.

Senator BENNETT. On the other hand——

Dr. ABBOTT. You do not mean that kind of debt?

Senator BENNETT. On the other hand, and this is a distinction I am glad to discuss with you briefly because Marriner Eccles made a great point of the statement you have just made, you would include in your term "borrow" in an overall sense, investment. If a man has savings and makes an equity investment or commits his savings to what may seem to be a longtime commitment, to me that is different from the kind of debt that a man creates with the assumption that he is going to pay it back over the near period.

Dr. ABBOTT. I would not call "equity" "debt" in the first place.

Senator BENNETT. O. K. That is the point I wanted to get at and does not much of savings go into equity?

Dr. ABBOTT. You are talking about personal savings?

Senator BENNETT. Yes.

Dr. ABBOTT. Or business savings?

Senator BENNETT. Yes, personal savings.

Dr. ABBOTT. No, I cannot cite the figures but it is my strong impression that most personal savings when they are invested through what Professor Harris called financial intermediaries or what I would call financial institutions, that a debtor-creditor relationship is set up.

Senator BENNETT. I recognize that but I am at a loss to understand by your definition how a man creates the capital then that he puts into an equity.

Does he not create it by saving, by sacrificing, by denying himself the privilege of spending it for consumption?

Dr. ABBOTT. Certainly.

Senator BENNETT. Isn't that essentially the same process as saving which could be defined as the process by which he puts it into a financial institution, and gets income from it?

Dr. ABBOTT. Or if he saves and creates a hoard, buries it in the ground, it is saving.

Senator BENNETT. That is right.

Dr. ABBOTT. I would say, Senator, that saving is saving. What is done with the savings makes a great difference. Savings may be buried in the ground and not put productively to work.

Senator BENNETT. That is right.

Dr. ABBOTT. They may be invested as an equity in a small business, a grocery store. A man starts it and he has an equity. Or he may buy shares of stock in a nationally listed corporation, in which case he again owns an equity but he has transferred the savings for management to someone else.

Senator BENNETT. That is right.

Dr. ABBOTT. Thirdly, he may lend the savings, either directly, to a friend——

Senator BENNETT. That is right; or indirectly.

Dr. ABBOTT. Or through a financial intermediary, a savings bank, insurance company.

Senator BENNETT. In the latter case he expects to be able to recover the identical amount that he put in or if he lends it to an insurance company he expects a different situation.

Dr. ABBOTT. It depends on the type of contract.

Senator BENNETT. Yes. That is right.

But all through these discussions, I have been greatly concerned by the expression that I have sensed, by the expression of an opinion that there was no essential difference in our economic processes between going to a bank and borrowing money—let me try another example.

Take one of the companies with which I am connected or any company.

The company goes to the bank and borrows $50,000, and invests it in the operation of the business.

I feel there is a difference in that situation compared with the situation in which the owners of the business increase their equity by $50,000.

I think there is a great deal more stability in the equity approach than there is in the approach of creating new current debt.

And that leads to what I sense is a very important and to me a very serious problem when we consider antirecession measures.

Not only do many people apparently feel, as you suggested earlier, that the way to get out of our present situation is to spend money to do it, but there are many people who feel that the way to get out of our present situation is to borrow money to spend to do it, to increase the debt, and that disturbed me very much because it seems to me that that debt has to be paid back and that we are at best postponing our problem.

A manifest indication of that, which has also fascinated me in these hearings, is the fact that several times the question of bankruptcy has been brought in and an attempt has been made to say this is a terrible condition because bankruptcies are rising.

Isn't bankruptcy created when debt has become unmanageable?

A man can no longer have hope of paying his debt, so he becomes a bankrupt and he escapes the consequences by that legal process.

Isn't that a fair statement?

Dr. ABBOTT. Yes. I suppose technically bankruptcy occurs when you cannot meet your legal obligations.

Senator BENNETT. That is right.

Dr. ABBOTT. In a financial sense you have, of course, two kinds of bankruptcies. One, as you might say in a balance sheet sense where the equity is extinguished, but a sharp operator by moving his cash account fast enough can stay out of bankruptcy for a very long period of time very often.

Senator BENNETT. But take the problem—I am thinking primarily of the problem of the individual, personal debt, and a man has accumulated it and has reached the point where he can no longer pay it then he takes bankruptcy as a means of relieving himself.

Dr. ABBOTT. Yes.

Senator BENNETT. I am puzzled by the apparent argument that the way to reduce the number of bankruptcies is to make money easier.

Dr. ABBOTT. I think I begin to see your difficulty, Senator. I suppose this raises the question of who is doing the borrowing. The bankrupt, in your frame of reference has obviously borrowed too much.

Senator BENNETT. That is right.

Dr. ABBOTT. And he cannot make productive use of the resources he has acquired.

Senator BENNETT. Or he has consumed them and has no way of getting the funds to satisfy his obligations?

Dr. ABBOTT. The theory of making credit more readily available and thereby inducing people to borrow, which is what was bothering you——

Senator BENNETT. Yes.

Dr. ABBOTT. Is, I think, along these lines: that at any given time, perhaps especially during a recession, there are unexploited business opportunities in front of a great many companies or persons. I, myself, think this is true; I think the world is full of unexploited opportunities.

Therefore, if you can induce the people who are capable of exploiting the opportunities in front of them to borrow and make productive use of the resources, not only will that raise business activity but this other activity may spill over in the area of the bankrupts, or of people about to go bankrupt, and provide them with additional business.

Senator BENNETT. It seems to me, on the face of it, if a man has put himself in the position where he cannot pay his debts he might postpone the dreadful day, but I do not think you can save him from his bankruptcy by loaning him more money.

Dr. ABBOTT. Not him; no. But somebody else.

Senator BENNETT. I see. It is an indirect situation then and you certainly cannot save the man by direct increase of debt.

Dr. ABBOTT. Typically not; no.

Senator BENNETT. We apparently now have a recession and at the same time prices are rising. I assume that your statement with respect to the rigidities put into the economy, when you mentioned Government debt, high Government debt, high Government taxes, and union contracts, as I remember——

Dr. ABBOTT. High depreciation, high interest, also.

Senator BENNETT. All of these have helped to produce this anomalous situation.

What would happen if we went through this recession and there were no balancing of the price index?

What could we expect of the next recession?

Dr. ABBOTT. You mean by "no balancing" no decline of the price index?

Senator BENNETT. No leveling off of the price index——

Dr. ABBOTT. Well, I would say this would, in the first place, prolong this recession, perhaps, if you have no compensating action on prices, although this is a very controversial point in economic theory.

This would be my feeling.

Then you would go presumably into the next recession with the same price level as before, or perhaps higher.

Well, you see, this is in effect what has happened since the postwar period. There have been two very minor recessions since 1945; and while the price index has not gone up steadily, month by month, the upward trend has, for the period as a whole, been uninterrupted.

It has gone up, leveled off periodically, gone up and leveled off.

So that you at the moment have a case history in front of you of going into a recession when there was no fall of prices in the preceding recession.

Senator BENNETT. Yes. But while there was no fall there was at least——

Dr. ABBOTT. A leveling——

Senator BENNETT (continuing). A leveling.

In this situation we have no leveling yet.

Dr. ABBOTT. No.

Senator BENNETT. It is fair to say that if this present situation should continue through a lengthened recession we can be sure that the next one will be a little worse than this one.

Dr. ABBOTT. No; I would not say so.

Senator BENNETT. You would not say so?

Dr. ABBOTT. I think there is no validity in the general argument that since 1800 or 1900 or 1929 recessions have gotten worse and worse.

This is not in accord with the historic pattern.

Senator BENNETT. No.

Dr. ABBOTT. So I think it would be dangerous to say that, because we have got a recession with a $5 billion tag on it, next time we will have a recession with a $10 billion tag.

Senator BENNETT. That was not my point.

I am sorry I did not make it clear. My point is if we go through this one which is the third since the end of World War II——

Dr. ABBOTT. Yes.

Senator BENNETT. And prices rise more sharply or fail to come into leveling balance, is it fair to assume that that will make the problems of the next recession more difficult, not simply the fact we are in a historical sequence, but the fact that we are now in a position where inflation—where recession and inflation are operating together?

Dr. ABBOTT. I would not draw that conclusion, Senator. There are too many other variables in your equation which you do not know about.

Senator BENNETT. I want to press my point a little further. If you won't draw the conclusion in admitting the existence of the variables, would it be fair to say that this situation might be one of the variables which would tend to make the next recession more difficult even though it were offset by others?

Or, Dr. Abbott, would it tend to make the inflation more difficult to control; let's turn it the other way around.

Dr. ABBOTT. It might make the intermediate period more difficult to control; yes.

Senator BENNETT. And would not it make—if the inflation continued through the next one, would not it make that more difficult to control because we will have gone through one period of inflation without moving to control it?

Dr. ABBOTT. It would be hard for me to say "Yes."

Senator BENNETT. I see.

I have another question or two, but I realize that I have already imposed on my friend from Indiana as well as the rest of the committee far too long, and before I conclude, Mr. Chairman, one thing that has impressed me throughout this series of hearings is that each witness, regardless of his views otherwise, has commented on the inflationary powers of trade unions.

We are all aware of the counterattacks by Mr. Keyserling, Mr. Reuther, and others to the effect that business could absorb even greater wage increases than it is doing. I assure you that the facts do not back up this latter assertion.

I submit for the record a table showing the increases in profits before taxes, total compensation of employees, hourly earnings in manufacturing, and output per man-hours in manufacturing. I realize that depending on the years chosen for comparison a more favorable or less favorable light can be shed on labor or business. To waylay such quibbling over years chosen for comparison, I have shown the change from each year over the period 1947–56 to the year 1957. I realize that some different relationships might be shown by stopping at some earlier year; but I have shown changes through the latest year, 1957.

You can draw your own conclusions as you examine the table, but I would like to observe that for each year from 1947 to 1956 the increases in wages to 1957 exceeds the increase in corporate profits before taxes.

Of particular interest is the increase in average hourly earnings in manufacturing compared to output per man-hour in manufacturing. Notice that the rise to 1957 in hourly wages has exceeded the rise in hourly output for every year since 1947.

The CHAIRMAN. Without objection, the insertion will be made.

(The document is as follows:)

Profits, wages, and productivity, 1947-57

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

Sources: Economic Indicators, April 1958. Economic Report of the President, 1958. U. S. Department of Labor.

Year	Hourly wages manufacturing[1]: Average hourly earnings in manufacturing	Hourly wages manufacturing[1]: Percentage increase from specified year to 1957	Productivity manufacturing: Indexes of output per man-hour (index: 1947-49=100)[2]	Productivity manufacturing: Percentage increase from specified year to 1957
		Percent		*Percent*
1957	$2.07		134.5	
1956	1.98	4.5	133.5	0.7
1955	1.88	10.1	130.0	3.5
1954	1.81	14.4	125.6	7.1
1953	1.77	16.9	119.7	12.4
1952	1.67	24.0	115.3	16.7
1951	1.59	30.2	111.6	20.5
1950	1.47	41.3	111.8	20.3
1949	1.40	47.8	105.4	27.6
1948	1.35	53.3	99.8	34.8
1947	1.24	67.3	90.5	41.0

[1] Manufacturing employment totaled 26 percent of total civilian employment in 1957.
[2] Computed from data prepared by Department of Labor.

Senator BENNETT. Thank you.

The CHAIRMAN. Senator Jenner?

Senator JENNER. Mr. Chairman, I realize it is late.

Back on what Senator Byrd was talking about a moment ago, this writeoff of depreciation of expansion of plant and capacity.

Should not really some thought be given there to expansion that pertains to nonproductivity, for example, the war elements, where there is no productivity there that is usable for consumption, but just waste goes into a machine, a war machine, in 3 or 4 years it is obsolete and so forth, with that thought in mind, don't you think it might clarify and benefit the proposition that you offered here?

In other words, give depreciation where there is increased productivity for efficiency and so forth where there is consumption that people can use it but not give the depreciation where expansion is for increased nonproductivity.

Just reversing what we have been doing in the past.

We have been accelerating atomic energy and so forth and so on and big Government expansion of these big corporations, don't give depreciation for that.

Let them enter into a contract with the Government; let them make a profit, sure; it is a profit-and-loss economy.

I want them to make a profit, but encourage the people who go out here and increase efficiency of productivity that the people can use and give them that benefit.

Dr. ABBOTT. As I said originally, I think it was a mistake to start monkeying with depreciation schedules in the first place, and I think you have a heaven-sent opportunity for getting rid of the problems at the moment.

Now to speak to your point directly, I think it would be very hard in a good many cases to draw a hard and fast line and say, "This capital investment is exclusively for war, has no peacetime use and this investment"——

Senator JENNER. I am only speaking of those contracts let directly by Government to contractors for war purposes, for defense purposes.

Dr. ABBOTT. Yes. But they always hope there is some salvage value in the equipment or something, so I am saying I think there is a technical difficulty here, although that may not be insuperable.

I think there is a great deal to be said for giving producers of goods that go into domestic civilian consumption as much encouragement as you have to the munitions makers.

I think this was an improper distinction in the first place. As I said, I think the whole thing has been a mistake.

So this would be a chance to correct it.

Now, the third point I would make is that I think a good many war contractors would say, "Well, if we are not going to get a rapid writeoff on the facilities then perhaps the Government ought to pay for all the facilities in the first place, and we operate under a contract with the Government. Let the Government own the facilities."

Maybe there would be some merit in that.

Let the Government get the salvage value, if any.

Senator JENNER. Well, that would put the Government in business more or less then, would it not?

Dr. ABBOTT. I think the Government has done this in a good many cases, Senator.

Senator JENNER. I know.

Dr. ABBOTT. I cannot cite them offhand. But——

Senator JENNER. They did during World War II quite a bit of it. But we have liquidated quite a few of those. I was just interested in this particular point.

I do not see how you are going to work out the inequities of a man, for example, who has had a business established and has been taking a long-term writeoff and then you let some competitor come in and build a big facility right by him, and produce the same product and give him a quick writeoff unless you separate that which is for domestic civilian consumption and that which is for nonproductivity like war materials.

Dr. ABBOTT. I would say there was an inequity in the first place, and this would be a way to correct it.

Senator JENNER. Well, the hour is late.

I do want to generally commend Dean Abbott on his fine statement because we have heard so many people come before us here and advocating the Keynesian theory of government and so forth and they say, "Well, in terms of recession like this what the Government has got to do is pump out a lot of money and get everything going again when we have good times, then the Government has got to contract, cut down taxes and cut Government's costs." It is a beautiful theory but it has never worked out.

I think in the last 20 years we probably have had two balanced budgets, so we never got around to the second phase of their beautiful theory and you have, I think, on page 3 here pretty well nailed down the proposition that is holding the situation where it is when you said the inflexibility stems from the great expansion of contractual commitments in our economy that increase the proportion of fixed costs involved in doing business, and I cited three examples, the growth of taxes at the Federal, State, and local levels of government.

I think you were very generous, however; you might have said you were referring to Federal expenditures when you said about a fourth of our total economy is in Federal taxes, but I think when you added the State and the local levels in it, it will run nearer a third, 30 percent. Then you said further, governmentally supported raw material prices and the increasing rigid costs of labor that stem from monopoly power of labor unions.

Again I want to compliment you on your courage and forthrightness, because I think you are about the second man of all the witnesses we have had who has had the courage to put the blame where it actually belongs.

I will not take any further time.

I do have some questions, but I know it is late, and I will just pass.

The CHAIRMAN. Dean Abbott, I want to congratulate you on your statement.

I think it is one of the ablest we have had in our hearings.

Dr. ABBOTT. Thank you very much, sir.

The CHAIRMAN. If you have anything to add in the way of comments or additions, we will be very glad to put it in the record.

Dr. ABBOTT. Thank you; I appreciate the privilege.

The CHAIRMAN. You made a fine statement. The committee will adjourn.

(Whereupon, at 12:50 p. m., the committee was adjourned, subject to the call of the Chair.)

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