June 11, 1959

Statement
by
Senator Hubert H. Humphrey
In the Senate of the United States

on June 10th the ~~yesterday~~

Mr. President, ~~in this morning's~~ Wall Street Journal ~~[illegible]~~ reported that Treasury Secretary Anderson told the House Ways and Means Committee ~~yesterday~~ that "the choice is either between a somewhat higher level of interest rates, or a stimulation of inflationary pressures through monetary expansion."

This, of course, is the same old song which the Administration has been playing and replaying in defense of its tight-money, high-interest rate policies. We have been hearing it dinned into our ears for so long and so frequently, by the Administration and by the majority of the newspapers and magazines which are allied with the Grand Old Party that a good many people have been sadly mislead into believing that this song rings true.

I say that the Administration and its public relation experts are working a great disservice on the American people and on our economy by such propaganda.

It is nothing new for the Republicans to advocate tight money and high interest rates. The GOP has been trying to sell this to the American people since the days of President Grant. The GOP richly deserves the reputation as being the tight-money party. It always has been and it probably always will be; I see no evidence that it will change.

The truth of the matter is that we are not now in an inflationary period. We do not face monetary inflation. There is not too much money chasing too few goods as the GOP would mislead us into believing.

With all due respect to Secretary Anderson, I prefer to have the advice and counsel of the distinguished senior Senator from Illinois, Mr. Douglas, who is one of our country's leading authorities on monetary policy. ~~On Monday of this~~ last week Senator Douglas has stated unequivocally that we do not face monetary inflation and that with our economy operating below full capacity "the addition to our monetary system of increased amounts of credit will not bring price increases provided only that these additions are properly managed."

It is time that the American people be told of the fallacies of the GOP's tight-money policies. It is time that we break through the propaganda barrage on the "virtues" of tight-money and that we set forth the cold facts on what tight money and soaring interest rates really means, who it benefits, and who it harms.

I intend in the weeks to come to set forth the statistics on the rising costs of borrowing money with which to buy a home or to expand a small business, and also to show the handsome profits of the big banks and other lenders who have benefited so much by the fantastic rise in the cost of money.

In conclusion, Mr. President, I ask unanimous consent that an article from the Wall Street Journal of June 10 entitled

"Tighter Money" be inserted in the Record at the conclusion of my remarks.

The lead paragraph of this article reads: "The impact of tight money is spreading to more and more businesses and beginning to touch many consumers."

The Wall Street Journal survey indicates that banks are becoming more selective on loans and are requiring larger "compensating balances", thereby increasing the true cost of loans. It is also reported that mortgage money is becoming tighter and interest rates are going up. Auto dealers are reported to be feeling the effects of tight-money also; they are losing sales due to credit restrictions.

We may expect more and more of this in the months ahead. It is going to hurt, in particular, small busineeses, as well as meaning a larger slice of wage earners' pay checks going into interest payments.

(Exhibit A)

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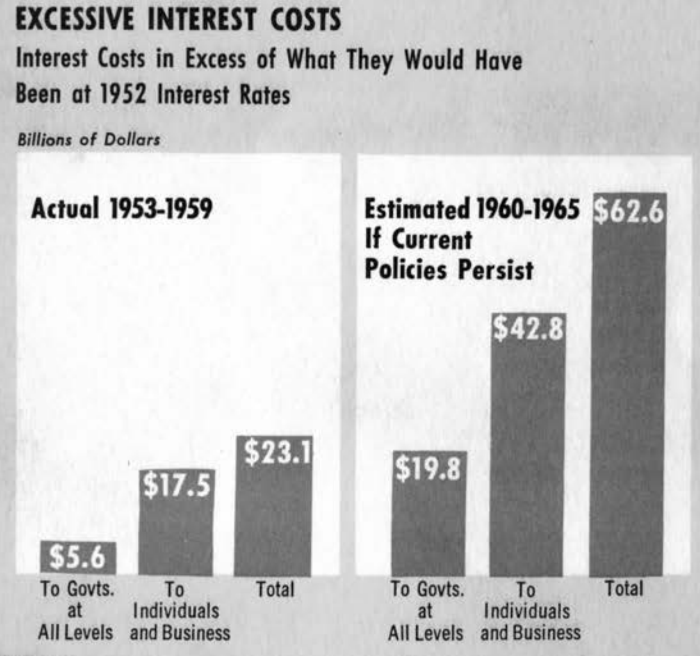
Tight Money and Rising Interest Rates

. . . AND THE DAMAGE THEY ARE DOING

[July 1960]



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I. Summary And Theme: To Reverse The Tight Money Policy

The tight-money-rising-interest-rates policy of recent years represents the use of public instrumentalities for purposes alien to the interests of the Nation and the people.

The policy is imposing wasteful costs upon governments at all levels, even while they have not been spending enough to meet national security and domestic public needs; burdening consumers and business enterprise with substantial increases in their costs, in order to pay interest bonanzas to those who do not need them; and, combined with other undesirable national economic policies, inflicting upon the whole economy a low rate of economic growth and a high level of unemployment of plant and manpower.

The same policy is fanning inflation under the banner of a "crusade against inflation"; multiplying the difficulties of managing the national debt; and at times making the solemn obligations of the United States Government more speculative than common stocks.

The advocates of this policy have attempted to justify it on two basic grounds: to fight inflation, and to encourage more saving for investment purposes. These arguments have been based upon incorrect analysis. The inflation in recent years has not been a general inflation due to "too much money chasing too few goods"; instead, it has been a selective inflation. The tight money policy has directed income and stimulation toward those parts of the economy which were already overstimulated, while repressing those parts which were already lagging. It has thus aggravated the troubles in the economy, including selective inflation, which it was intended to cure.

Especially, by periodically stimulating investment in producer facilities while repressing private consumption, home building, and vital public programs, during the very periods when these activities were failing to keep up with investment in the power to produce, the policy has contributed during seven years to a succession of short booms, periods of stagnation, and recessions. The consequence has been the low growth rate of the American economy which has meant high unemployment of plant and manpower, and made us as a Nation "unable to afford" the great things which we need to do both at home and overseas.

The experience with this wayward policy has been long enough. Unless reversed, its damaging consequences will swell in the years ahead.

The strain placed upon public budgets

For the seven years 1953-1959 inclusive, rising interest costs (contrasted with what these costs would have been if the 1952 level of interest rates had been maintained) have imposed an excess interest burden of more than 5 billion dollars upon the Federal Budget, more than half a billion dollars upon State and local budgets, and about 17½ billion dollars upon the budgets of private individuals and enterprises, coming to a total excess interest burden of more than 23 billion dollars.

If the same policies continue, it is estimated that, during the six years 1960-1965 inclusive, there will be an additional excess interest burden of about 16 billion dollars upon the Federal Government, 3.7 billion dollars upon the States and localities, and 42.8 billion dollars upon private borrowers, coming to a total of almost 62.6 billion dollars.

Waste instead of utility in the use of funds

During 1953-1959, the transfer of more than 23 billion dollars in excess interest payments, out of the pockets of those who borrow money and into the pockets of those who lend money, has been socially unjust and damaging to the national economy. This transfer has been accomplished by national policy. Other national policies could have been used to transfer an equivalent amount in ways which would have been socially just and economically beneficial by reinforcing consumption.

For example, the transfer in the form of excess interest payments has averaged about 3.3 billion dollars a year during the past seven years. Instead of this transfer, policies such as improved social security, an improved tax structure, an improved farm program, and improved minimum wage laws, could have been used to transfer the same annual amount on a more productive and equitable basis. If this amount had been applied annually to the 3½ million American multiple-person families with annual incomes below $2,000, whose average annual incomes are only $1,225, this average might have been raised by $925 or more than 75 percent. Looking ahead, if the estimated excess interest costs (assuming the same money policies) averaging more than 10.4 billion dollars a year for the six years 1960-1965 inclusive were used instead to reduce poverty, they could lift the average annual incomes of these same families by $2915 or 238 percent.

Using the excess interest payments for public purposes

The average annual excess interest payments—public and private—during the past seven years, compared with the average annual amounts in the Federal Budget during the fiscal years 1954-1960, were more than nine

times the outlays for education; almost seven times those for health; more than 11 times those for housing; about twice those for public assistance; and about five times those for labor, manpower and other welfare services. If the estimated annual excess interest payments during the six years 1960-1965 inclusive were applied to the annual amounts in the President's proposed Budget for fiscal 1961, less than half of these would be enough to bring our national security into line with the almost uniform judgment of informed experts. These excess interest bonanzas, on an annual basis, come to almost 19 times the proposed outlays for education in the President's fiscal 1961 Budget; more than 11 times those for health; more than 24 times those for housing; five times those for public assistance; and 14 times those for labor, manpower, and other welfare services.

Even if only the excess interest bonanzas paid by the Federal Government are taken into account, they would average an estimated 2.7 billion dollars a year for the six years 1960-1965 inclusive. As applied to the President's fiscal 1961 Budget, these annual bonanzas come to almost five times the outlays for education; almost three times those for health; more than six times those for housing; more than 29 percent more than those for public assistance; and more than 3½ times those for labor, manpower, and other welfare services.

Damage inflicted upon the economy as a whole

The tight-money-rising-interest-rates policy, by misdirecting the flow of a very substantial part of national income, is an integral part of a wide range of misdirected economic policies which stunt economic growth and lift unemployment of plant and manpower.

During the period 1953-1959 as a whole, the American economy grew at an average annual rate of only 2.4 percent in real terms. It needed to grow about twice this fast to maintain reasonably full utilization of manpower and other productive resources. In consequence, during the period from the beginning of 1953 through the first quarter of 1960 as a whole, the aggregate deficiency in total national production was about 218 billion dollars, and the aggregate deficiency in man-years of employment opportunity was about 16 million. In their private economic lives, American families on the average forfeited about $3500 during the past seven years. At existing tax rates, governments at all levels forfeited about 65 billion dollars in revenues. This would have been sufficient to wipe out the total deficit in the Federal Cash Budget during this period, and also to have brought our national security and essential domestic programs up to at least tolerable levels.

If the same policies including the tight-money-rising-interest-rates policy should persist in the future, it is estimated that this would cost us about 470 billion dollars in total national production and about 23 million man-years of employment opportunity during the years 1960-1965. This would cause American families to forfeit on the average about $6500. At existing tax rates, it would mean a forfeiture of about 125 billion dollars in public revenues at all levels, or an average of about 21 billion a year.

This difference would be enough, with balanced public budgets, to bring our national security outlays into line with clearly defined needs; to double our economic assistance to the underdeveloped free peoples; to conserve and develop our national resources adequately; and by 1965 to come close to the goal of a decent home, suitable educational opportunity, adequate health services at costs within their means, and ample social security protection, for practically all American families.

The inflationary impact of tight money

The inflation in recent years has been due primarily to the "inefficiencies" of an economy growing too slowly, and suffering from excessive idleness of manpower and plant. This differs from classical inflation, due to the "inefficiencies" of an economy growing at too hectic a pace, and placing an excessive strain upon its resources. The inflation has also been due to shortages of such services as medical care and housing. Thus "the new inflation" has been aggravated by the repressiveness of the tight money policy and the penny-wise and pound-foolish budgetary policy.

During the years 1953-1959, consumer prices rose more than 27 percent faster, wholesale prices more than twice as fast, and retail prices twice as fast, as during the period 1922-1959 as a whole (excluding the inflations produced by the unique circumstances of war and reconversion). And during the period 1955-1959, wholesale prices increased twice as fast, consumer prices more than 60 percent faster, and industrial prices more than 27 percent faster, than during the period 1922-1959 (even when the unique inflations of wartime and reconversion are included).

Fumbling and stumbling in debt management

The management of the national debt during the past seven years has produced results diametrically opposite to those intended by the money managers in the Federal Reserve System and the Treasury.

The average length of maturities on the national debt has been greatly reduced, when the intent was to lengthen it. The effort to place more of the national debt outside the banking system, on the ground that placing too much of it within the banking system "inflates" the money supply, has

made very little progress. The sharp rises and falls in the price of Government bonds have provided a rich harvest to some speculators who guessed right, and have imposed heavy burdens upon any average individual who has had to make a sudden liquidation of his savings. Successive "crises" have attended substantial marketings of Government obligations.

The interest-bearing national debt has increased from 260 billion dollars in 1952 to 285 billion in 1959. In the Federal Conventional Budget, the average annual deficits during the fiscal years 1954-1960 were 3½ times as great as during the fiscal years 1947-1953. In the Federal Cash Budget, there was an annual average surplus of 2.4 billion dollars in the earlier period and a deficit of 1.6 billion in the more recent period.

Immediate policy needs

(1) It is sometimes desirable to expand the money supply very liberally, sometimes desirable to restrain its expansion, and usually desirable to apply money policy selectively to deal with varying conditions within the economy. But there can be no sensible monetary policy except as part of a sensible overall national economic policy. Toward this overall policy, the *Economic Reports* of the President should contain a *National Prosperity Budget*. This *Prosperity Budget* should contain short-range and long-range goals and the means to their attainment. All major national economic policies and programs, including the Federal Budget, should be part of the *National Prosperity Budget*.

(2) The monetary policy should be set forth in and reconciled with the *National Prosperity Budget*. If the President alone cannot accomplish this, legislation should require it. The Congress should declare that the monetary policy be geared to overall national economic policy.

(3) The Congress should declare its general intent that the Federal Reserve System should support Treasury financing sufficiently to assure orderly marketing at reasonably low interest rates.

(4) The Congress should restore the authority of the Federal Reserve System to use selective controls (including consumer credit and housing credit), because general control of money and credit is too blunt to promote economic balance, to serve national needs, and to avoid gross injustice.

(5) In debt management, bonds with callable features should be stressed, to enable benefitting by any future interest rate drops. Auction methods, applicable to Treasury bills, should be applied to long-term issues. The 4¼ percent ceiling on long-term bonds should not be abandoned.

This study has been directed by Leon H. Keyserling, with the assistance of Mary Dublin Keyserling, Lawrence A. Leonard, and Philip M. Ritz.

II. The General Philosophy Of Tight Money

There are two main schools of economic policy in the United States, as they bear upon monetary policy, and the basic differences between them have always been plain.

The liberal school

The so-called liberal school gives top priority to "maximum employment, production, and purchasing power"—the goals of the Employment Act of 1946. This school believes it desirable always to hold unemployment of plant and manpower to a minimum. And this requires a high enough rate of economic growth to absorb a steadily growing labor force and a rapidly accelerating productivity and technology.

The liberal school believes that all groups should join in our general economic progress. But on grounds of both economic performance and social justice, this school places special emphasis upon positive policies to help the great majority of the people who are in the middle- and low-income groups. This emphasis, by combatting the tendency of consumption to fall behind our power to produce, helps the whole economy. This economic philosophy is called "watering the tree at its roots."

The liberal school is deeply concerned about protection of the dollar and prevention of inflation. But ultimately it seeks to protect human beings. It looks not only at whether the dollar is getting bigger or smaller, but also at how many dollars there are and who is getting them. In its stress upon high economic growth and sustained maximum employment, this school concentrates mainly upon expanding the *real* purchasing power of the people as a whole. In summary, this school can be said to advocate "the economics of abundance."

The conservative school

The other school, the so-called conservative school, tends to stand for what might be called "the economics of scarcity." It has never become fully committed to the goal of "full employment." It has frequently asserted that unemployment of manpower and plant, considerably above minimum levels, helps to make the economy work "more efficiently." This school is opposed to large depressions. But it believes that smaller recessions have "a corrective value," or at least it hesitates about taking action quickly against these smaller recessions.

The so-called conservative school also differs from the liberal school regarding income distribution. It leans toward "watering the economic tree at the top," in the belief that favoring the higher economic groups who

"save and invest" will be most beneficial to the whole economy in the long run. It thus neglects the fact that the production which results from investment must be sustained by consumption. This school states vehemently that it favors protection of the value of the dollar and prevention of inflation. But the policies which it adopts toward this end frequently boil down to doing relatively more for those who have more dollars, and for those engaged in the business of managing dollars.

The liberal approach to the money supply

The liberal school recognizes fully the need for the management of the money supply which the Federal Reserve System conducts. It recognizes that money policy, like other economic policies, must be adjusted to changing circumstances. It recognizes that the money supply can be expanded either too rapidly or too slowly for the good of the economy, and that there are times when restraints should be imposed and other times when an expansionary policy should be pursued.

The liberal school's criticism of the money policy in recent years may be summarized briefly. In general, this school believes that the restraints upon the money supply have been excessive in recent years, and that this has worked against economic growth and reasonably full employment. It believes in a more selective control of money and credit, because the economic situation in recent years and even now calls for restriction of some lines of activity and stimulation of others to achieve balanced economic development.

More important still, the liberal school believes that the money policy must be made an essential part of an overall national economic policy, which includes spending policies, tax policies, and many others. It believes that, during recent years, operations of the Federal Reserve Board independent of the President and of the Government generally have resulted in erroneous money policies, and have also neglected vigorous attention to other economic policies of equal or even greater importance.

The conservative approach to the money supply

The conservative school, in contrast, has generally supported the excessively restrictive money policies of recent years. That this has been conducive to only a low annual average rate of economic growth, and has not been consistent with maximum employment and production, does not disturb the conservative school, which is not really convinced that a fully active economy is desirable. This school is not concerned that the money policy in recent years has tended to redistribute incomes upward, because it believes in "watering the tree at the top." The conservative school inclines to oppose the incorporation of money policy within the framework of over-all economic policy. It welcomes the undue influence which a so-called independent money policy places in the hands of the money managers. And that the tight money policy encourages rather than discourages inflation has thus far escaped the champions of this policy.

The champions of tight money favor rising interest rates

During periods when rising interest rates have manifestly been injurious, the spurious argument has been advanced that the Federal Reserve System, and the actions of the national Administration in basic support of Federal Reserve policies, have been responsible for tight money but not for rising interest rates. The rising interest rates, so it is claimed, have resulted from the "laws of supply and demand in a free market." It has even been said that the great and powerful Government of the United States has had to pay whatever interest rates lenders have exacted in return for their magnanimity in lending the Government money.

It is strange indeed to accept responsibility for the tight money policy, while disclaiming responsibility for the rising interest rates which are the inevitable consequence. Cutting the money supply increases its price.

Besides, the disclaimer itself is highly inconsistent. For when the champions of the tight money policy first set upon their course, they argued vehemently and consistently for rising interest rates. They said that interest rates were abnormally and artificially low, and thus penalized "thrift" for purposes of "investment." They insisted that higher interest rates would be more equitable, contribute to economic growth by furnishing incentives for investment, and help to stabilize prices.

The Federal Reserve System and the national Administration have been indulging in a "heads I win and tails you lose" propaganda campaign. They have proudly claimed credit for rising interest rates when they temporarily seemed of some doubtful value, and disavowed responsibility for them when in the long run they have palpably done so much damage.

Tight money anywhere means tight money everywhere

The tight-money-rising-interest-rates policy, applied to borrowings by the Federal Government, has necessarily influenced borrowing by State and local governments and by private businesses and individuals.

The Federal Reserve System also powerfully affects, if indeed it does not completely control, the availability of funds for public and private borrowing throughout the Nation. Moreover, there are well-

recognized margins between the rates at which the Federal Government borrows money and the rates at which others borrow. An upward movement in interest rates on Federal borrowings tends to propel interest rates upward everywhere.

In addition, the tight-money-rising-interest-rates policy has been reflected in the behavior pattern of other national instrumentalities, for example, various housing agencies and the Federal Home Loan Bank System. It has even been encouraged by some legislation. And all of these economic and financial factors have been aided by the psychological results of the propaganda to the effect that the tight-money-rising-interest-rates policy is good for the country.

All of this has become apparent as the money managers, once having opened the Pandora's box, have urged the lifting of one interest rate ceiling after another in order to "equalize" interest rates.

Just how much damage have the money managers done?

It is impossible, in a complex economy, to weigh exactly what part of the damages to the economy and the well-being of the people have been attributable to the tight-money-rising-interest-rates policy, as against damages attributable to other ill-conceived policies.

But this refined distinction is not really essential, because the same economic philosophy responsible for the tight-money-rising-interest-rates policy has been responsible for the other ill-conceived national economic policies. These policies hold that scarcity is more desirable than abundance, and that in the face of scarcity the well-positioned should be allowed to get what they can at the expense of those more vulnerable.

An outstanding example of this scarcity philosophy has been the Federal Budget policy, vainly striving to balance the Federal Budget by creating a scarcity of vital domestic programs and national defense. Another example is the national policy which has made farm income more and more scarce. Still another example is the inflexible opposition to the expansion of social security, aids to education and health and housing, resource development, and improved minimum wage laws—all of which would help to lift the purchasing power of the people so as to call forth fully the abundant productive powers of the Nation. And the scarcity policy has found its peak in the repeated efforts to "fight inflation" which have translated prosperity into stagnation or recession—which mean essentially a scarcity of employment, production, and purchasing power.

III. The General Impact Of Tight Money Since World War II

The misreading of war-created inflation to "justify" tight money

Among those clamoring for a return to the tight-money-rising-interest-rates policy immediately after World War II, the banks and other financial institutions were naturally in the lead. The bankers, whose ownership of United States Government obligations had increased by about 100 billion dollars during the war, were understandably predisposed toward higher interest rates. They argued that the interest rate structure had been driven "artificially" lower since the early New Deal. And especially, they argued that the rigid "pegging" at low levels of the interest rates on Federal obligations in the war year 1942, combined with general stabilization of interest rates by Federal Reserve "support" (purchases) of Treasury issues, made the Federal Reserve System an "engine of inflation." To justify this claim, they cited the price inflation during World War II and immediately thereafter.

These citations ignored the fact, entirely clear now as a matter of hindsight, that both the wartime inflation and the immediately postwar inflation were due primarily to causes more basic than money policy. During the war era 1939-1945, the inflation was due essentially to these factors: abnormal pressure upon all of our productive resources; an entirely extraordinary overall economic growth rate of about 9 percent a year in real terms; Federal deficits averaging more than 60 billion dollars a year (measured in 1959 dollars); and Federal outlays rising more than 50 percent a year. Some earlier wars in our history produced even more inflation than World War II, before there was any Federal Reserve System to be called an "engine of inflation."

To be sure, the money supply during the war years 1939-1945 expanded at the extraordinary average annual rate of more than 15 percent.* But this was essential to float the vast and unparalleled economic expansion which was imperative to win the war. A substantially slower expansion of the money supply during the war would have been responsive only to the clamor of those who would have run the risk of losing the war by regarding "inflation as a greater danger than Hitler."

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* In this study, the term "money supply," unless otherwise indicated, means total demand deposits (exclusive of U.S. Government deposits), currency outside of banks, and time deposits.

Further, the Treasury had to borrow about 200 billion dollars during the war, of which only about 50 billion were loaned to the Government by individuals. The balance was loaned mostly by banks, which acquired these holdings virtually without cost to their stockholders. The banks "paid for" these bond holdings merely by setting up on their books "credits to the Treasury." To have allowed interest rates to soar on such holdings would have been unjust enrichment to the *nth* degree, and would certainly have done nothing to help hold down wartime inflation—which in fact was held down surprisingly well by other methods.

The misreading of reconversion inflation to "justify" tight money

The reconversion inflation during the years 1945-1948 was due primarily to the same causes as inflation after other wars, intensified by the unparalleled size of World War II. Moreover, the inflation during this reconversion period, several times as rapid as during World War II, was aggravated by (a) the conservative school's effective opposition to a sufficiently high level of taxation during the war, which left too much purchasing power in private hands immediately after the war, and (b) the conservative school's effective support of the premature abolition of the direct controls during the reconversion period. This inflation was certainly not occasioned by money policy. The average annual expansion of the money supply during this period was only about 4 percent, representing a tremendous reversal of the highly expansionary money policy during World War II.

Tight money and the 1949 recession

While the tight money policy got off to an early start after World War II, the first postwar recession—in 1949—appears not to have been due substantially to monetary causes. The main causes included a sharp contraction of Federal spending during 1947-1949 for the first time in many years; a severe drop in farm income; a slowdown of demand for durable goods and housing; and most important of all, a more rapid growth in productive facilities than in consumption resulting from unsound wage-price-profit relationships.

However, the sharp contraction in the rate of expansion of the money supply after 1945 was probably too severe. There was a fairly rapid increase in interest rates on short-term business loans between 1947 and 1949. The sharp rise in bank reserve requirements in 1948—a method of tightening up on money—may well have contributed to this recession.

The Korean war and the "accord" of March 1951

The recession of 1949 had some restraining effect upon the tight-money-rising-interest-rates school. But the inflation during the first years of the Korean war was again misinterpreted to strengthen this school. And in this drive, the financial community was emboldened and assisted by the open cooperation of the Federal Reserve System, which increasingly asserted its "independence" of the national Administration.

The Korean war inflation, occurring during 1949-1951, was due neither to excessive general pressures upon our productive resources similar to those during World War II, nor to an unusually expanding money supply. Actually, the expansion of the money supply during these years was unusually low in relation to the expansion of total national production.

The inflation in 1950 and 1951 was due almost entirely to speculative and anticipatory price increases, especially surrounding the Chinese entry into the war. This is substantiated by the fact that industrial and wholesale prices stabilized *before* the historic "accord" of March 1951 between the Federal Reserve Board and the Treasury began to make itself felt.

Under this "accord," the Federal Reserve Board and a Treasury under severe duress formalized the far-reaching policy shifts which had commenced several years earlier. The Federal Reserve System openly abdicated the general responsibility to stabilize government securities by purchasing them in the amounts required to maintain a generous money supply and low interest rates. Since then, with some temporary ups and downs, the money supply has been tight and interest rates have trended sharply upward.

Tight money and the 1953-1954 recession

The recession of 1953-1954, more serious than that of 1949, was far more substantially attributable to the tight money policy, although other powerful factors were also at work. As already indicated, by the time of the 1951 "accord" it was clear that an inflation due to other than money causes was abating for reasons other than money causes. Consumer price increases from 1951 to 1952 were less than one-third as great as during the preceding year. Prices stabilized in general around the middle of 1952, and declined somewhat in late 1952 and early 1953. And by early 1953, after a considerable period of "leveling off" in most economic indicators, recessionary trends were clearly in the making.

Despite these trends, in late 1952 and early 1953 the Federal Reserve System intensified the tight money policy in its crusade against an inflation which no longer existed. This action was perversely at loggerheads with the realities of economic developments, but entirely consistent with the tone of the 1952 campaign of those who became the new national Administration. By the end of 1952, member bank reserves were tighter than at any time since 1932. Interest rates, which had jumped rapidly during the first year of the Korean war but tended to level off thereafter, shot upward again. And with the aid of these misguided policies, more than a full year of economic recession commenced in the middle of 1953, and the pre-recession level of total output was not reached until early 1955.

Belatedly and insufficiently in the middle of 1953, the Federal Reserve System began to loosen the money supply by lowering reserve requirements, and this was repeated twice in the middle of 1954. But it was not until February 1954 that Federal Reserve Bank discount rates were lowered. And economists in general would agree that the 1954 tax cuts and the programs built into the economy during the New Deal were far more important in reversing the 1953-1954 recession than the changes in the money policy. In any event, it is hardly wise to help create a recession in order to gain an opportunity to help to overcome it.

Tight money, economic stagnation, and the 1957-1958 recession

Beginning in 1954 and extending into the spring of 1955, the economy as a whole made a vigorous recovery, paced by a swelling volume of private investment and increasing sales of consumer durables—especially automobiles. But there were many signs of unevenness in this boom, and these intensified during the two-year period from early 1955 through early 1957.

In fact, this two-year period was not a period of high or even satisfactory economic growth, nor of classic inflation resulting from excessive pressure upon productive resources. Instead, this was a period marked by an emerging economic stagnation, rising unemployment of plant and manpower, and selective rather than general inflation. Some prices were rising while others were falling. Some incomes were rising relatively too fast, while others were rising too slowly or actually declining.

To illustrate, public outlays were not rising rapidly enough to meet essential public needs, nor to play their necessary part in the maintenance of maximum employment and production. Housing construction, particularly sensitive to tight money, commenced to decline after the third quarter of 1955. Key investment in producers' plant and equipment was proceeding at a hectic boom pace, getting further and further out of line with consumer incomes and spending, which were not advancing rapidly enough to keep up with our increasing ability to produce.

In the overall, the economy grew only about 2 percent from 1955 to 1956, evidencing virtual stagnation. It slowed down still more from the middle of 1956 to early 1957; unemployment of plant and manpower became disturbingly high; and surpluses of goods or unused productive facilities were practically everywhere in plain view.

During the same two-year period, trends in incomes and prices were similarly diverse. While the profits of prime investors zoomed, wages rose too slowly in real terms to help sufficiently in the expansion of consumption, and farm income continued its very large decline. The new and very large price inflation during this period was also selective. The rise in wholesale prices was composed of sharply rising industrial prices and rapidly falling farm prices. Consumer prices moved upward at the very high annual rate of about 2½ percent. This upward movement gained momentum after April 1956, when general stagnation had become apparent, and did not reflect an excessive overall demand. Instead, both industrial and consumer price increases reflected "administered" price action even in the face of deficient production and sales. Some of the price increases, moreover, such as in housing, were aggravated by the mistaken retrenchment policy with respect to public outlays.

It was during this two-year period of emerging stagnation and recession that the Federal Reserve System again intensified its tight-money-rising-interest-rates policy, and propagandized this once again as a "war against inflation." Instead of recognizing the unevenness in the economy and the selective nature of the new inflation, or asking Congress for the tools needed to correct these difficulties, the Federal Reserve again relied upon the blunderbuss instrument of general monetary controls.

During 1955-1957, the average annual expansion of the money supply was only 2.5 percent. This contrasted sharply with the period 1952-1955, when this expansion had averaged 3.6 percent during a period of moderately high economic growth with virtual price stability. Between April 1955 and August 1957, the Reserve discount rate increased from 1½ percent to 3½ percent. The interest rate on Treasury bills rose from a low of less than 0.7 percent in June 1954 to more than 3½ percent in October 1957. This tight-money-rising-interest-rates policy intensified all of the distortions within the economy. It repressed the portions of the economy which were advancing too slowly before it touched those which were advancing too

rapidly. It swelled the wrong incomes and shrunk the wrong incomes. It literally coaxed the recession to take place.*

During the first half of 1957, appearing before the Senate Finance Committee, the Federal Reserve Board still insisted that the inflation was due to the high or extensive level of overall demand. It urged that the tight-money-rising-interest-rates policy was still needed to encourage consumers to spend less and to promote a larger volume of savings so that business could invest still more. It is interesting to note that a year later, before the same Committee, the Federal Reserve Board reversed its course, saying that the recession had been due in large measure to an inordinate investment boom getting out of line with the consuming power of the country.

In the middle of 1957, by far the most severe general economic recession since World War II commenced. But it was not until mid-November 1957 that the monetary authorities woke up and reduced the discount rate by the exceedingly small amount (measured against the previous rise) of only ½ percent. In early 1958, there were substantial and badly needed reductions in the discount rate, reductions in reserve requirements, and increased open market operations—all pointed toward a more rapid expansion of the money supply. These actions (though less effective than the reform programs of the 1930's built into the economy) had some effect upon the reversal of the recession which the money managers had helped to create.

Tight money rides again: the economic outlook now

The next major manifestation of the tight money crusade occurred during the years 1958-1960. Undaunted by the consequences of its crusade preceding the most recent recession, the Federal Reserve System insisted that it had acted tardily and inadequately before that event, which leads one to wonder how much bigger a recession it wanted than the one which actually occurred.

And the Federal Reserve System was determined not to make the same "mistake" again. In August 1958, discount rates were increased, and interest rates began their most rapid and sustained spurt since the well-remembered years 1927-1929. This policy shift by the money experts came during the month when unemployment was at its post-war peak, aggregating 5.2 million or about 7.5 percent of the civilian labor force (seasonally adjusted). Throughout 1959, the tight money crusade and other national economic policies directed against satisfactory economic growth and maxi-

* For a fuller discussion, see *"The Recession"—Cause and Cure,* published by The Conference on Economic Progress in June 1958.

mum employment of manpower and plant continued relentlessly. Thus far in 1960, any abatement of these policies has been minor.

Curiously, in March 1959, one of the top experts in the Federal Reserve Board published a letter in a leading newspaper. He stated that the experience of recent years should have taught us that the imposition of general monetary restraints could not get at the types of selective inflation from which we have been suffering. He said that such restraints could succeed only in stunting economic growth and aggravating unemployment. But this letter seems to have had no effect upon the theory or practice of the agency in which he serves.

The damaging results of this latest phase of the tight-money-rising-interest-rates crusade are overwhelmingly apparent, even though still another recession is not yet upon us. Indeed, some of those associated with the money policy have been assuring us recently that the next recession, instead of occurring in late 1960, may well be "delayed" until 1961 or even a bit later.

In May 1960, total production of durable goods was lower than a year earlier. In early June, the steel industry was operating at only about 60 percent of capacity and threatening to move still lower. During the first half of 1960, unemployment, measured as a percentage of the civilian labor force, was about 60 percent higher than in 1953 despite the recession which started in the middle of that year.

Yet, the monetary authorities are still preening themselves upon avoiding the "mistakes" which they made during 1955-1957, instead of observing the real nature of those mistakes and benefiting accordingly.

With this general review as a starting point, the following chapters will detail step by step the damaging consequences of the tight-money-rising-interest-rates policy. These chapters will portray the increased burdens upon public budgets at all levels of government; the increased burdens upon private business and individual borrowers; the vast transfer of national income in the wrong direction; the public and private benefits which might have accrued if similar amounts of income had been used for more worthy purposes; the damaging effects upon the overall economy, including their immense domestic and worldwide significance; the inflationary consequences of this "crusade against inflation"; the magnitudes of the further injuries which will be inflicted if the policy is not promptly changed; and the practical changes in policy which should be initiated at once.

IV. Increased Public And Private Interest Costs

Sharply rising interest rates on Federal borrowings have represented in recent years the most inexcusable kind of rising cost.

Other borrowers may pay higher interest rates for reasons entirely beyond their control. But this is not true of the Federal Government. The rising interest costs borne by the Government in recent years have reflected deliberate decisions of national policy.* The rising costs have been no more unavoidable than a decision by the Federal Government to enlarge any other expenditure.

The only real diffierence is this: Unlike decisions to enlarge other types of expenditures, the decision to pay higher interest rates has served no conceivable public purpose. Enlarged expenditures for additional or more highly qualified personnel may increase efficiency or serve new and essential programs. Enlarged expenditures for national security may reduce the perils confronting the Nation. Enlarged expenditures for roads or dams or education may manifestly be beneficial. Even enlarged expenditures for special groups, such as the unemployed or the aged, represent an accepted public responsibility and are helpful to the whole economy.

But in paying out more and more interest on its new borrowings, the Federal Government has added nothing to efficiency; expanded no useful program; shouldered no commonly acknowledged public responsibility; added nothing to the national wealth; and merely used the taxpayer's money to pay unearned bounties to those in no need of public assistance.

A rising Federal debt occasioned by the defense of the country may be more than worthwhile. A Federal deficit incurred to put idle men to work, and thus to add to national production, is a sound outlay. But increased interest payments which have added to public debts and deficits have had no counter-balancing merit whatsoever.

These principles are not universally applicable; rising interest rates sometimes may be unavoidable or even desirable. But this has not been true in recent years. And these principles are doubly applicable now. For never before in history (except during the first neglectful years of the Great Depression) has the Federal Government so insistently as in recent years proclaimed that it "could not afford" the things that the Nation needs most. And never before has national policy been so predisposed to find ways to "afford" to pay out more and more in interest bonanzas.

* See Chapter II.

Cost to Federal Government of rising interest rates

Comparing 1959 with 1952, the interest rates on new borrowings by the United States Treasury went up 52 percent in the case of long-term bonds, and 103 percent in the case of three- to five-year issues. On short-term new borrowings, the rate of interest went up 93 percent in the case of three-month bills, and 127 percent in the case of nine- to twelve-month issues. To grasp the fantastic size of this deliberate inflation of interest rates, it should be noted that consumer prices, about which the national Administration talked so much but did so little, went up 9.8 percent during the same period of time.

These higher interest rates do not yet apply to the whole Federal public debt, because a large part of it still represents borrowings made before 1953 and not refinanced since then. Nonetheless, the average interest rate on the total outstanding Federal public debt was 28 percent higher in 1959 than in 1952. This represented an annual advance averaging 3.6 percent, or almost three times as fast as the average annual advance in consumer prices over the same period of time.

In 1959, the actual interest charges on the Federal debt were more than 1.8 billion dollars higher, and during the seven years 1953-1959 inclusive more than 5 billion higher, than if interest rates had been maintained at the 1952 levels.

Further, these figures somewhat understate the excess interest costs, because they are derived by applying the interest rate increases since 1952 to the actual Federal public debt from 1953 through 1959. Allowance could also be made for the fact that the rising interest rates in themselves added to the increases in the debt during this period.

Costs to States and localities of rising interest rates

The same national policies which have pushed up the interest rates on Federal borrowings have also pushed up the interest rates on State and local borrowings. Comparing 1959 with 1952, interest rates on new general obligation bonds issued by State and local governments rose 68 percent. The average interest rate on total debts at these two levels of government (including older debts not yet affected by the rising interest rates) rose about 16 percent. Due to this, the excess interest costs (costs in excess of those which would have resulted at 1952 interest rates) were about 300 million dollars in 1959 alone, and about 550 million during the seven years 1953-1959 inclusive.

In many ways, the tight money policy has imposed more hardship upon the States and localities than upon the Federal Government. The tight money policy has merely forced the Federal Government to pay higher interest rates. But it has forced the States and localities, not only to pay more for what they borrow, but also to forego a substantial amount of borrowing for essential purposes.

The States and localities operate under much more severe financial restrictions than the Federal Government, with regard to their powers to tax, to borrow, and to spend. And within these limits, the State and local governments have been trying much harder in recent years to meet their responsibilities than has the Federal Government. Comparing fiscal 1958 with fiscal 1952, State and local governments increased their expenditures about 74 percent, while Federal Government expenditures increased only 10 percent. The debts of the States and localities multiplied more than three-fold during the decade fiscal 1948 to fiscal 1958, while the Federal debt* increased less than one-tenth during the same period.

It has been profoundly unjust for national policies to impose rising interest rates upon State and local governments, even while the national Administration has insisted that these two levels of government bear an increased share of responsibility for essential domestic programs.

Costs to private borrowers of rising interest rates

The tight money policy has also forced up interest rates on private borrowings. The total interest-bearing private debt is estimated to have risen from almost 238 billion dollars in 1952 to more than 439 billion in 1959. Meanwhile, the average interest rate on total outstanding interest-bearing private debts is estimated to have risen by about 13 percent. In consequence, private borrowers made excess interest payments of more than 4½ billion dollars in 1959 alone, and excess interest payments of about 17½ billion during the seven years 1953-1959 inclusive.

Total costs, public and private, of rising interest rates

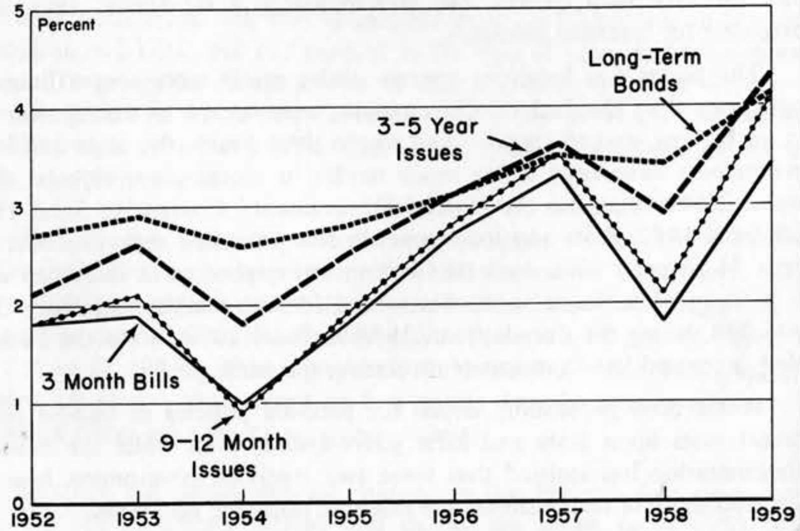
Looking at all forms of debts—both public and private—the average interest rate on all outstanding interest-bearing debts in 1959 was about 29 percent higher than in 1952. The excess interest payments, resulting from interest rates above the 1952 levels, were more than 6½ billion dollars in 1959 alone, and more than 23 billion dollars for the seven years 1953-1959 inclusive.

The following charts illustrate this discussion.

* Gross public debt and guaranteed securities.

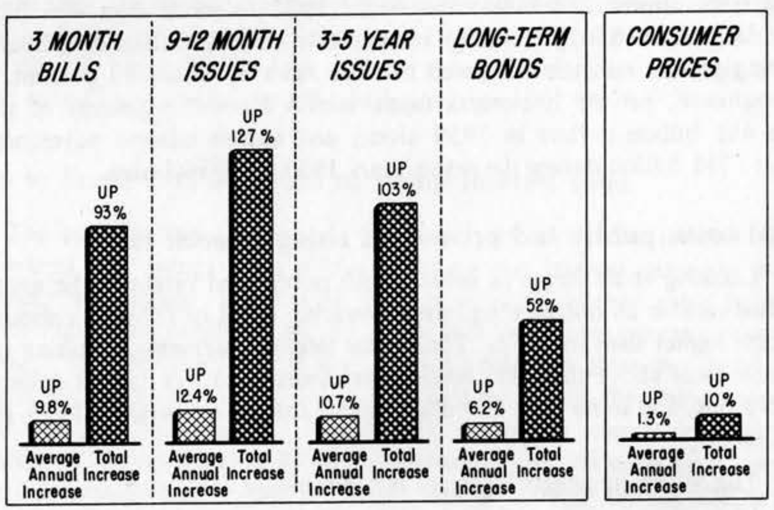
INTEREST RATES ON NEW BORROWINGS BY U.S. TREASURY, 1952-1959

Calendar Years



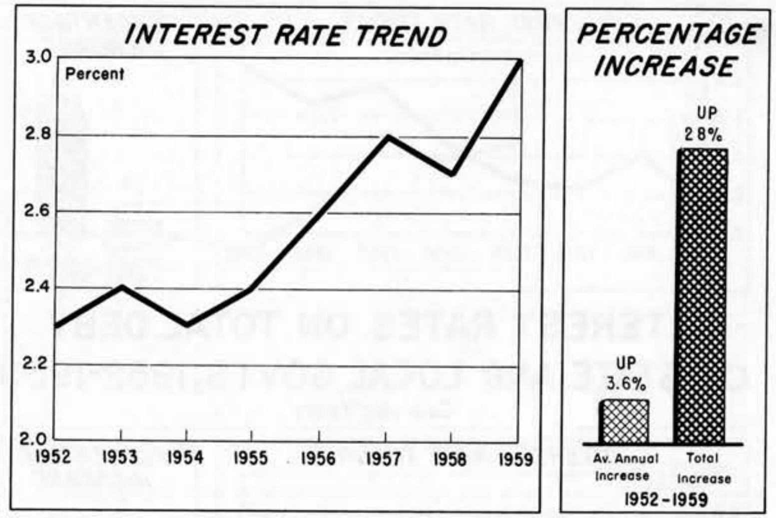
PERCENTAGE RISE IN INTEREST RATES ON TREASURY BORROWINGS, 1952-1959

Calendar Years



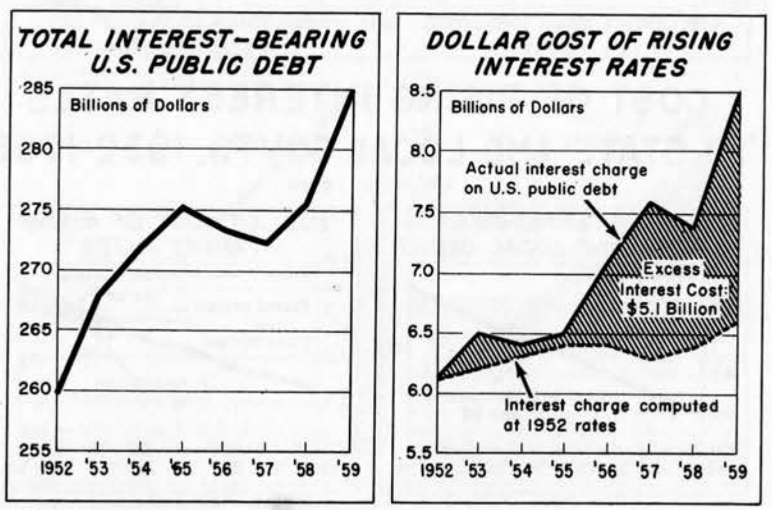
AVERAGE INTEREST RATES ON FEDERAL PUBLIC DEBT, 1952-1959

Calendar Years



COST OF RISING INTEREST RATES TO U.S. GOVERNMENT, 1952-1959

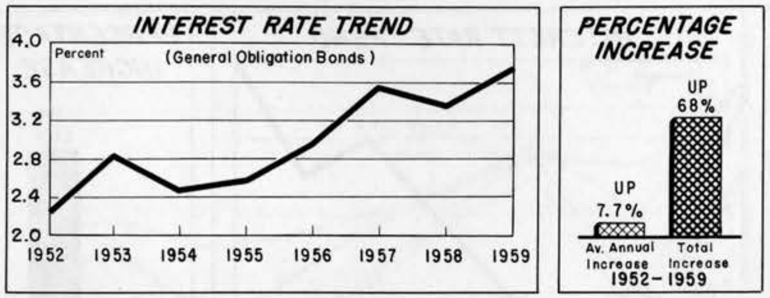
Calendar Years



NOTE: All figures relate to total amounts outstanding

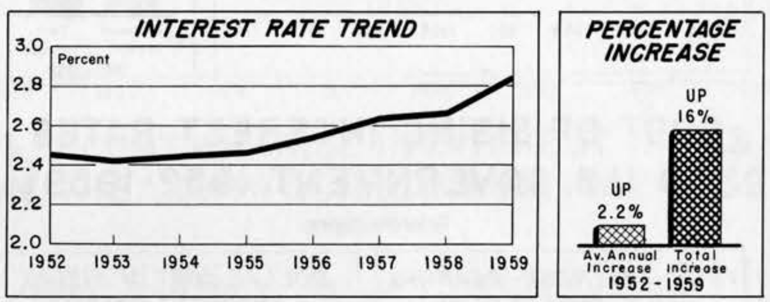
INTEREST RATES ON NEW BORROWINGS BY STATE AND LOCAL GOVTS, 1952-1959

Calendar Years



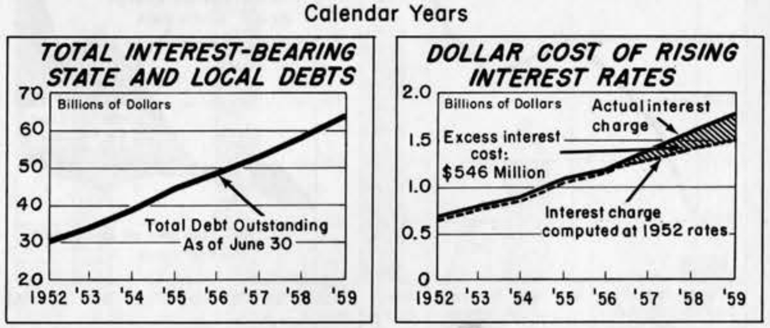
INTEREST RATES ON TOTAL DEBT OF STATE AND LOCAL GOVTS, 1952-1959

Calendar Years



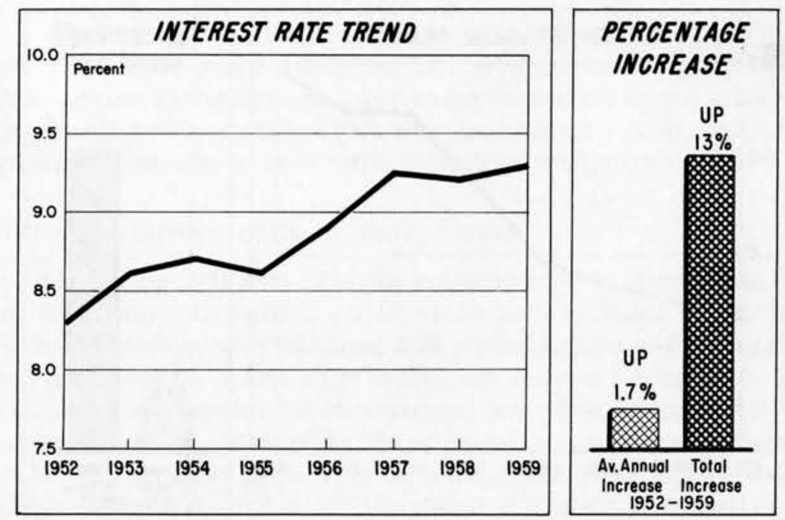
COST OF RISING INTEREST RATES TO STATE AND LOCAL GOVTS, 1952-1959

Calendar Years



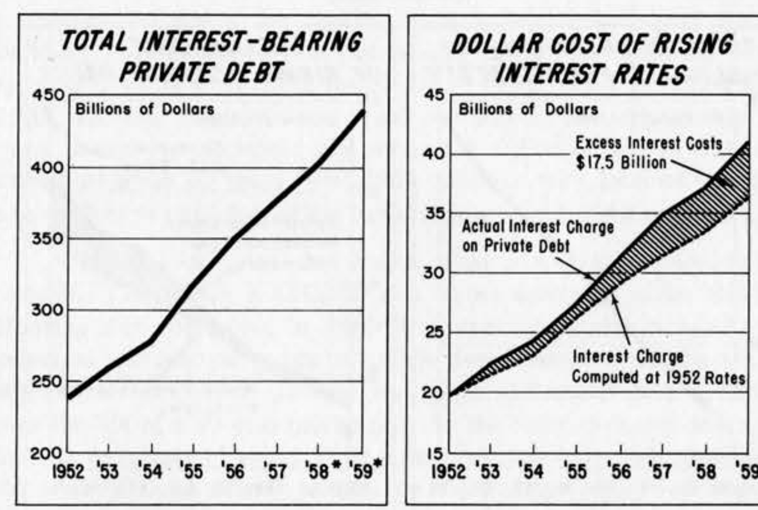
INTEREST RATES ON TOTAL INTEREST-BEARING PRIVATE DEBT, 1952-1959

Calendar Years



COST OF RISING INTEREST RATES TO ALL PRIVATE BORROWERS, 1952-1959

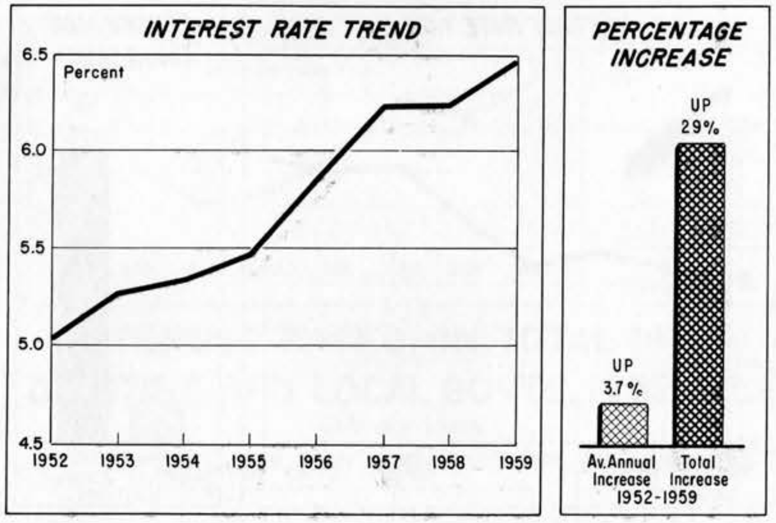
Calendar Years



* Preliminary estimate by Conference on Economic Progress

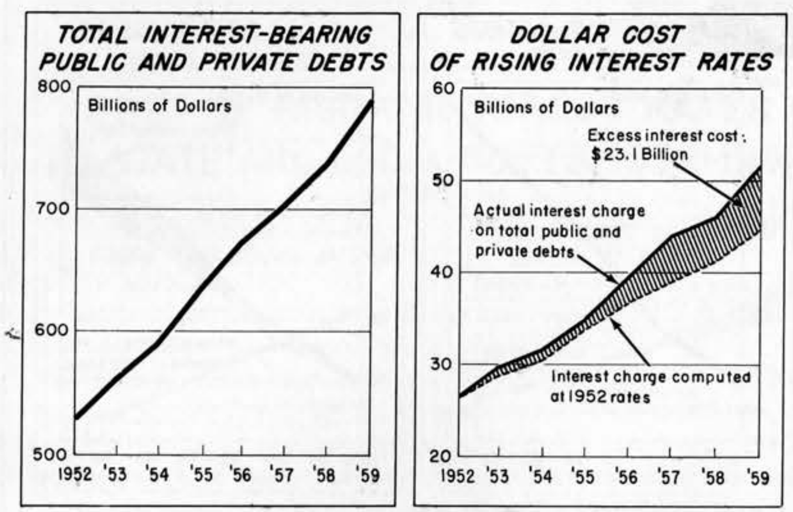
AVERAGE INTEREST RATES ON TOTAL PUBLIC AND PRIVATE DEBTS, 1952-1959

Calendar Years



TOTAL PUBLIC AND PRIVATE COST OF RISING INTEREST RATES, 1952-1959

Calendar Years



V. Increased Interest Costs To Home Owners, Consumers, Farmers, And Small Business

The increased private interest costs imposed by the tight money policy, portrayed in the previous chapter, have been particularly burdensome to those groups who cannot avoid borrowing money, whose moderate or low incomes make every dollar which they spend count heavily, and who are generally vulnerable to unfavorable economic developments.

Increased interest costs to home owners

Comparing 1959 with 1952, the estimated effective interest rate (allowing for changes in discount practices) on homes insured by the Federal Housing Administration rose from 4.28 percent to 5.68 percent, an interest rate increase of 33 percent. The interest rate rise was 30 percent for homes insured by the Veterans' Administration, and about 14 percent for conventional housing. Meanwhile, the estimated outstanding debt contracted since 1952 on these three types of housing rose from slightly above 15 billion dollars at the end of 1953 to almost 117 billion at the end of 1959. The occupants of these three types of housing paid almost 2 billion dollars more in interest than they would have paid if interest rates had been maintained at the 1952 level.

If the general economic policies of recent years including the tight money policy should be continued, including their impact upon home building, it is estimated that outstanding debts contracted on these three types of housing since 1952 would rise to more than 185 billion dollars by 1965, and that interest rates would continue to rise appreciably. In this event, home owners would pay about 8½ billion dollars in excess interest rates during the six years 1960-1965 inclusive, or a total of 10.4 billion in excess interest rates during the thirteen years 1953-1965 inclusive.

Without looking to the future, what has already happened is bad enough. Comparing a $10,000 new home mortgage under the National Housing Act contracted in 1960 with one contracted in 1952, the total principal and interest payments of the home owner would be about $876 higher over the life of 10-year mortgage, and more than $3,300 higher over the life of a 30-year mortgage.* In the latter instance, average excess interest payments of about $110 a year are approximately equivalent to a sales tax of more than 7 percent on the average total food expenditures of the average family living in a $10,000 home.

* This conservative estimate does not allow for possible or probable discounting.

Damage to housing in general and to the whole economy

The tight-money-rising-interest-rates policy, as applied to housing, is not only hurting those home occupants who pay the higher rates. It is hurting those who cannot obtain the new homes they need because of the curtailment of credit or its excessive costs. And it is hurting the whole economy very seriously. The level of home building has been and is still being held far below the levels required for a satisfactory rate of general economic growth and maintenance of reasonably full employment of manpower and other productive facilities.

The new technology and the new automation, displacing workers in great numbers from various industrial occupations, mean that a home building program averaging annually in the neighborhood of twice the recent levels is essential to help prevent rising unemployment of plant and manpower. In addition, a home building program of this size is needed to take care of new family formation, and to make satisfactory inroads upon slums and other substandard housing in urban and rural areas.

For this kind of housing program to get started and keep going, most of the new housing must be geared to the needs of middle- and low-income families. This requires, among other things, a downward rather than upward movement in interest charges and other financing costs.

Housing is therefore a perfect example of how the policies of the Federal Reserve System, blunderbuss in nature, have suppressed the types of economic expansion which are in greatest need of acceleration, even while these same policies have encouraged excessive expansion and speculation in some other fields of activity.

Increased interest costs to consumers generally

Taking into account installment credit held by financial institutions and by automobile dealers, and single-payment consumer loans, total interest-bearing consumer debt outstanding rose from about 20 billion dollars in 1953 to about 36 billion in 1959. Combining this with rising interest rates, the excess interest costs during the seven years 1953-1959 inclusive exceeded one billion dollars. If the same general economic and money policies should be continued in future, it is estimated that the total interest-bearing consumer debt outstanding would rise further to about 62 billion dollars by 1965. The excess interest payments, during the six years 1960-1965 inclusive, would come to more than 3½ billion dollars, and the excess interest payments for the thirteen years 1953-1965 inclusive would total about 4.7 billion.

These trends represent a very severe strain upon the middle- and low-income families who buy necessary consumer durables on time. Our entire economic performance is also seriously affected. As already noted, the vast expansion rather than the repression of consumer outlays is vital to a satisfactory rate of economic growth and the maintenance of reasonably full employment of manpower and plant.

Increased interest costs to farmers

The cruel and contrived deflation of farm income in recent years, proceeding at an accelerating pace, would be bad enough without the additional injury of denying to farmers the credit which they so much need and making them pay more and more to obtain this credit.

The total outstanding farm mortgage debt rose from less than 7 billion dollars in 1952 to almost 12 billion in 1959, and is estimated to rise to almost 17 billion by 1965 if current farm policies and general economic policies are continued. Coupled with rising interest rates, this has cost farmers almost 112 million dollars in excess interest during the seven years 1953-1959 inclusive. It is estimated to cost them an additional 553 million dollars in excess interest during the six years 1960-1965 inclusive, coming to a total of about 665 million dollars in excess interest costs for the thirteen years 1953-1965 inclusive.

The systematic deflation of farm income,* of which the tight money policy is an integral part, is another prime example of policies which deliberately ration income in the wrong direction. These policies not only embody economic injustice, but also bear down heavily upon the performance of the whole economy. Farmers, when they are prosperous, are very heavy purchasers of goods and services produced by others. The prolonged and growing farm depression is thus a powerful factor in the poor overall economic performance.

Injury to small business

When credit is restricted by the tight money policy, while those who want or need credit are left free to scramble for the short supply according to ability to pay, small business is obviously injured out of all proportion to big business. In the first place, interest costs loom larger in the total costs of small business than in those of big business. Secondly, small business is much less able than big business to pass along rising interest costs to the consuming public through the device of administered

* Net farm operators' income fell from $15.3 billion in 1952 to $11.8 billion in 1959.

prices. And thirdly, big business, unlike small business, can to a large degree avoid high-cost borrowing by financing a much larger proportion of its total financing needs out of retained earnings and depreciation and depletion allowances.

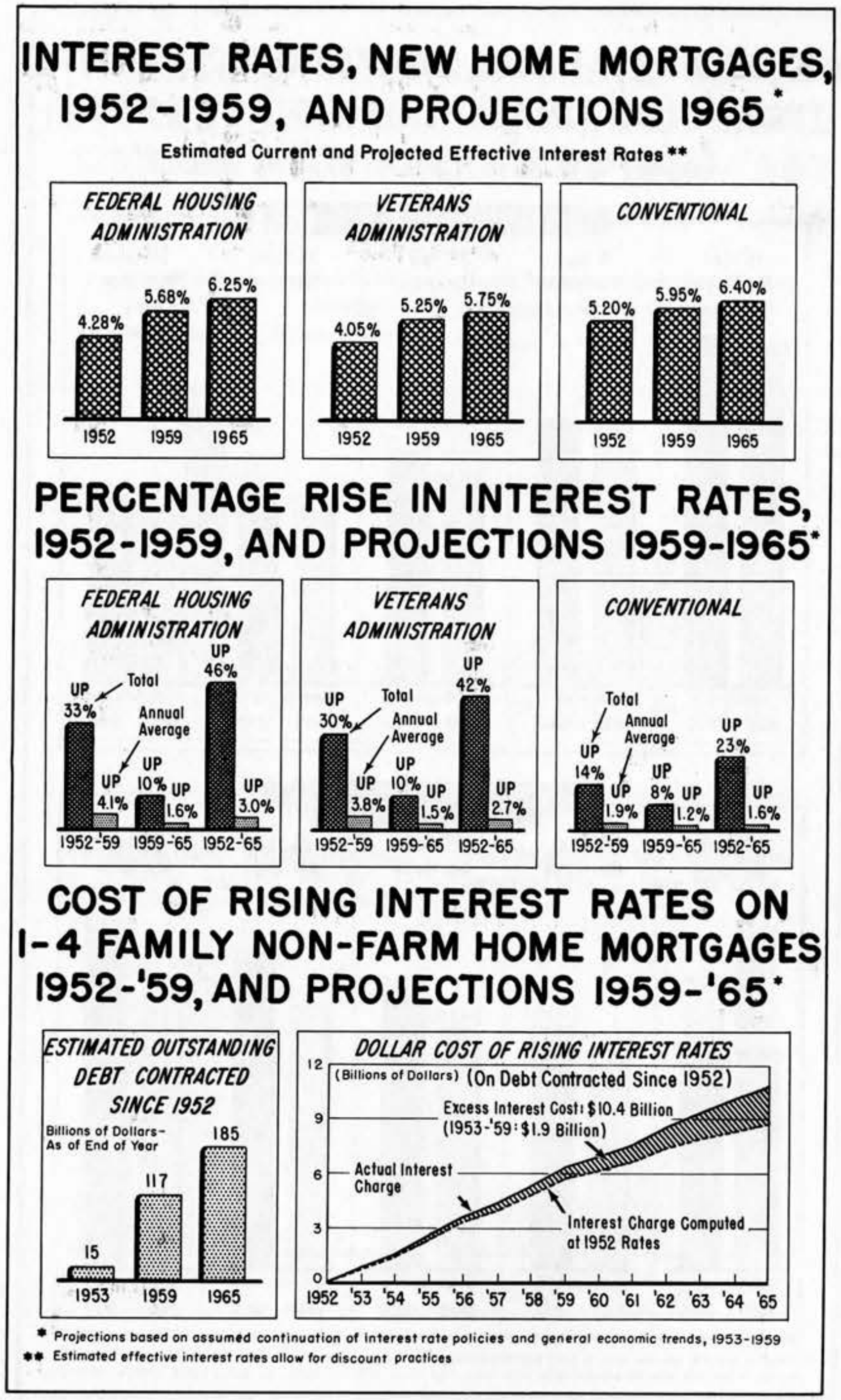
Comparing 1953 with 1959, debts as a percentage of the assets of all manufacturing corporations rose from only 22.3 percent to only 23.6 percent, a relatively small change. But in the case of small manufacturing firms with assets under one million, these debts rose from about 28 percent to about 36 percent of total assets.

Looking at firms with assets under one million dollars, their total debts outstanding rose from slightly above 4 billion dollars in 1953 to about 6½ billion in 1959, and are estimated to rise to almost 8 billion by 1965 if current economic policies are continued. Combined with rising interest rates, the excess interest costs to these small business firms have been about 149 million dollars during the seven years 1953-1959 inclusive, would be about 617 million for the six years 1960-1965 inclusive, and thus would total about 766 million for the thirteen years 1953-1965 inclusive.

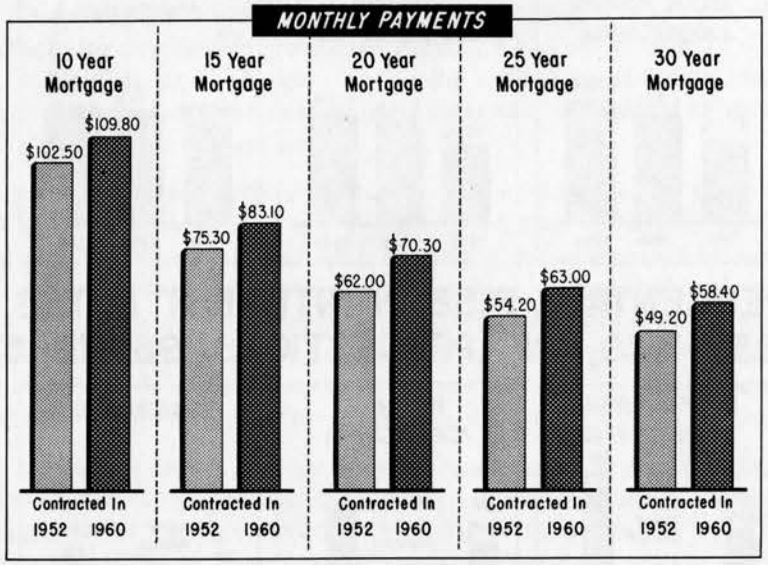
The rate of profits after taxes on stockholders' equity, in the case of large businesses with assets above 100 million dollars, was above 13 percent in a majority of the years 1947-1959, and was 11 percent in 1959. In the case of middle-size businesses with assets between one million and 100 million, the rate of profits was above 10 percent in a majority of these years, but declined from 17.5 percent in 1947 to 9.5 percent in 1959. And in the case of small businesses with assets under one million dollars, the rate of profits was above 10 percent in only five of these years, and declined from 16.3 percent in 1947 to 8.3 percent in 1959.

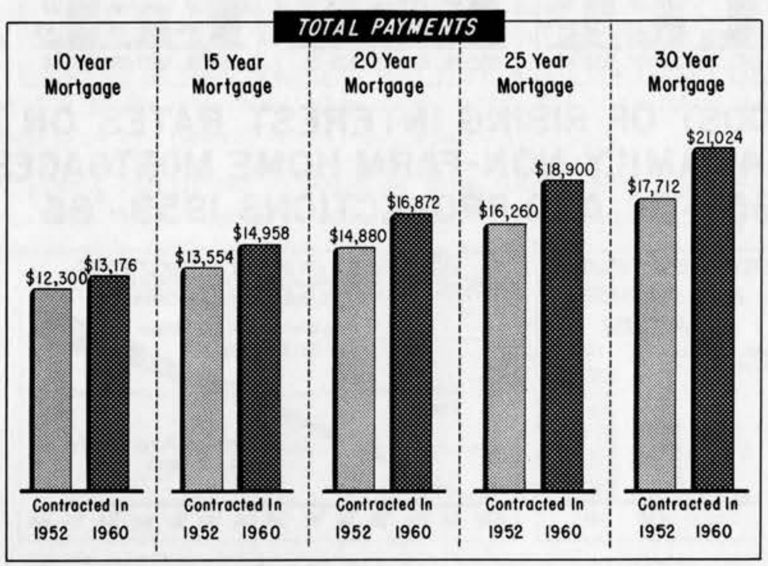
Business failures per 10,000 listed firms rose from 14.3 in 1947 to 51.9 in 1959. More than 90 percent of these failures occurred among small businesses with liabilities under 100 thousand dollars.

The following charts amplify this discussion.



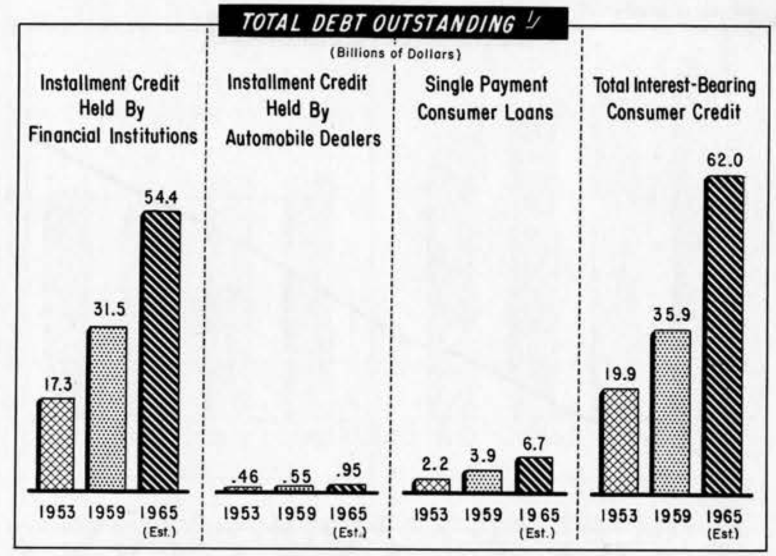
$10,000 NEW HOME MORTGAGE PAYMENTS UNDER NATIONAL HOUSING ACT (FHA) COMPARING 1952 WITH 1960*

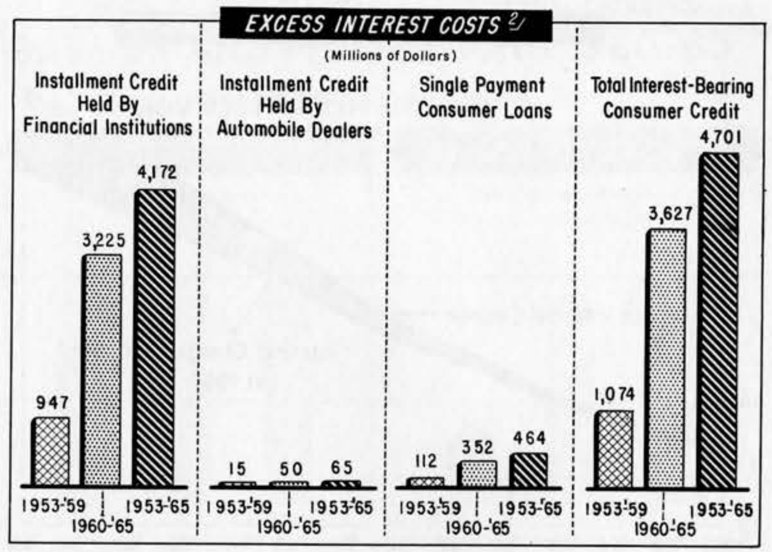




*Based on 4 1/4% interest rate in 1952 and 5 3/4% interest rate in 1960. Payments exclude insurance premiums.

EXCESS INTEREST COSTS ON INTEREST-BEARING CONSUMER DEBTS 1953-'59 AND PROJECTIONS 1960-'65*



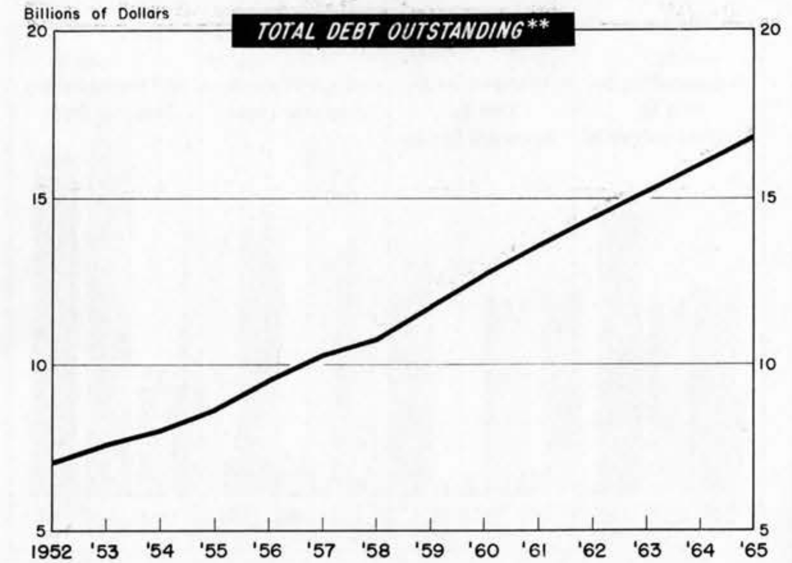


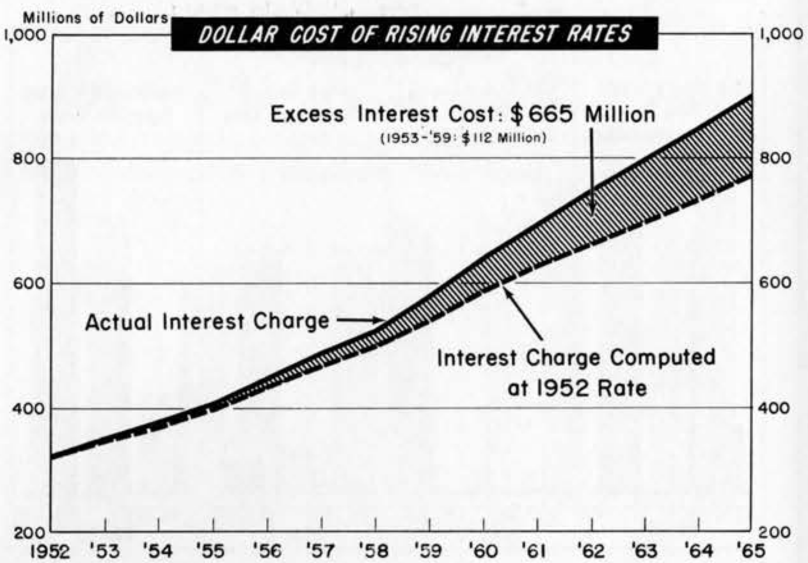
*Projections based on assumed continuation of interest rate policies and general economic trends, 1953-1959

1/ Average of amounts outstanding at beginning and end of years shown

2/ Excess interest costs based on actual interest rates compared with 1952 interest rates

EXCESS INTEREST COSTS ON FARM MORTGAGE DEBT 1953-'59 AND PROJECTIONS 1960-'65*

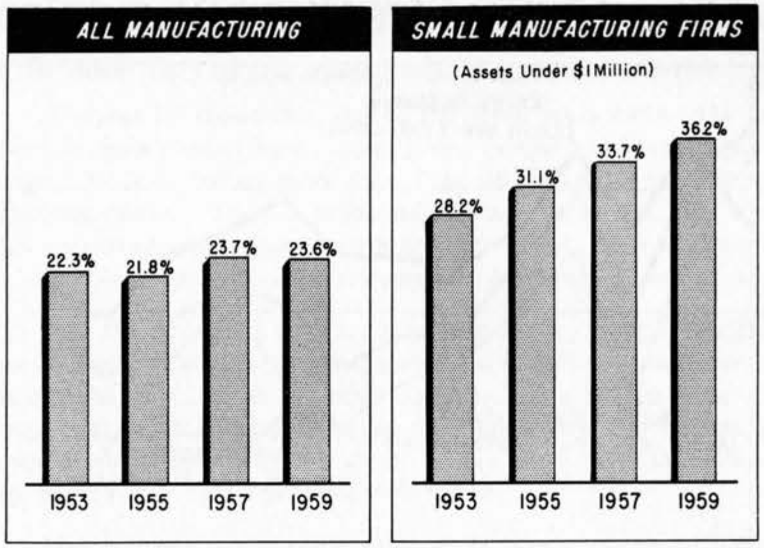




* Projections based on assumed continuation of interest rate policies and general economic trends, 1953-1959

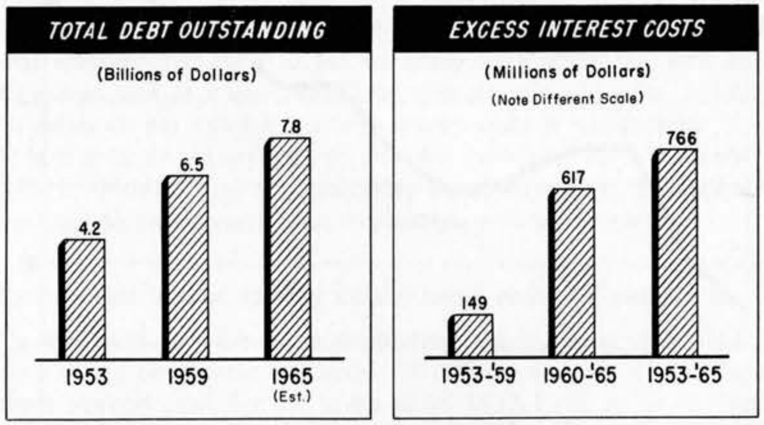
** Average of amounts outstanding at beginning and end of years shown

DEBTS AS PERCENTAGE OF ASSETS OF MANUFACTURING CORPORATIONS, 1952-'59

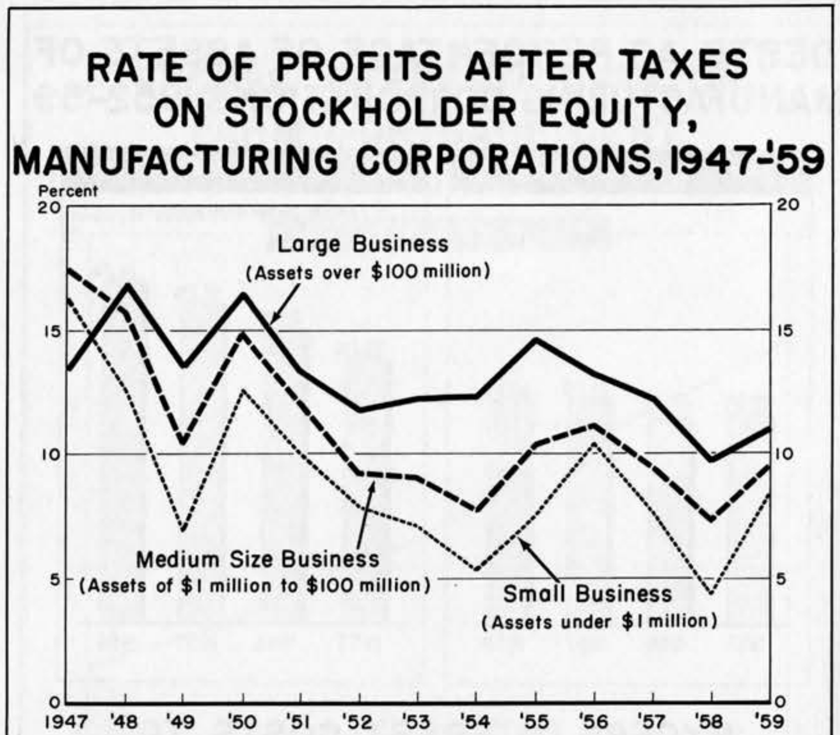


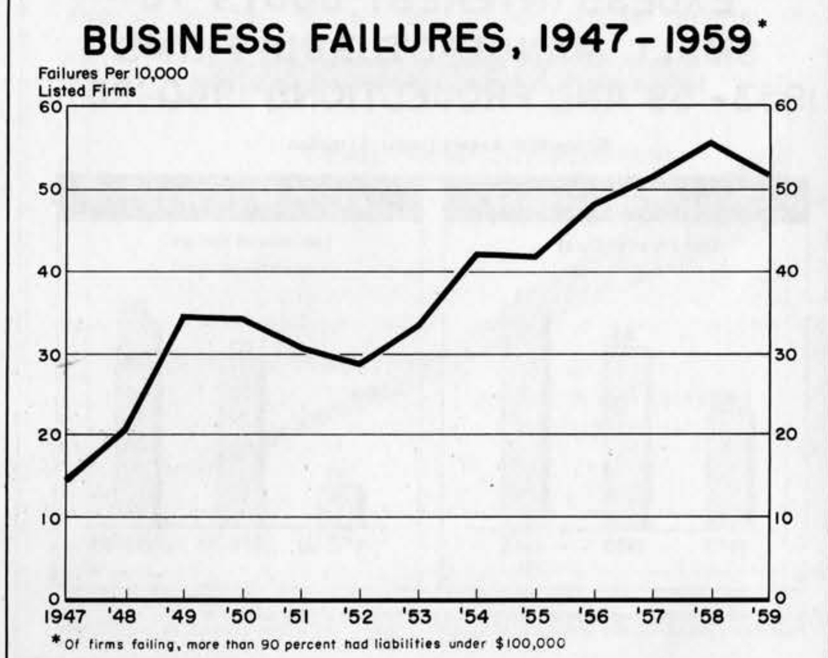
EXCESS INTEREST COSTS TO SMALL MANUFACTURING FIRMS 1953-'59 AND PROJECTIONS 1960-'65*

Firms With Assets Under $1 Million



* Excess interest costs based on actual interest rates compared with 1952 interest rates
Projections based on assumed continuation of interest rate policies and general economic trends, 1953-1959





VI. How The Money Could Have Been Spent Better

Why other uses of the money would have been better

Chapter IV shows that, during the seven years 1953-1959 inclusive, the tight-money-rising-interest-rates policy caused borrowers to pay lenders about 23 billion dollars more than if the 1952 level of interest rates had been maintained. Thus, a deliberate national policy was used to transfer this amount of money from certain hands to certain other hands—in short, to redistribute approximately this amount of national income or wealth.

The significance of this fact is not reduced by pointing out that some people are both borrowers and lenders, and therefore benefited on the one hand while they lost on the other hand by rising interest rates. For we know that, on net balance, there are more borrowers than lenders, and that a policy which shifts income from the former to the latter shifts income in a regressive rather than a progressive direction.

Nor is it relevant to point out that, because taxes are higher on high income people than on low income people, the Government collected some extra taxes by helping to shift incomes upward, and that these extra tax collections offset some of the cost of the rising interest rates to the Government. If this argument had any merit, then the Government should try to shift as much of the national income as possible to the top of the income structure, in order to collect more taxes.

As the net effect of the tight-money-rising-interest-rates policy has been severely damaging to the economy as a whole, as well as socially iniquitous, and as it has yielded no compensating benefits, it follows that the policy on net balance has been utterly without justification. This being so, it is entirely appropriate to examine how alternative national policies might have transferred approximately the same amount of income in ways beneficial to the economy and compatible with social justice.

How better use of money could have reduced private poverty

If spread over the entire population, the excess interest costs in 1959 alone would have come to almost 38 dollars on a per capita basis. The excess interest costs for the seven years 1953-1959 inclusive would have come to more than 137 dollars per capita. The comparable figures, applied to families of four, would be more than 151 dollars and almost 549 dollars, respectively.

No one would seriously propose that the 23 billion dollars redistributed through the tight-money-rising-interest-rates policy should have been taken from some parts of the economy and distributed equally among all the American people or all American families. But it might very validly be proposed that, instead of distributing 23 billion dollars through the tight money policy, it would have been much more sensible to distribute the same amount intelligently and progressively through a different set of policies. For example, changes in the tax structure, the farm program, the social security system, and the minimum wage laws, could have redistributed 23 billion dollars in ways concentrating upon the reduction of poverty in America.

Let us look at how this would have worked out. The 23 billion dollars in excess interest costs over a seven-year period comes to about 3.3 billion a year. In 1958, there were almost 12 million multiple-person families in the United States with annual incomes under $4,000, and the average income of these families was only $2,538. The sum of 3.3 billion dollars a years would have been enough to lift the annual income of each of these families by $283, or to lift their average income by more than 11 percent.

If applied only to the almost 7 million multiple-person families who in 1958 had annual incomes under $3,000, and whose average income was only $1,845, the sum of 3.3 billion dollars a year could have added $483 to the income of each of these families, or lifted their average income by more than 26 percent.

If applied to the more than 3½ million multiple-person families with annual incomes below $2,000 in 1958, and whose average income was only $1,225, the sum of 3.3 billion dollars a year could have added $925 to the income of each of these families, or increased their average income by more than 75 percent.

Benefits to all of the alternative use of the money

This demonstration is very meaningful. For the same money managers, who unblushingly engineered the transfer of 23 billion dollars largely in the direction of those whose incomes were already relatively high, objected to expansion of social security, improvement of minimum wage laws, and similar measures, on the ground that these kinds of transfers of income would be "dangerously inflationary."

Moreover, while the 23 billion dollar transfer wrought by the tight money policy has been highly damaging to the entire economy, a transfer of a similar amount to reduce poverty in America would have been highly beneficial to the entire economy. Instead of aggravating the distortions

which caused investment in the means of production periodically to outrun consumption, it would have helped to keep the two factors in better balance, contributed to a higher rate of economic growth, and avoided huge unused amounts of plant and manpower. This would have been beneficial in the long run even to those who superficially might think themselves adversely affected by a progressive rather than a regressive redistribution of national income.

How the money could have been used to improve public programs

Just as the 23 billion dollars in excess interest payments could have been used better to reduce private poverty, so in alternative fashion this money could have been used better to reduce the glaring gaps in our national security and our domestic public services. Instead of policies channeling about 23 billion dollars into the pockets of interest recipients, other policies could have been used to channel the same amount of money into the servicing of our vital public needs. An additional benefit of this alternative is that it would have kept the economy in better balance, accelerated economic growth, and reduced the unemployment of plant and manpower.

As already noted, the annual average excess in interest costs (public and private), during the seven years 1953-1959 inclusive, was about 3.3 billion dollars. Let us compare this sum with some important outlays in the Federal Budget, using the annual average size of these outlays during the fiscal years 1954-1960. The average annual excess interest payments were more than nine times the average annual Federal Budgetary outlays for education; almost seven times the outlays for health; more than eleven times the outlays for housing; about twice the outlays for public assistance; and about five times the outlays for labor, manpower, and other welfare services.

In 1959 alone, the excess interest payments came to almost 6.7 billion dollars. Comparing these bonanzas with the Federal Budget for fiscal 1960, the bonanzas came to more than twelve times the Budget outlays for education; almost eight times the outlays for health; more than eleven times the outlays for housing; much more than three times the outlays for public assistance; and more than nine times the outlays for labor, manpower, and other welfare services.

There is nothing fallacious about these comparisons. The national policies which were responsible for the higher private and public interest payments at all levels—and not just for the higher interest payments by the

Federal Government—could have been converted into other national economic policies to give our urgent national public needs priority over the privately-paid as well as the publicly-paid interest bonanzas.

How the Federally-paid interest bonanzas might have been used

But it is also informative to compare the interest bonanzas paid by the Federal Government alone with outlays in the Federal Budget. For the seven years 1953-1959 inclusive, the average annual excess interest payments on the Federal public debt came to about 722 million dollars. This was more than twice the average annual Federal outlays for education during the fiscal years 1954-1960; about 45 percent higher than the outlays for health; and more than 2⅓ times as high as the outlays for housing. It was considerably higher than the outlays for labor, manpower, and other welfare services.

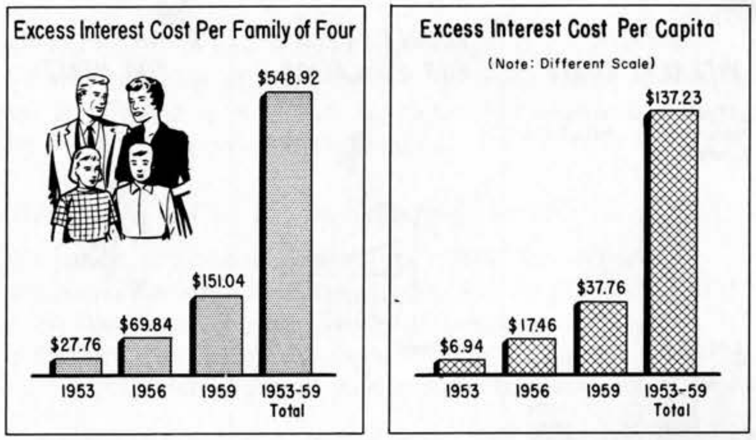
In 1959 alone, the excess interest costs paid by the Federal Government were more than 1.8 billion dollars. Comparing this figure with Federal Budgetary outlays in fiscal 1960, the excess interest payments by the Federal Government were much more than three times the outlays for education; much more than twice the outlays for health; more than three times the outlays for housing; almost as high as the outlays for public assistance; and more than 2½ times as high as the outlays for labor, manpower, and other welfare services.

What a contrast there is between willingness to spend so much for so little, and determination to spend so little for so much.

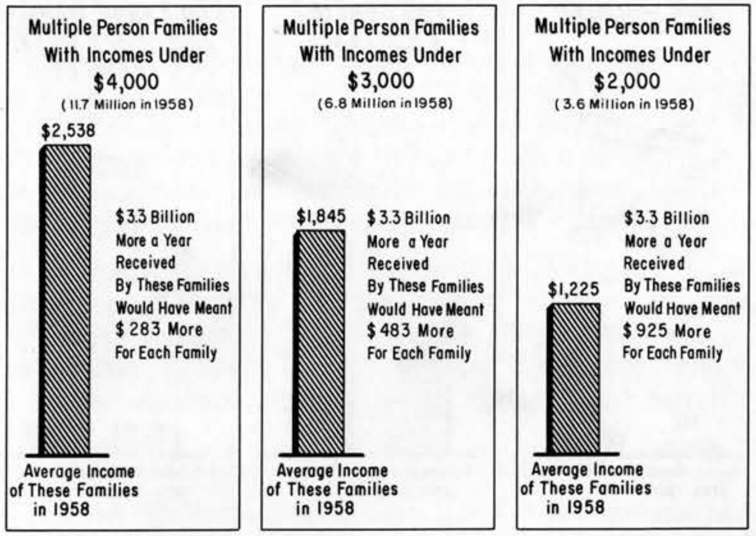
The following charts amplify this discussion.

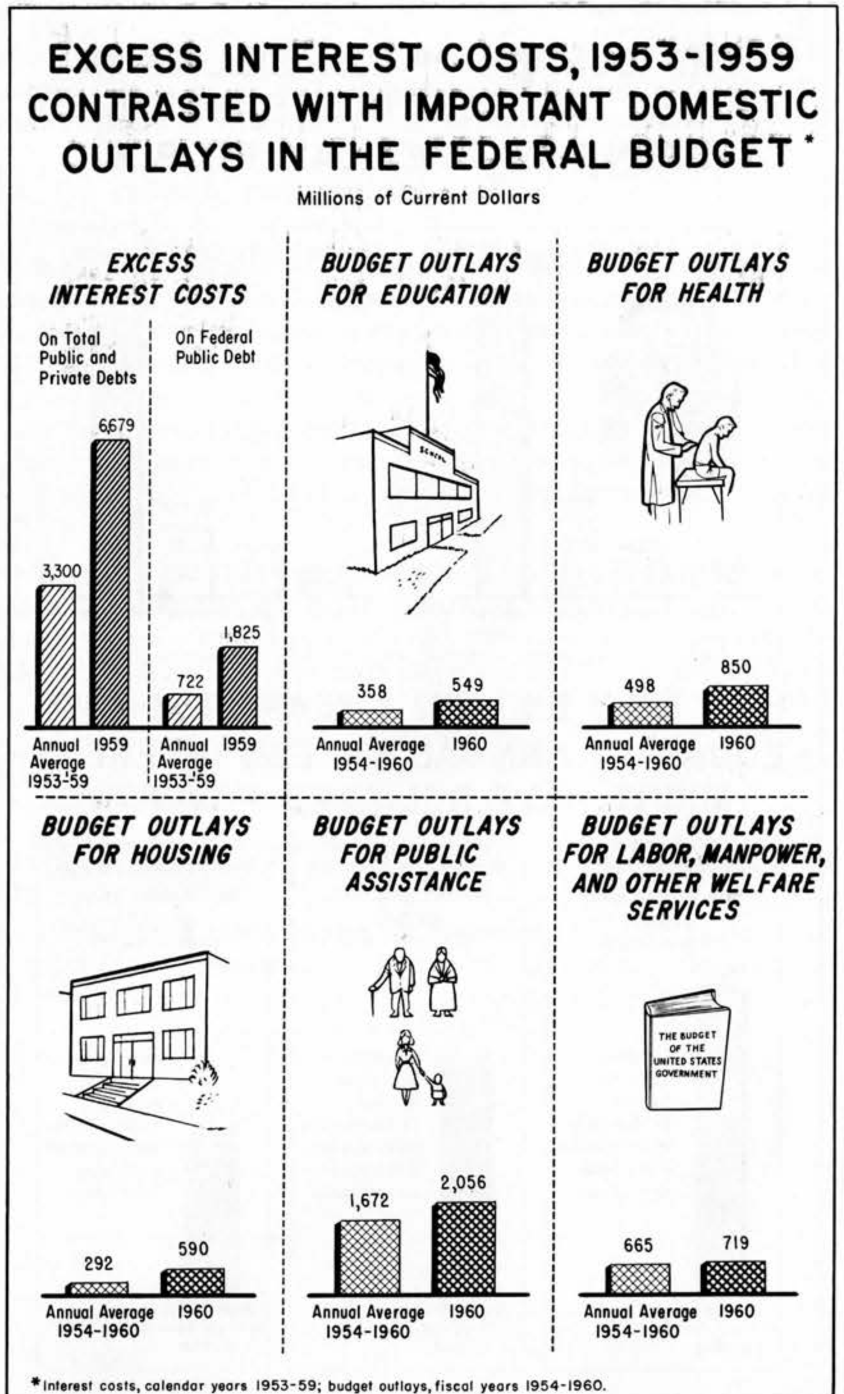
THE BURDEN OF $23 BILLION IN EXCESS INTEREST COSTS, 1953-1959 UPON THE AMERICAN PEOPLE

Calendar Years



HOW $3.3 BILLION A YEAR, 1953-1959 - EQUAL TO ANNUAL EXCESS INTEREST - MIGHT HAVE RELIEVED POVERTY





VII. Injuries Done To The Economy As A Whole

The injuries done to the economy as a whole by the tight-money-rising-interest-rates policy are not merely the sum of the injuries to specific sectors depicted in the preceding chapters. For this policy, combined with other policies, has made the total damage much larger than the sum of its parts. The historic unfolding of this total damage was covered substantially in Chapter III. But it is now desirable to portray this total damage more broadly and in a more consolidated fashion.

The shabby record of low economic growth

The most important damage has been the suppression of the American economy's overall rate of growth. For the period 1922-1959 as a whole, the American economy grew at an annual average rate of 3.5 percent in real terms. Excluding the years affected by wars and depression, this long-term average annual growth rate in real terms was about 3.8 percent.

Moreover, the advance of technology and automation has tended to *accelerate* the average annual rate of growth under the favorable incentives of high-level prosperity. Thus, the average annual rate of growth in real terms was 4.2 percent during the years 1947-1950, and 4.7 percent during the years 1947-1953.

In dismal contrast, despite a technology and automation which are still accelerating, and despite the unique urgency of our domestic and worldwide needs, the average annual growth rate of the American economy in real terms during the period 1953-1959 was only 2.4 percent. This average is lifted to only about 2.7 percent, if estimates for 1960 are included. In short, for a significantly long and perilous period, our average annual growth rate has been only in the neighborhood of about half that required to maintain reasonably full employment of manpower and plant.

In consequence, during the period from the beginning of 1953 through the first quarter of 1960, the Nation had about 16 million man-years *less* of employment opportunity, and about 218 billion dollars *less* of total national production, than it would have had if a satisfactory growth rate had maintained reasonably full employment of plant and manpower.

Private and public progress have both been hurt

These vast deficiencies have hit every sector of our economic performance, safety, and well-being. During the years 1953-1959 inclusive, average family income has been about $3,500 lower than it should have been. The total personal incomes of the people have been more than 177 billion dollars too low; wages and salaries about 131 billion too low; farm operators' net income about 36½ billion too low; and unincorporated business and professional income more than 10½ billion too low. All of these measurements are in uniform 1959 dollars.

Not only our private economic lives but also our public performance have been gravely affected. At existing tax rates, the deficiency in total national production during 1953-1959 resulted in a deficiency of about 65 billion dollars in Federal, State, and local revenues. With these additional revenues, we could have lifted our national security outlays to satisfactory levels instead of slashing them dangerously, and we could have brought our grossly neglected domestic public services up to at least tolerable levels of performance. Enough revenues would have been left over to have wiped out the entire deficit in the Federal Cash Budget of about 19 billion dollars* during these seven calendar years.

How the economy got out of balance

The causes for these defaults all along the line are clear. Basically, our private and public consumption (outlays for public programs) have not grown enough to keep up with the actual increases in producer facilities, much less to keep up with the larger increases in producer facilities which would have formed an essential part of a balanced program of satisfactory economic growth.

During the period 1953-1959 as a whole, personal consumption expenditures needed to grow at an average annual rate well in excess of 5 percent in real terms; instead, they actually grew at an average annual rate of only about 3½ percent. Public outlays at all levels of government needed to expand, not only to meet basic public needs, but also to help sustain economic growth and reasonably full employment. Instead, public outlays in real terms contracted substantially. This was due to an average annual contraction of almost 4½ percent in Federal outlays for goods and services in real terms, while State and local outlays (in much smaller absolute magnitudes) expanded at an average annual rate of about 6 percent.

The third component in total economic activity, total private investment, expanded only about half as fast as it should have, during the period as a whole. But unlike private consumption, this deficiency was not due to inadequate business income and other potentially available funds. Instead, it was mainly due to the fact that private and public consumption did not expand enough to call forth a high and stable level of fundamental business investment. As already indicated,* the periods which led up to economic recession were preceded by exorbitant investment booms getting more and more out of line with the rest of the economy.

* In uniform 1959 dollars. The current dollar figure is more than 16 billion.

Wrongful public policies, including tight money

While policies within the private economy itself contributed greatly to these difficulties, public policies were a very large factor. The most damaging public policies were probably the penny-wise and pound-foolish Federal Budget policy, the cruelly deflationary farm policy, and the inflexible resistance to the adequate expansion of social security and other programs designed to advance private incomes and living standards. But the tight-money-rising-interest-rates policy, which transferred 23 billion dollars of national income in the wrong direction during this period, wrought a great deal of damage on its own.

This is clearly shown by some comparative trends. Comparing 1959 with 1952, the average interest rate on total outstanding private and public debts increased about 29 percent, and total public and private interest charges as a percent of total national production rose from 7.6 percent to 10.7 percent. Meanwhile, comparing 1959 with 1953, total national production increased only 15 percent in real terms. Comparing the same two years, while total personal income increased only 19 percent and wages and salaries only 18 percent, and while farm proprietors' net income decreased 17.5 percent, dividend income increased more than 22 percent, and personal interest income more than 48 percent. These trends are all measured in uniform 1959 dollars.

It is equally revealing to look at some of the trends in the earnings of those who benefit primarily by interest bonanzas. Comparing 1959 with 1952, and using current dollars, total national production increased 38 percent. Meanwhile, the net current earnings of member banks in the Federal Reserve System increased 81 percent, and their net profits after taxes increased 52 percent. Their earnings on U. S. Government securities increased 51 percent, their earnings on loans increased 118 percent, and their declared cash dividends increased 77 percent.

All of these distortions in income flow gave powerful economic and psychological momentum to the poor overall performance and the great national losses in all fields which have blemished the period under review as a whole.

* See Chapter III.

Speculation in the stock market abetted

The behavior of the stock market during these years has been sharply indicative of distorted trends and distorted policies. The Standard and Poor's combined index of 500 stocks soared from 24.50 in 1952 to 57.38 in 1959. This represented an incredible average annual increase of about 13 percent, during a time when the average annual increase in the gross national product measured in current dollars was only 4.7 percent.

Despite this, with new issues of corporate stocks in limited supply, most stock purchases were of outstanding issues and thus resulted in no new real investment for the economy. Thus, the profiteering and huge capital gains in stock transactions, far outweighing the low yields at times on stocks compared to bonds, inflated the value of equity shares held by a relatively small group of people without contributing to economic progress.

This is why there was nothing "paradoxical" about the months or even years when the stock market was moving sharply upward while the economy was moving sharply downward. This merely reflected the fact that there was too much money in the hands of those who did not want to spend most of it, and who had no opportunity to use it for the genuine expansion of fundamental investment, even while there was too little money in the hands of those who should have been spending more for the expansion of consumption.

While the Federal Reserve System made some changes in stock margin requirements at turning points in economic developments, these were not always well-timed nor sufficient to curb rampant speculation. In any event, they distracted attention from the urgently useful things which the System was consistently refusing to do.

Real money and "near-money"

It should also be noted that the tight-money-rising-interest-rates policy increased the velocity of money, even while it was restraining the expansion of money in its more traditional forms. During the years 1952-1959, money as often defined (demand deposits adjusted to exclude inter-bank and U. S. Government deposits, less cash items in process of collection, plus currency outside of banks) increased at an average annual rate of only 1.7 percent. Currency outside of banks increased at an average annual increase of only one percent. Money even more broadly defined (to include deposits in commercial banks, mutual savings banks, and the Postal Savings System) * increased at an average annual rate of only 3.4 percent, or only about half as fast as the average annual increase of total public and private credit and debt. But during the same period, time deposits were increasing at an average annual rate of 6.4 percent, and other items of "near-money," such as savings and loan shares and short-term Government securities outside the banking system, were also growing at rapid rates.

* This definition equates with the general use of the term money supply in this study.

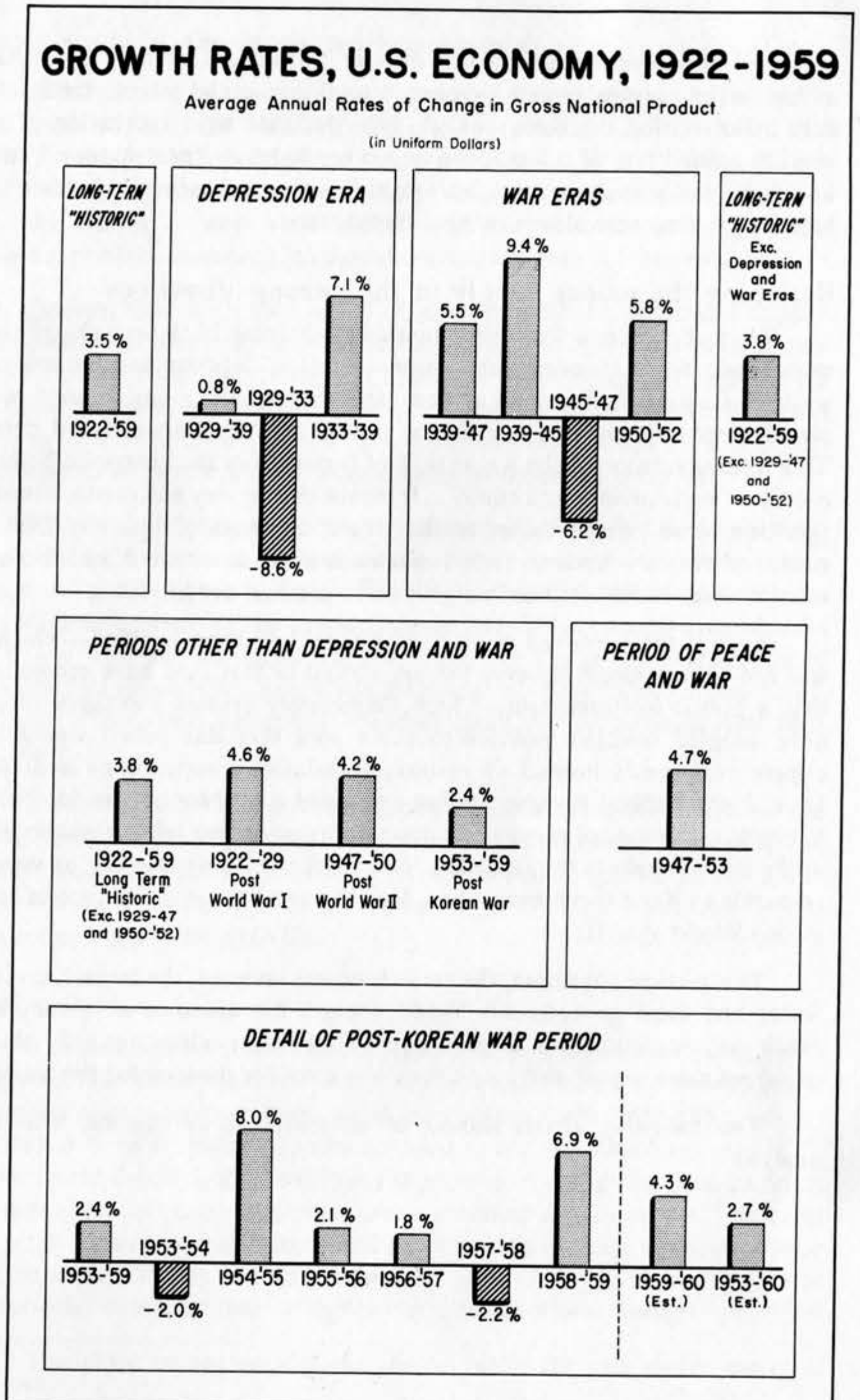
Rationing the money supply in the wrong directions

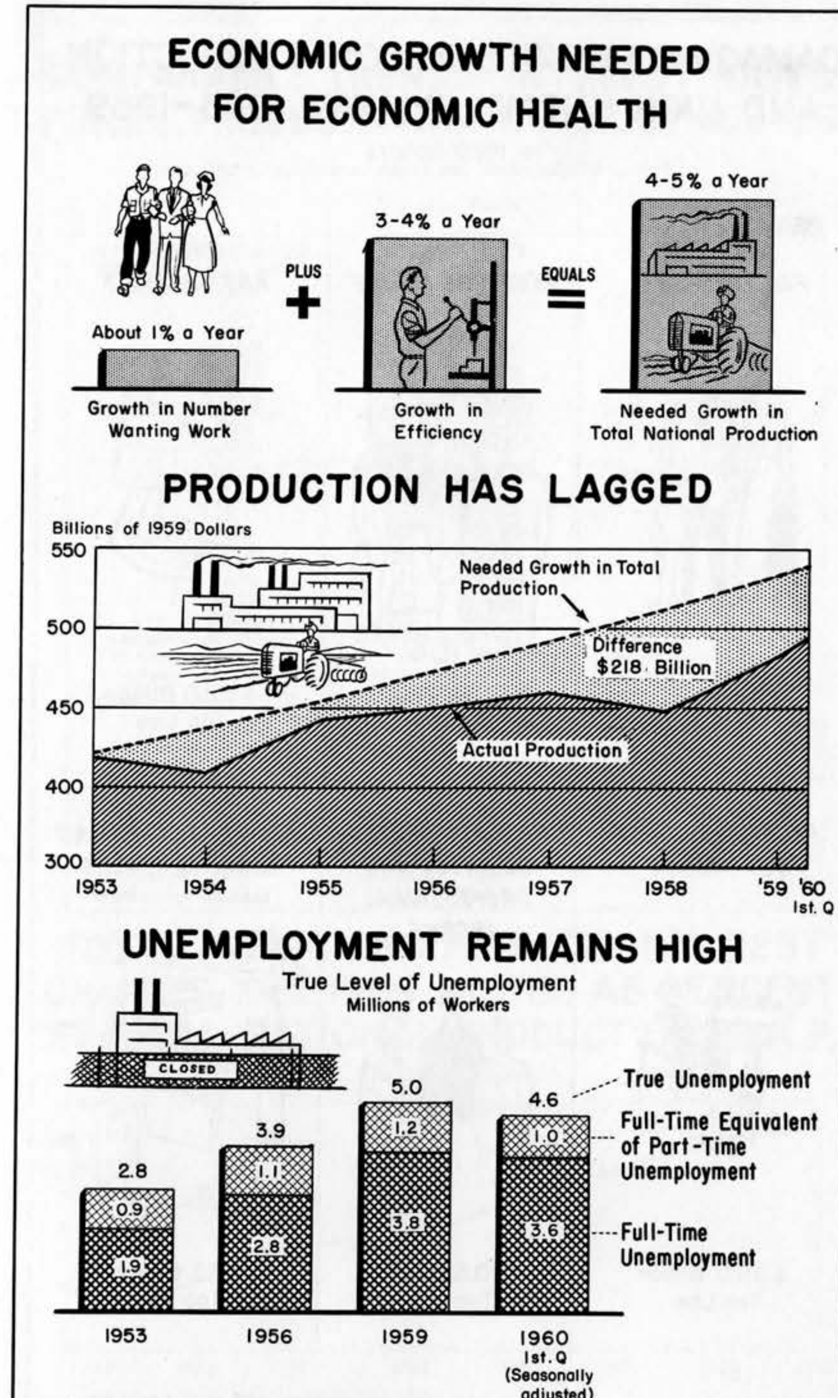
Thus, the Federal Reserve policies were holding back very sharply the most liquid types of money expansion—demand deposits and currency—while restraining ineffectually at best (and through the rising interest rates actually encouraging in part) the expansion of "near-money" and debts. This seriously distorted the whole flow of funds, from the viewpoint both of economic performance and equity. It meant that money and credit, broadly speaking, were being rationed in the wrong direction, just as any kind of contrived scarcity tends to ration commodities in favor of those who can outbid others rather than in line with more genuine needs.

Even if the contrived scarcity of money had been justified—which it was not—the Federal Reserve System should in that case have recognized that a public instrumentality which deliberately creates shortages should have adopted selective policies to make sure that this policy would not cripple real needs instead of restraining relatively superfluous activities. Instead, the Federal Reserve System employed a positive nationwide policy to create a shortage of money and drive up its price, but left the distribution of the short supply to the so-called "free market." This was just as unconscionable as if the Government had done the same thing in the case of food during World War II.

The average consumer, the small business investor, the farmer, and the States and local governments, could not get the amounts of money and credit they needed for useful purposes. Those more advantageously placed could get more money and credit than was good for them or for the country.

The following charts should be examined in connection with this analysis.


GROWTH RATES, U.S. ECONOMY, 1922-1959
Average Annual Rates of Change in Gross National Product
(in Uniform Dollars)
LONG-TERM "HISTORIC"
3.5%
1922-'59
DEPRESSION ERA
0.8%
1929-'39
1929-'33
-8.6%
7.1%
1933-'39
WAR ERAS
5.5%
1939-'47
9.4%
1939-'45
1945-'47
-6.2%
5.8%
1950-'52
LONG-TERM "HISTORIC" Exc. Depression and War Eras
3.8%
1922-'59
(Exc. 1929-'47 and 1950-'52)
PERIODS OTHER THAN DEPRESSION AND WAR
3.8%
1922-'59
Long Term "Historic" (Exc. 1929-47 and 1950-'52)
4.6%
1922-'29
Post World War I
4.2%
1947-'50
Post World War II
2.4%
1953-'59
Post Korean War
PERIOD OF PEACE AND WAR
4.7%
1947-'53
DETAIL OF POST-KOREAN WAR PERIOD
2.4%
1953-'59
1953-'54
-2.0%
8.0%
1954-'55
2.1%
1955-'56
1.8%
1956-'57
1957-'58
-2.2%
6.9%
1958-'59
4.3%
1959-'60 (Est.)
2.7%
1953-'60 (Est.)


ECONOMIC GROWTH NEEDED FOR ECONOMIC HEALTH
About 1% a Year
Growth in Number Wanting Work
PLUS
3-4% a Year
Growth in Efficiency
EQUALS
4-5% a Year
Needed Growth in Total National Production
PRODUCTION HAS LAGGED
Billions of 1959 Dollars
550
500
450
400
300
Needed Growth in Total Production
Difference $218 Billion
Actual Production
1953
1954
1955
1956
1957
1958
'59
'60 1st. Q
UNEMPLOYMENT REMAINS HIGH
True Level of Unemployment
Millions of Workers
CLOSED
2.8
0.9
1.9
3.9
1.1
2.8
5.0
1.2
3.8
4.6
1.0
3.6
True Unemployment
Full-Time Equivalent of Part-Time Unemployment
Full-Time Unemployment
1953
1956
1959
1960 1st. Q (Seasonally adjusted)

DAMAGING EFFECTS OF LOW PRODUCTION AND HIGH UNEMPLOYMENT, 1953-1959

In 1959 Dollars

AVERAGE FAMILY INCOME

$3,500
Too Low

TOTAL PERSONAL INCOME

$177.4 Billion
Too Low

WAGES AND SALARIES

$131.0 Billion
Too Low

FARM OPERATORS' NET INCOME

$36.5 Billion
Too Low

UNINCORPORATED BUSINESS AND PROFESSIONAL INCOME

$10.6 Billion
Too Low

FEDERAL, STATE AND LOCAL REVENUES

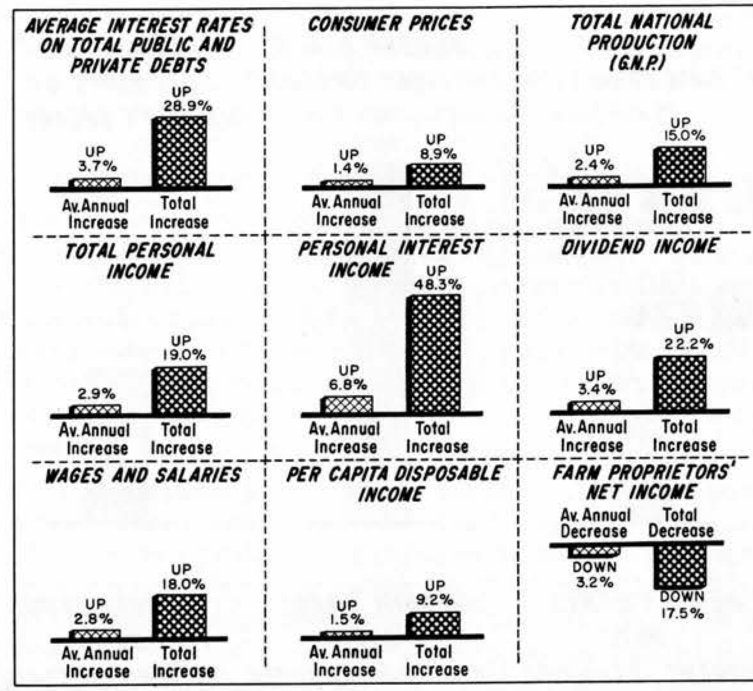
(At Existing Tax Rates)

$65 Billion
Too Low

COMPARATIVE TRENDS: INTEREST RATES, PRICES, PRODUCTION, & INCOMES, 1953-'59*

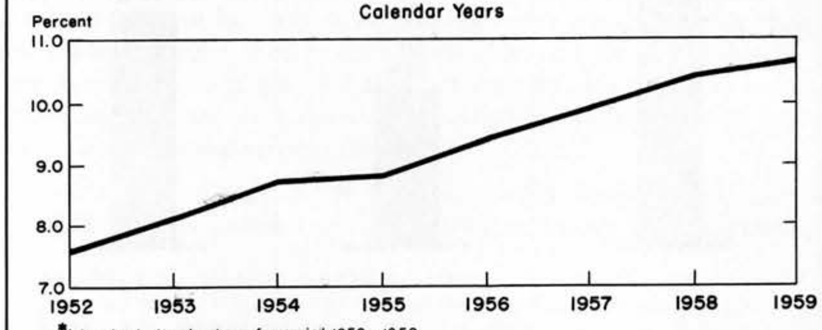
Items Other Then Interest Rates and Prices in 1959 Dollars

Calendar Years



TOTAL PUBLIC AND PRIVATE INTEREST CHARGES, 1952-1959, STATED AS PERCENT OF TOTAL NATIONAL PRODUCTION (G.N.P.)

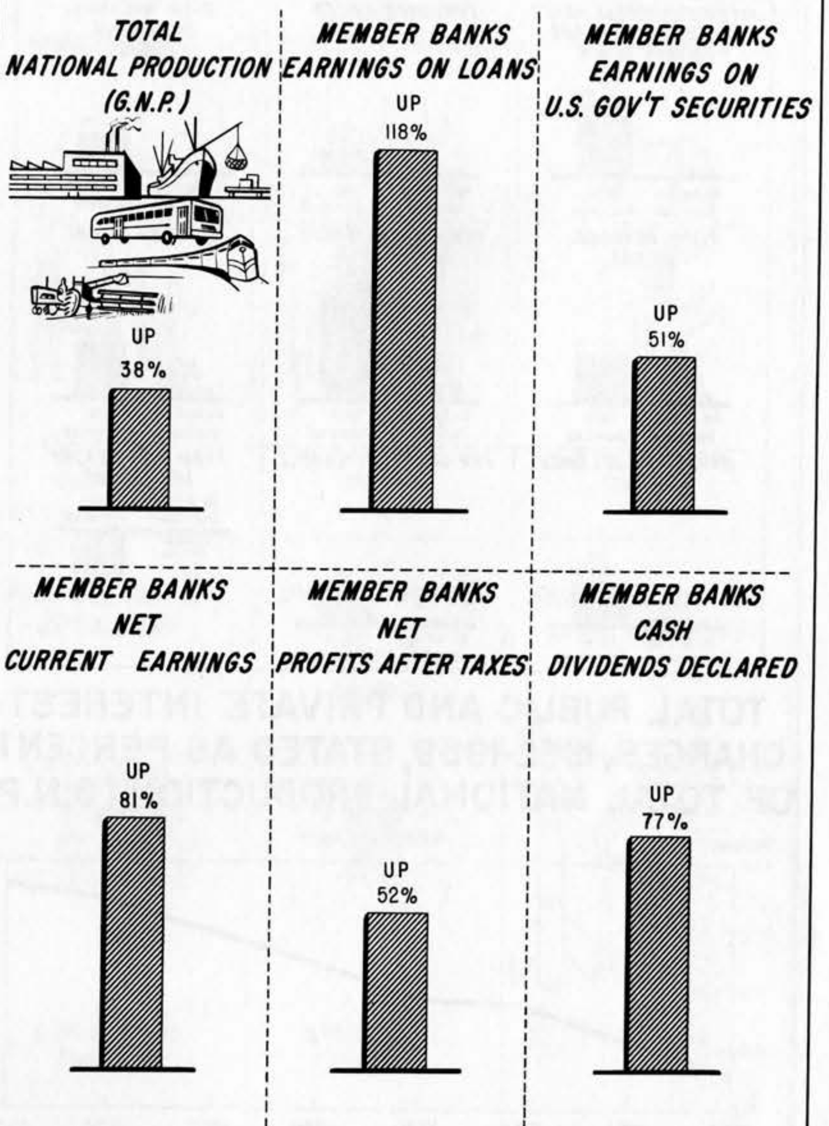
Calendar Years



*Interest rate trends shown for period 1952 - 1959

RISE IN TOTAL NATIONAL PRODUCTION AND IN EARNINGS OF FEDERAL RESERVE MEMBER BANKS, 1952-1959

In Current Dollars



VIII. Tight Money Is Inflationary

Despite all the manifest damages wrought by the tight-money-rising-interest-rates policy, its champions persistently defend it as a prime weapon to protect the value of the dollar and prevent inflation. Even if the policy in some degree accomplished this anti-inflationary purpose, other ways should have been found which are not so injurious in so many other respects. But the fact is that the policy, in addition to its other demerits, has proven under recent conditions to be inflationary rather than anti-inflationary.

Common sense indicates rising money costs are inflationary

The ordinary citizen understands quickly that any important rise in the price of anything is inflationary, unless the higher price is a payment for improved performance or a better commodity, or provides other worthwhile incentives to the recipient. Higher wages are not inflationary, when they represent payment for increased productivity. Higher prices are not inflationary, when they pay for a better article. Higher incomes in general are not inflationary, when they provide additional funds for useful economic enterprise.

But paying a higher price for each dollar borrowed in recent years has served none of these worthy purposes. The higher interest rate did not make the dollar more productive. It did not make the dollar more valuable, but rather less valuable, to the person borrowing it. And it cannot be claimed that higher interest rates should have been used to provide incentives to more lending, because the tight money policy was asserted to be for the purpose of reducing the volume of lending in order to stop inflation.

To be sure, it is sometimes argued that higher interest rates promote more saving by consumers, so that more funds will be available for investment in producer goods, and that this is a cure for inflation. But as already noted, this argument is not relevant to recent economic developments, when the central problem has been to expand consumer spending rather than to stimulate investment.* And most consumers can save *less* rather than *more,* when their living costs are increased not only by rising interest rates on money they must borrow, but also by the inflationary effect of rising interest rates on the goods and services they buy.**

In short, the rising interest rates, as already demonstrated, have increased the average person's costs of owning or renting a home, running a

* For fuller development, see Chapter III.

** During 1953-1959, personal savings declined from 7.9 percent to 6.9 percent of disposable personal income. Even gross savings, including those of corporations and governments, declined as a percent of gross national product.

small business, operating a farm, and buying automobiles and lawn mowers and refrigerators and other consumer durables. These rising costs are inflationary by definition. And insofar as the champions of tight money protest so frequently about wage increases adjusted to the rising cost of living, it is hard to understand their encouragement of increases in so many elements in the cost of living.

Applying a classical remedy to a non-classical inflation

All of these inconsistencies arise because the champions of tight money are applying a classical type of remedy, designed to deal with a classical type of inflation which has not existed during the recent years under review. This classical type of inflation results from "too much money chasing too few goods." It occurred during World War II, and during some earlier periods in our history. But as set forth quite fully in the discussion in Chapters III and VII, the inflation during the more recent years has not been of this type. It has occurred when there was not enough "money chasing goods" to keep our productive resources of manpower and plant satisfactorily employed. To attempt to remedy this by repressing the expansion of the money supply (i.e. holding down the expansion to an unusually low rate) has been ridiculous on its face.

Just how ridiculous this policy is becomes more apparent, when we examine carefully the nature of the economic developments which have accompanied "the new inflation." As already noted in various parts of this study, the inflation in recent years has been *selective* rather than *general*. Some types of economic activities and prices and incomes have risen relatively too rapidly, while other types have not risen sufficiently, or have stood still when they should have risen, or have fallen backward when they should have risen or been stabilized. And the tight-money-rising-interest-rates policy, by creating a scarcity of money and credit while allowing the strong and the weak to compete for the short supply, has helped those who were doing relatively too well and hurt those who were doing very poorly in absolute or relative terms. Figuratively speaking, this policy has inflated the fat and starved the lean.

Applying the brakes at the wrong time

The tight-money-rising-interest-rates policy in recent years has been based on the notion that the inflation was resulting from an excessive pressure of total demand upon our total productive resources. This is tantamount to the notion that the inflation resulted because our economy was growing at an excessive speed, or because unemployment of plant and manpower were at an "inefficiently" low level rather than at an "inefficiently" high level. If this notion had been correct, there might have been some merit in using the tight money policy to slow down the rate of growth or to reduce the pressure on resources, although in that event there should have been selective policies to assure "equity of sacrifice" as during wartime.

But the excessive inflation in recent years has occurred, not because the economy was growing too fast or because unused resources were too low, but rather in considerable degree because the economy was growing too slowly and unused resources were too high.

To use an analogy, just as an automobile burns more gas per mile and operates "inefficiently" if it is driven at an excessively fast rate, so it will burn more gas per mile and operate "inefficiently" if it is driven at an excessively slow rate. The same thing is true of our national economy. And, therefore, policies which stunt growth and lift unemployment have inflationary implications.

It is true that these policies may temporarily bring an end to inflation, when they produce absolute recessions of serious magnitude. But this is throwing out the baby with the bath. Moreover, the experience in recent years indicates that a quick succession of booms, stagnation, and recessions generates more price inflation *in the long run* than would result from a sustained rate of economic growth following a middle road between the extraordinarily high growth rate of wartime and the extraordinarily low growth rate in recent years.

"Administered" price inflation

To understand why policies which lead to slow economic growth are inflationary, we need to examine manifestations of "the new inflation."

The inflation in industrial prices during recent years, which also affects consumer prices, has not occurred in those competitive areas where small business operators are quickly responsive to the so-called laws of supply and demand. Instead, the industrial price inflation in recent years has occurred mainly in a number of key industries which "administer" or deliberately set their prices. And careful examination shows an increasing trend on the part of these industries, when their production and sales fall seriously below the reasonably full use of their productive resources, to raise their prices even faster than during periods of fuller prosperity, in order to try to achieve their defined objectives for profits and investment funds.

Although the steel industry is one of the outstanding propagandists of the indefensible position that increasing wage costs have forced its prices upward, the truth is that the steel industry now has a break-even point in the neighborhood of 40 percent of capacity. An industry which breaks even at such low-level operations, and makes huge profits at a 60 or 70 percent level of operations, cannot in good grace claim that either the excessive demands of labor or the excessive demands of consumers have been responsible for the price increases which have taken place. The steel price inflation is a prime example of "scarcity economics."

Reasons underlying cost-of-living price increases

Administered price increases, responsive to deficient rather than excessive levels of economic activity, have not been limited to the industrial area. Consumer supplies at the retail level are increasingly dominated by large concerns which administer their prices. Some of these concerns have also fallen into the habit of relying upon rising prices, rather than upon rising volume, to satisfy their profit and investment requirements.

In addition, some of the most recent increases in the cost of living, such as in housing, have resulted from fundamental shortages in supply. And these shortages have been aggravated by repressive policies in the "crusade against inflation." The adverse effect of tight money upon the housing supply has already been discussed.

The supporting facts in brief

The trends in economic growth, in the money supply, and in prices during wartime and reconversion are so unique to these periods that they do not have much relevance to other periods.* But during the whole period 1922-1959 (excluding the war eras and the era of the Great Depression), there was a very close correlation between the growth of the economy and the growth of the money supply. During these years, the economy grew at the average annual rate of 3.8 percent in real terms, and the non-Federally-held money supply expanded at an average annual rate of 3.6 percent.** These years, averaging a fairly good economic performance, and demonstrating the role of the money supply in facilitating this performance, did not register what would generally be considered a high average annual rate of price inflation for a dynamic economy. Consumer and industrial prices both increased at an average annual rate of about one percent, and wholesale prices at an average annual rate of only about 0.6 percent.

Perhaps we should have done still better in stabilizing prices. But this rate of price increases was very much lower than that during the period

* For a discussion of the gross misuse of the wartime and reconversion experience in the formulation of recent monetary policy, see Chapter III.

** The money supply, as here referred to includes total demand deposits (exclusive of U. S. Government deposits), currency outside of banks, and time deposits.

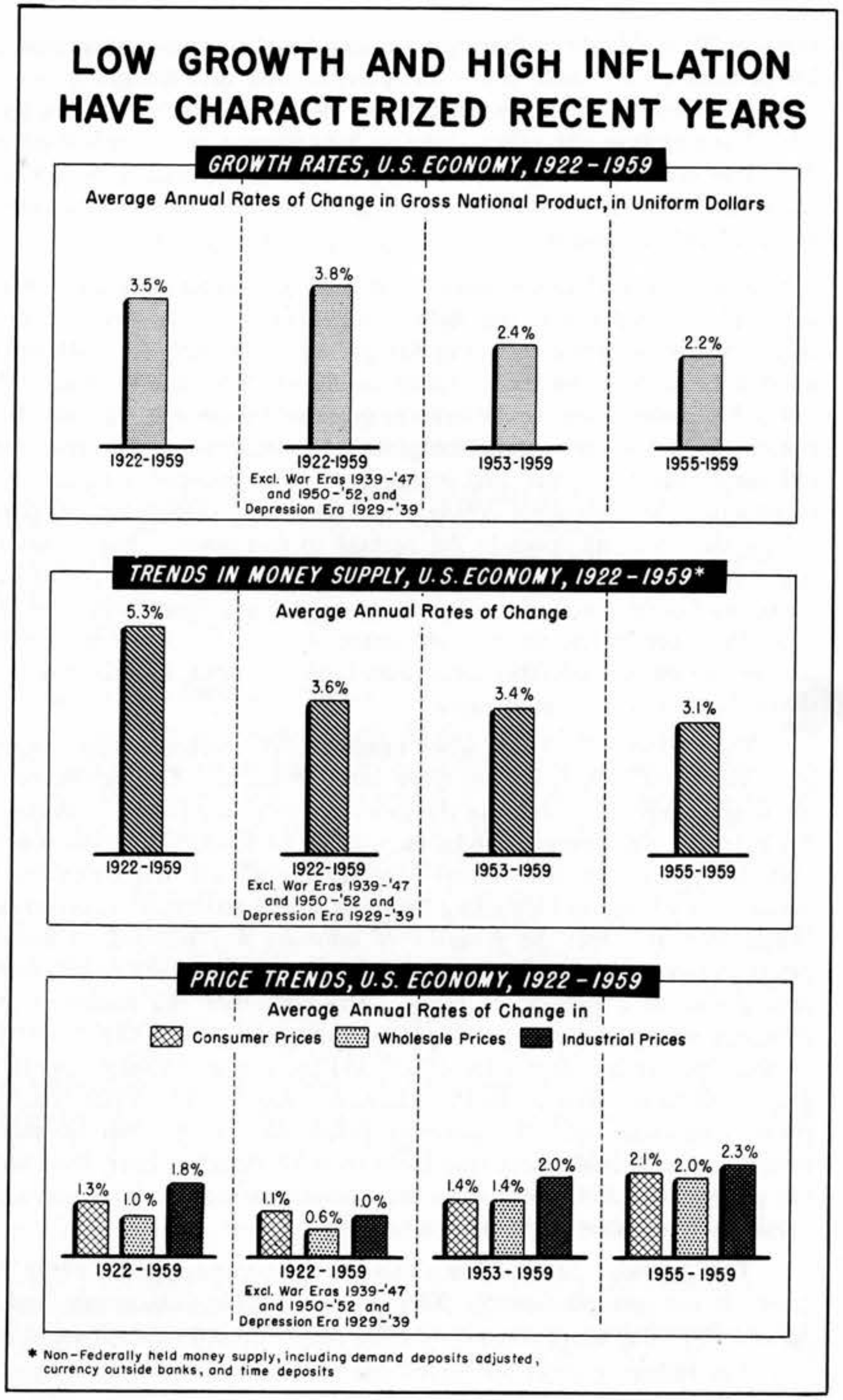
1891-1922, when the average annual increase in consumer prices was 2.9 percent, in wholesale prices 2.5 percent, and in industrial prices 2.3 percent. These comparisons indicate the utter irresponsibility of the widespread agitation to the effect that the tight money policy has saved the American economy from an inflation like that which took place in some countries overseas, when the value of the currency changed thousands of times within a few years.

Now let us look at the more recent history, characterized by "the new inflation" against which the tight-money-rising-interest-rates policy has been allegedly directed. During the period 1953-1959 as a whole, the average annual increase in the money supply was held to 3.4 percent, when a 4½-5 percent figure would have been more compatible with the 4½-5 percent annual average economic growth required to maintain reasonably full employment of plant and manpower. This repressive policy, combined with other repressive policies, held the actual average annual growth rate of the economy down to 2.4 percent in real terms. But during this recent tight money period, the average annual increase in the cost of living (consumer prices) was more than 27 percent faster than during the years 1922-1959 (excluding the war and depression eras). The rise in wholesale prices was considerably more than twice as rapid, and the rise in industrial prices was twice as rapid.

The period 1955-1959, when interest rates reached heights unparalleled since 1927-1929, is even more more revealing. During this period, the average annual increase in the money supply was further repressed to 3.1 percent. The average annual increase in total national production was only 2.2 percent in real terms—representing virtual stagnation for the period as a whole, and including the most severe economic recession since World War II. But the progress of inflation was marked. Consumer prices, wholesale prices, and industrial prices all increased at an average annual rate of 2 percent or more. The consumer and industrial price increases were about twice as rapid as during the period 1922-1959 (excluding the war and depression eras), and the rise in wholesale prices was more than three times as rapid. Moreover, during 1955-1959, wholesale prices rose twice as fast, consumer prices rose more than 60 percent faster, and industrial prices rose more than 27 percent faster, than during the period 1922-1959 even when the vast inflation of wartime and reconversion are included in the 37-year average.

This provides clear evidence that the tight-money-rising-interest-rates policy is not anti-inflationary. This policy is highly inflationary, and this adds to the many other reasons why this policy should be reversed at once.

The following chart reinforces this conclusion.



IX. The Mismanagement Of The National Debt

The new accord of 1953 and its declared purposes

With the advent of a new Administration and new national economic policies in 1953, the tight-money-rising-interest-rates-policy was supported not only by the formal "accord" of March 1951 between the Federal Reserve Board and the Treasury. It was now supported by a more far-reaching accord between these two centers of public responsibility.

The widely heralded purposes of this new accord were many. One purpose was to use the tight-money-rising-interest-rates policy to stop inflation, and to suffuse the whole economy with economic health. How far this purpose failed of attainment has already been reviewed.

Another purpose of the new accord between the Federal Reserve Board and the Treasury was to improve the management of the national debt. This purpose was divided into four parts:

(1) To shift from more short-term maturities to more long-term government borrowing as outstanding obligations became due and required refinancing, and thereby to increase the average length of maturity of outstanding Federal obligations. This aim was declared to be in aid of general economic stability and price stability;

(2) Gradually to place a larger portion of the outstanding Federal debt outside of the banking system, and preferably in the hands of individuals. This aim was explained on the ground that the relatively large portion of the national debt which had been placed in the hands of banking institutions during World War II "monetized" the debt, in that it provided a base for expansion of the money supply and credit, and thus contributed to inflation;

(3) To decrease the size of the national debt, by prudent spending, by wise taxation, and by virtue of an economy in the bloom of health;

(4) To bring more order and confidence into the general management of the national debt and the marketing of government securities, by applying the same businesslike practices which were going to bring more order and confidence into everything.

Some of these four objectives may be eminently desirable, while others are debatable. But it is not necessary to discuss here whether, for example, it is desirable to increase or to shorten the average length of Federal borrowings.* It is pertinent here only to point out that those who declared the four objectives set forth above have failed to achieve any of them after 7½ years of effort. Thus, they can no longer defend their money and fiscal policies even in terms of their own avowed objectives.

The maturity period of the debt has been shortened, not lengthened

Comparing 1959 with 1952 (end of fiscal years), the percentage of the total marketable interest-bearing Federal debt outstanding having a maturity period of five years or longer decreased from 32.9 percent to 26.2 percent, and the percentage having a maturity of ten years or longer decreased from 23 percent to 16.6 percent. Even outstanding obligations having a maturity of 1 to 5 years decreased from 34.1 percent of the total to 32.8 percent. In sharp contrast, outstanding obligations having a maturity of less than one year increased from 33 percent of the total to 41 percent. The average length of the debt outstanding declined from 5.67 years in 1952 to 4.58 years in 1959.

The "demonetization" of the debt has not been substantially accomplished

Comparing 1959 with 1952 (as of June 30), the percentage of the total outstanding Federal debt** held by the banking system (Federal Reserve member banks, commercial banks, and mutual savings banks) declined from 36.1 percent to 33.2 percent. This might seem to represent some progress in the avowed direction, if it were accounted for by a larger percentage of the outstanding debt being held by individuals and business concerns outside the banking system. But this has not been the case. Again comparing 1959 with 1952, the percentage of the outstanding debt held by individuals declined from 25 percent of the total to 23.5 percent, and the percentage held by insurance companies and other corporations declined from 13.4 percent to 11.4 percent. Among other things, this does not indicate greatly increasing confidence in Federal obligations on the part of those who have more freedom and flexibility in deciding whether or not to hold these obligations than the banking system has.

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* It may well be desirable under certain conditions to shorten the average length, *if* this policy is used to reduce rather than to increase interest costs to the Government, and to make the Government less rather than more dependent upon the financial community.

** Securities issued or guaranteed by the U. S. Government excluding guaranteed securities held by the Treasury. This exceeds the interest-bearing debt by several billion dollars.

These declines have been compensated for by the portion of outstanding Federal obligations held in United States Government investment accounts, which rose from 17.1 percent of the total in 1952 to 19.2 percent in 1959; by the portion held by State and local governments, which rose from 4 percent of the total to 5.9 percent over the same period; and by the portion held by "miscellaneous investors," which rose from 4.5 percent of the total to 6.8 percent over the same period.

The trend toward holding of Federal obligations in Government investment accounts is more or less a required bookkeeping transaction, resulting from legal mandates rather than monetary policy. The increasing holdings of Federal obligations by State and local governments probably represents in large part their desire to get the advantage of rising interest rates on Federal issues (on earmarked or temporarily idle funds), to compensate them in small degree for the much larger amounts in interest bonanzas which they are paying out to those from whom they borrow.

The national debt has been greatly increased

In consequence not only of the tight-money-rising-interest-rates policy (which in 1959 alone made the cost to the Federal Government of servicing the national debt more than 1.8 billion dollars higher than it would have been if 1952 rates had been maintained), but also in consequence of the erroneous fiscal policies which have attempted to balance the Federal Budget at the expense of the national economy, the interest-bearing Federal debt rose from about 260 billion dollars in calendar 1952 to about 285 billion in calendar 1959. And during the fiscal years 1954-1960, the annual average deficit in the Federal Conventional Budget was about 3½ times as high as during the fiscal years 1947-1953 (despite the Korean war). During the more recent period, the Federal Cash Budget ran an average annual deficit of 1.6 billion dollars, while during the earlier period it ran an annual average surplus of 2.4 billion.

Those in the national Administration and in the Federal Reserve System, who always place balanced budgets at the top of the list of their weapons to combat inflation, must feel very chagrined indeed to note how their "crusade against inflation" has produced budgetary deficits unparalleled except in times of total war.

Disorder in Federal financing: making bonds as speculative as stocks

It is a first principle of our system of responsible enterprise and responsible government that private enterprise investment should involve more risk, fluctuation, and speculation than investment in the solemn obligations of the Government of the United States. This is one conservative doctrine to which the liberal school of economics can subscribe fully.

But the conservative school in charge of the Federal Reserve System and the national Administration have produced the opposite result. At many times during recent years, if not generally, the solemn obligations of the United States Government have fluctuated in price as rapidly as stocks, and been traded by speculators more aggressively than stocks. This has had so injurious an impact upon the sensible and orderly marketing of Treasury issues, that people interested in financial matters have at times opened up their newspapers and read that the most recent effort of the U. S. Government to borrow money has been a "failure."

This tragic farce has represented what George Washington would have called "speculation, peculation and an insatiable thirst for riches." The churning disorders in the Federal bond market have undoubtedly been beneficial to those strong and "wise" enough to take advantage of them. But what has happened to the small holder of a Government bond, who due to an emergency need to sell has had to take a very large percentage loss on the face value of his bond?

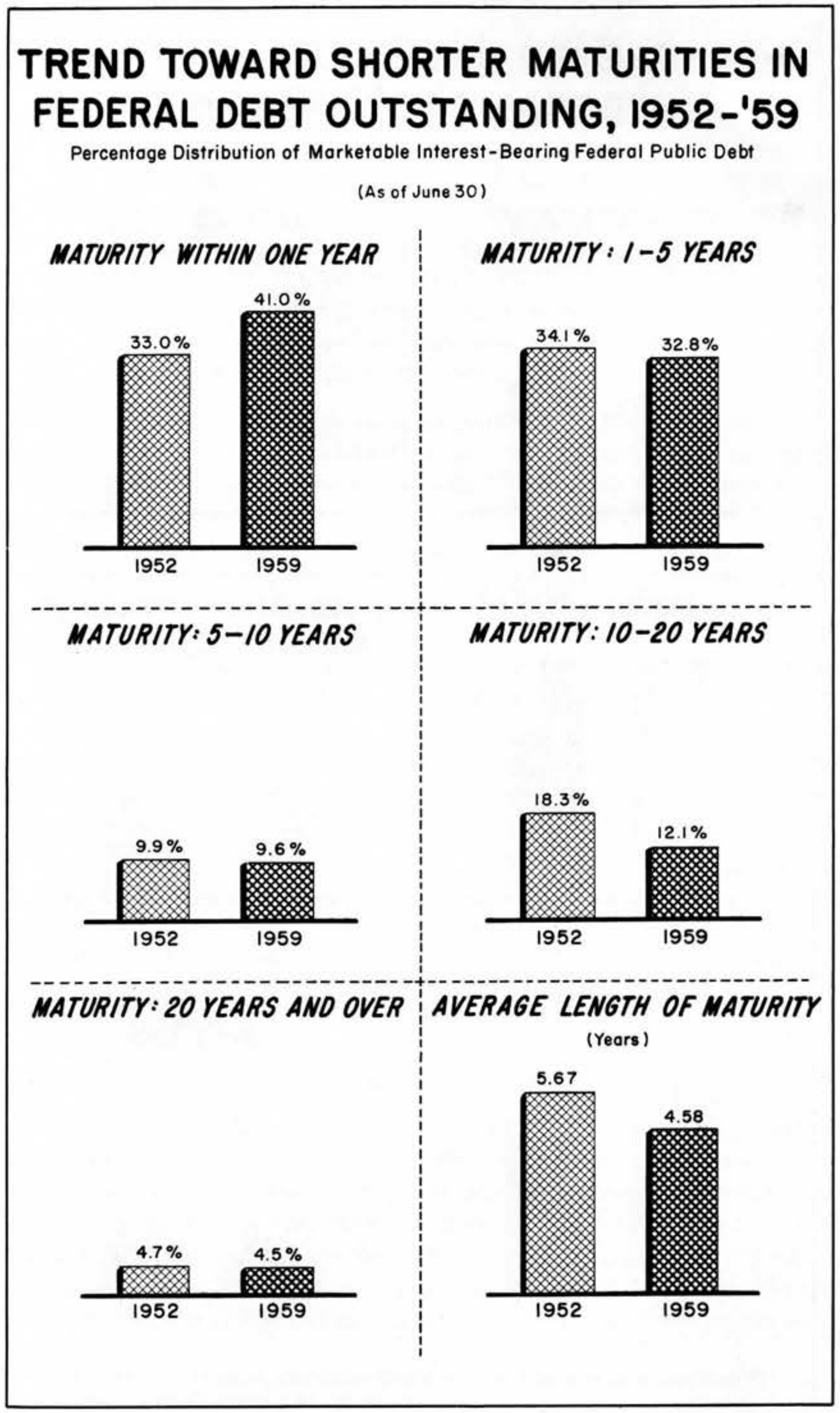
Private and public money groups—and their behavior

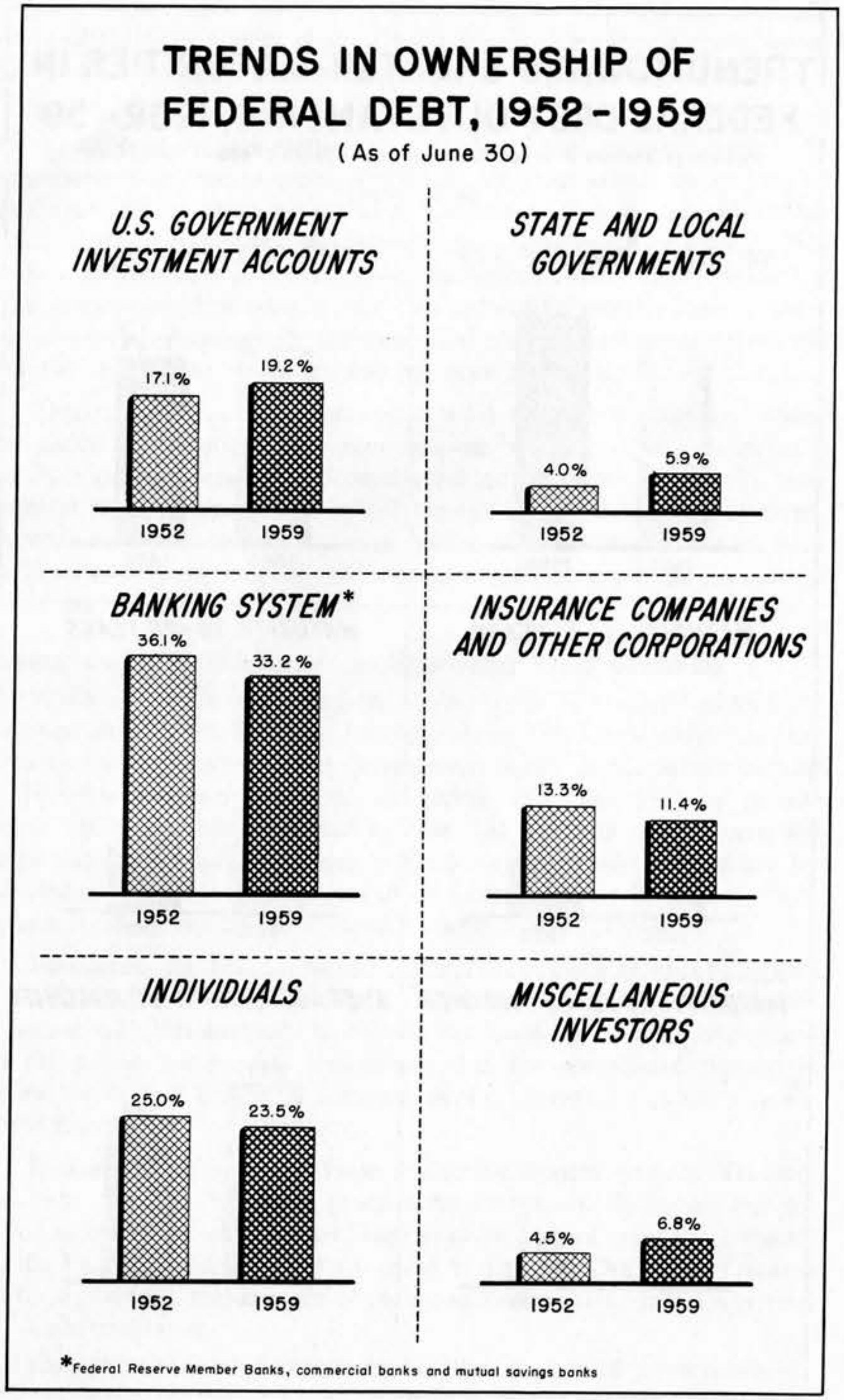
While all this has been going on, a grouping of 17 "recognized traders" in Government bonds has been handling about 200 billion dollars a year in transactions, including direct Government issues, public securities held by the Federal Reserve Board, and public securities held by private traders. It is illuminating indeed to note that, in some recent years, the annual volume of trading in these public issues by private holders has far exceeded in amount the handling of direct Government issues and the trading in securities held by the Federal Reserve System combined.

Meanwhile, the Federal Reserve System—the banking agency created by the Congress of the United States to prevent these kinds of travesties by joining with the Treasury to protect the financing of the Government and the public credit—has maintained that the speculative trading in Federal issues as if they were common stocks represents a salutary return to "the free market."

Spokesmen for both the Federal Reserve System and the Treasury have even said that it is good practice for everybody—including but not limited to the speculators—to be "kept guessing" about what the Treasury and the Federal Reserve Board are going to do next. Often, the Treasury and the System, in consequence of their own follies, have not known what *they* ought to do next.

The next two charts illustrate some salient aspects of this discussion.





X. The Tremendous Danger Of Tight Money In The Future

The damage done by the tight money policy thus far is only prelude. The policy is still in effect, even if slightly eased at the moment. And the other wrongful and repressive economic policies, of which tight money is an integral part, are also still in effect. The purpose of this chapter is to estimate the further damage which will be done if the whole complex of wrongful and repressive policies, including the tight money policy, are continued during the years running through 1965.

The method used in making these estimates is simple. First of all, it is assumed (under such policies) that the average annual growth rate of the economy as a whole for the years through 1965 would not be appreciably higher than the 2.4 percent average annual rate during the years 1953-1959. This is a reasonable assumption, because the most recent economic developments show no fair promise of a long-term improvement in the average annual growth rate under current policies.*

Secondly, estimates are made as to how much various types of interest rates would rise in future, if the tight money policy is continued within the framework of estimated economic developments in general. These estimates do not assume that interest rates would continue to rise as rapidly as they have in recent years; that would be unlikely. Nonetheless, further interest rate increases of various sizes are projected for various types of debts.

And thirdly, estimates are made of how much various types of debts would increase, as a basis for estimating future excess interest costs.

Using these various estimates, the impact of repressive policies not only upon interest charges but also upon the performance of the overall economy are portrayed through 1965.

Projected increases in interest costs under current policies

It is estimated that, comparing 1965 with 1959, the average interest rate on the Federal interest-bearing public debt would rise by another 15 percent, on State and local government debts by another 19 percent, on total interest-bearing private debts by another 4 percent,** and on total outstanding public and private debts by another 13 percent. Combining this with estimated increases in the various sizes of debts, it is estimated that excess interest charges (charges in excess of those which would result

* See Chapter III for a fuller discussion of this point.
** A most conservative estimate.

from application of 1952 interest rates) would be about 16 billion dollars on the Federal public debt for the six years 1960-1965 inclusive, thus aggregating more than 21 billion for the thirteen years 1953-1965 inclusive; that excess interest charges on State and local government debts would be 3.7 billion over the same years ahead, thus aggregating 4.3 billion for the whole period 1953-1965; that excess interest charges on total interest-bearing private debts would be 42.8 billion for the years ahead, thus aggregating 60.3 billion for the whole period 1953-1965; and that excess interest charges on all public and private debts would come to 62.6 billion for the years ahead, thus aggregating the stupendous figure of 85.7 billion for the thirteen years 1953-1965 inclusive.

How the money could be used better to reduce private poverty

On a per capita basis for the entire United States population, the excess interest charges of almost 63 billion during the six years 1960-1965 would be almost $65 in 1965 alone, and aggregate more than $333 for the six-year period. Applied to a family of four, the corresponding figures would be almost $260 and about $1,333, respectively.

If the average of more than 10.4 billion dollars a year in excess interest costs during the six years ending with 1965 were used through alternative policies to reduce poverty in America,* the results would be as follows:

If applied to the nearly 12 million multiple-person families (with incomes below $4,000) who in 1958 had average annual incomes of $2,538, this average could be increased by $892, or more than 35 percent.

If applied to the almost 7 million multiple-person families (with incomes below $3,000) who in 1958 had average annual incomes of $1,845, this average could be increased by $1,520, or almost 83 percent.

If applied to the more than 3½ million multiple-person families (with incomes below $2,000) who in 1958 had average annual incomes of $1,225, this average could be increased by $2,915, or about 238 percent.

Manifestly, these alternative economic policies, instead of wasting the nearly 63 billion dollars and damaging the whole economy besides, would result in enormous social gains. These alternative economic policies would establish a large part of the consumer underpinning for a satisfactory rate of economic growth and reasonably full employment of manpower and plant.

* For discussion of the validity of this approach, see Chapter VI.

How the money could be used better to expand public programs

To illustrate another worthwhile approach, the more than 10.4 billion dollars in average annual excess interest charges during the six years 1960-1965 inclusive could be applied to remedy the huge and dangerous gaps in essential public services.* Less than one-half of this sum would lift our national security outlays to the levels which most experts who are not placing dollars above security urgently recommend. About one-fifth of this amount could more than double our annual technical and economic assistance to the underdeveloped areas of the free world,** thus contributing mightily to human progress and the prospects for enduring world peace.

Looking at some of the important domestic public outlays in the President's proposed Budget for fiscal 1961, excess interest charges averaging more than 10.4 billion dollars a year come to almost 18½ times the President's proposed fiscal 1961 outlays for education; much more than 11 times the proposed Budget outlays for health; more than 24 times the proposed Budget outlays for housing; about five times the proposed Budget outlays for public assistance; and more than 14 times the proposed Budget outlays for labor, manpower, and other welfare services.

How the Federally-paid interest bonanzas could be used better

The excess interest costs on the Federal public debt alone are estimated to average almost 2.7 billion dollars annually during the six years 1960-1965 inclusive. This comes to almost five times the proposed fiscal 1961 Budget outlays for education; almost three times the proposed outlays for health; more than six times the proposed outlays for housing; more than 29 percent more than the proposed outlays for public assistance; and more than 3½ times the proposed Budget outlays for labor, manpower, and other welfare services.

In short, the redirection of the swelling interest bonanzas in the Federal Budget alone would be sufficient to make tremendous improvements in all of the basic aspects of those severely starved public services which are supported in part by the Federal Budget. And the redirection to public purposes, at all levels of government, of the swelling interest bonanzas both public and private, would be enough to cover at least two-thirds of the total amounts required to bring our national security, international, and domestic public outlays, during the period 1960-1965, into line with the needs of the country and the fulfillment of their essential role in satisfactory economic growth and reasonably full employment of manpower and plant.

* For discussion of the validity of this approach, see Chapter VI.

** This item was 1.823 billion dollars in the fiscal 1961 Budget as proposed by the President.

Difference between high and low overall economic growth, 1960-1965

If a reversal of the tight-money-rising-interest-rates policy and other perverse national economic policies injurious to economic growth were promptly put into effect, and combined with the improvements in private economic policies which these changes would induce, our overall economy could grow at an average annual rate of about 5 percent a year between now and the end of 1965. In fact, a considerably higher rate of growth is essential during the next year or longer, until reasonably full employment of manpower and plant are restored.

Comparing the results of this desirable rate of growth with approximate repetition of the 2.4 percent average annual growth rate during 1953-1959, the aggregate difference in total national production during the six years 1960-1965 inclusive would be about 470 billion dollars. The aggregate differences in man-years of employment would be about 23 million.

These differences would translate into private and public differences all along the line. For the six-year period as a whole, the difference in average annual family income would be about $6,500. The difference in personal consumption expenditures would be about 279 billion. The difference in total wages and salaries would be about 260 billion, in farm operators' net income about 61 billion,* and in unincorporated business and professional income about 21 billion. The difference in private domestic investment opportunity, including net foreign investment, would be about 112 billion.

The impact upon public programs would be equally great. The difference in government transfer payments to individuals, including social security and other related programs, would be about 41 billion dollars. *At existing tax rates,* the difference in Federal, State, and local public revenues would be about 125 billion dollars—a difference averaging almost 21 billion a year. This difference, with balanced public budgets, would improve the national security, fulfill our true responsibilities to the underdeveloped peoples of the free world, meet our basic resource development needs, and lift other domestic public programs to high enough levels to come close to the goal of decent homes, ample educational opportunity, and adequate health services for practically all American families.**

The following charts make even more vivid the stake which the Nation and the people have in the abandonment of the tight money policy and its companion policies of economic repression and social injustice.

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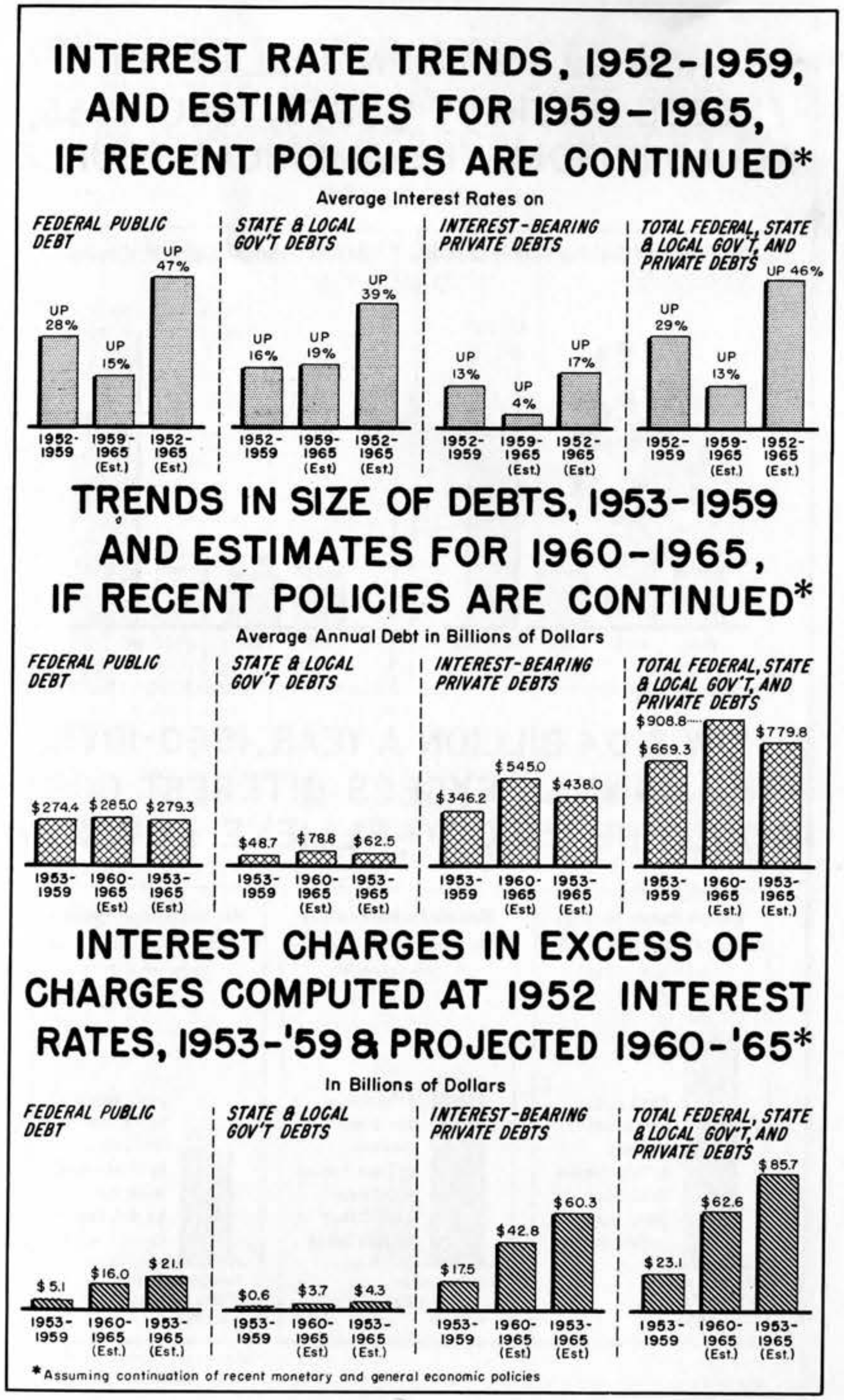
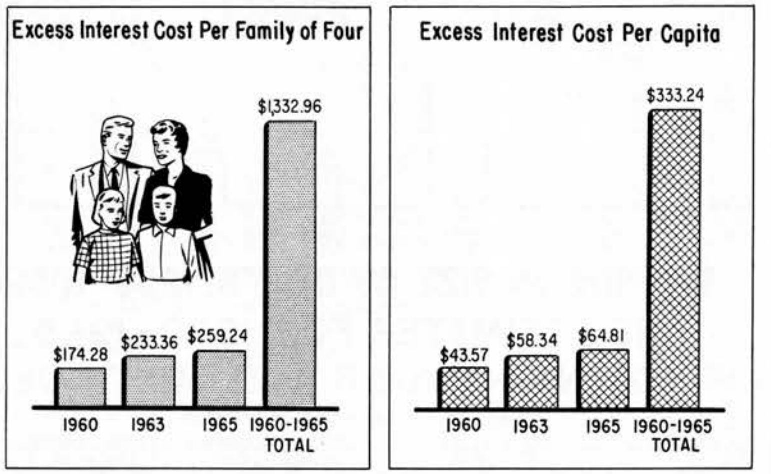
* Assuming a completely recast national farm policy.

** For a fuller discussion, see *The Federal Budget and "The General Welfare,"* published by the Conference on Economic Progress in December 1959.

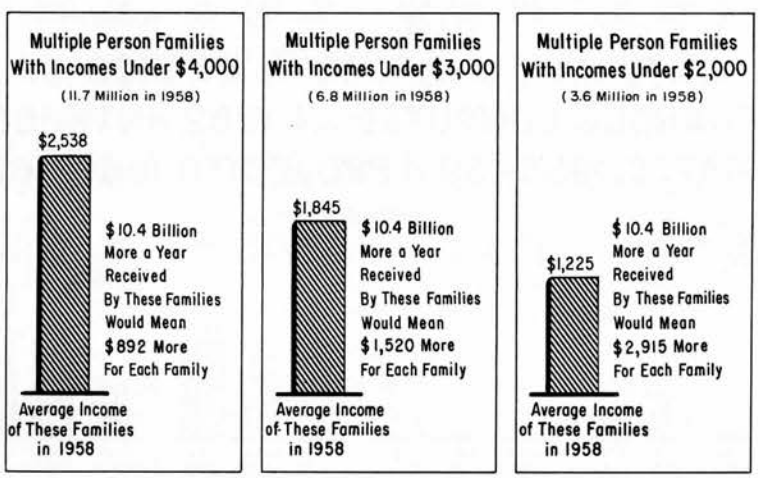


HOW 62.6 BILLION DOLLARS IN EXCESS INTEREST COSTS, 1960-1965, WOULD BURDEN THE AMERICAN PEOPLE

Calendar Years

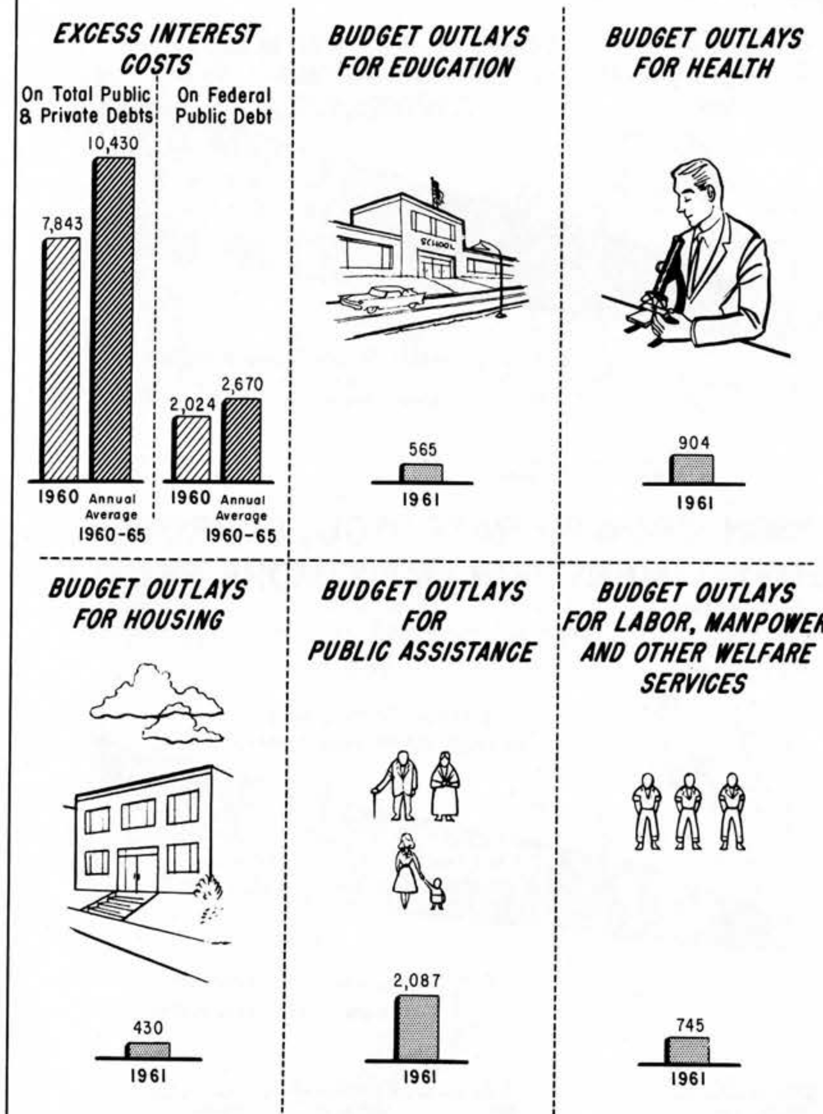


HOW $10.4 BILLION A YEAR, 1960-1965, -THE ANNUAL EXCESS INTEREST COST- COULD BE USED TO RELIEVE POVERTY



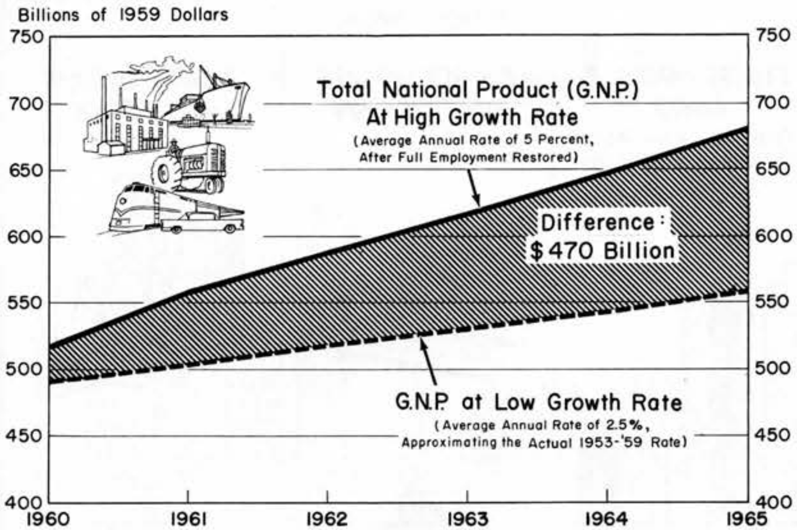
ESTIMATED EXCESS INTEREST, 1960-'65 CONTRASTED WITH IMPORTANT OUTLAYS IN CURRENT FEDERAL BUDGET *

Millions of Dollars

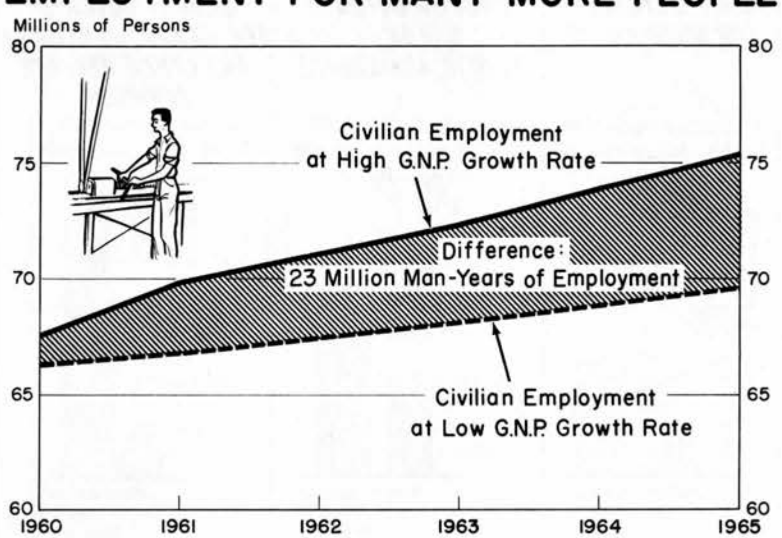


* Interest costs, calendar years 1960-1965; Budget outlays, fiscal year 1961, as proposed by the President, January, 1960

HIGH GROWTH RATE, 1960-1965 WOULD YIELD $470 BILLION MORE TOTAL PRODUCTION THAN LOW RATE*



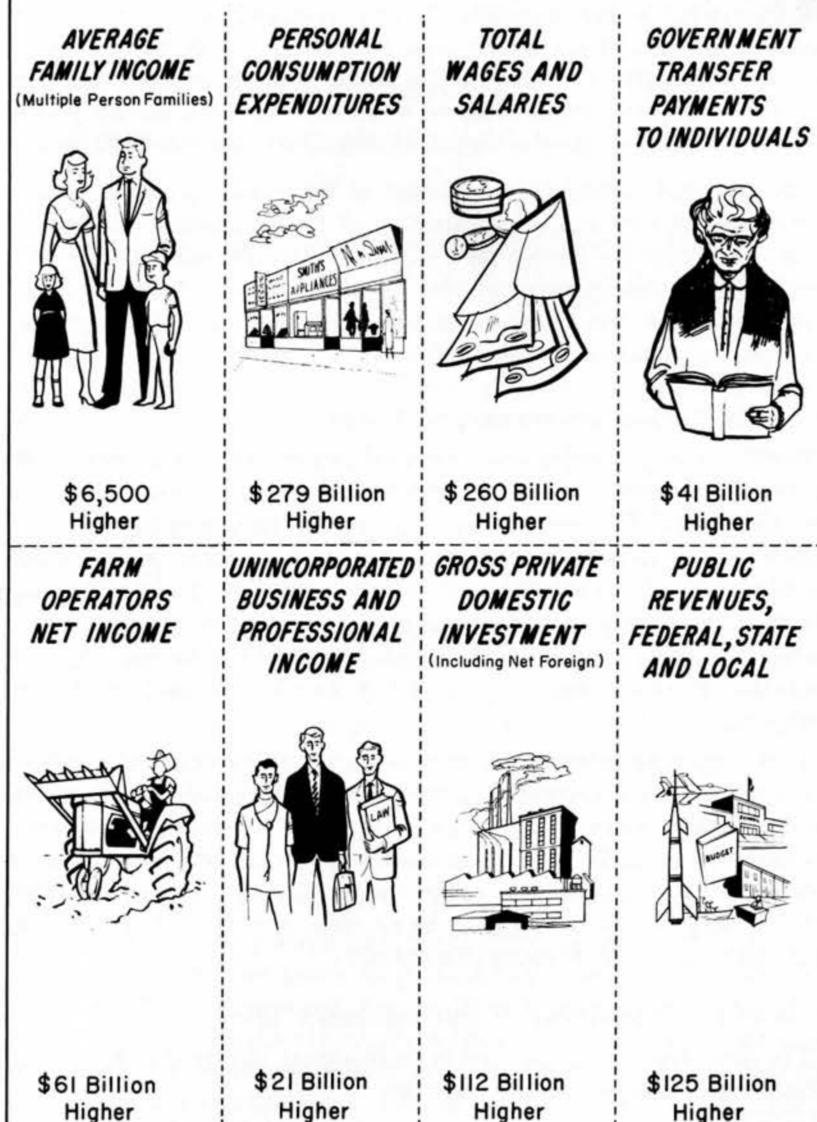
HIGH GROWTH RATE WOULD PROVIDE EMPLOYMENT FOR MANY MORE PEOPLE



* The year 1959 is used as projection base

BENEFITS OF HIGH GROWTH RATE CONTRASTED WITH LOW GROWTH RATE 1960-1965 AS A WHOLE

In 1959 Dollars



XI. First Steps Toward A Sound Monetary Policy

The money policy must be a part of an overall economic policy

Monetary policy cannot successfully be conducted in isolation. It must reinforce spending and tax policy, and *vice versa*. Otherwise, policies operate at cross purposes, too heavy a strain may be placed upon one policy, and inadequate weight attached to others. In short, money policy needs to be an integral part of a consistent overall national economic policy.

The so-called independent operation of the money policy in recent years has worked very seriously against all of these objectives. To overcome this difficulty, the money policy must be brought substantially into line with the general initiative of the President and his Administration, subject of course to the legislative will of the Congress, and the general consents of the American people.

There is no overall economic policy now

But the money policy cannot be administered within the framework of an overall economic policy if no such overall policy exists. And in recent years, there has been no such policy, no definition of the basic purposes of such a policy, no enunciation of the specific goals toward which these purposes should aim, and consequently no programs adequately adjusted to these aims. Instead, we have had a series of short-range, random, and inconsistent policies, which have been both faltering and ineffectual. In short, we have had no great national purpose in our economic life.

This long-range national purpose is essential for domestic reasons. And it is imperative for world-wide reasons. An America which is feeble in the declaration and indecisive in the achievement of great purposes cannot compete successfully with the monolithic purposes and granite will of the societies which are not free. Our crucial task now and in the years ahead is to demonstrate our capacity to establish purpose and unity in the great things under the institutions of freedom.

The three great purposes of our economic life

The first step toward this end is to recognize clearly the three great purposes of our economic life. These are:

(1) Sustained economic growth at a rate which calls forth fully our productive resources of manpower and plant, technology and science,

managerial skills and human attitudes. This maximum economic growth does not in itself solve all of our economic problems, but it provides us with the material means to solve them;

(2) The use of our total production to meet the priorities of our private and public needs, in accord with our sense of values democratically conceived, so that the things we need most are not subordinated to the things we need least;

(3) The achievement of economic justice.

Maintenance of reasonable price stability should be fused with these three purposes.

The necessary conditions for achieving these purposes

The main economic condition for the evolving achievement of these three great purposes is the balanced development of (a) investment in the expanding means of production and (b) the expansion of private and public consumption (outlays for public programs, including those sometimes called public investments). If the former expands much more rapidly than the latter, excessive unemployment of plant and manpower results. If the latter expands much more rapidly than the former, the classic type of inflation results. The internal composition and overall magnitudes of investment and consumption need also to be consistent with the priorities of our private and public needs and with economic justice.

Prices and wages and profits, public spending and taxation and other public programs, and the management of the money supply, are but means toward the achievement of these three basic purposes. The private and public economic policies which shape the factors just mentioned are also means toward these ends. It follows inescapably that, without clear definition and integration of these purposes or goals, all private and public economic policies are flying blind.

Role of the Employment Act: A National Prosperity Budget

Instead of casting about aimlessly for new agencies and instrumentalities (though some may prove to be necessary), we should recognize first of all that the Employment Act of 1946 furnishes ample and flexible authority for the President and his Administration to initiate the process of defining and coordinating these basic purposes or goals, as well as the means toward their attainment. But the specific mandates of this Act, and not merely its "spirit," have been progressively abandoned. In recent years, the President in his *Economic Reports* to the Congress has neither set forth the goals for maximum employment, production, and purchasing power (which if interpreted broadly and defined quantitatively would cover practically all of our basic economic goals and the economic relationships required for their attainment), nor set forth in comprehensive fashion the national economic policies pertinent to these goals.

It is therefore of prime urgency that the President set forth in each of his *Economic Reports* (which should be submitted twice rather than once a year) a *National Prosperity Budget.* This *Prosperity Budget* should include short-range and long-range goals for optimum economic growth; for maximum employment, production, and purchasing power; for meeting the great priorities of our public and private needs; and for improvements in economic justice.

The national economic policies contained within the *National Prosperity Budget,* properly attuned to the goals, should manifestly include the spending and tax programs of the Government, both on a short-range and a long-range basis. The Federal Budget should be an integral part of the *Prosperity Budget.* Other Federal programs which bear importantly upon the economy (such as social security and other welfare programs, basic resources development, and protective legislation dealing with education, health, and minimum wages) should also be included within the *Prosperity Budget,* and their size and timing should be governed by its goals. Similarly and for equally cogent reasons, the monetary policy of the Nation should be set forth fully in the *Prosperity Budget,* attuned to its goals, and thoroughly rationalized with its other policies.

Bearing of this approach upon the Federal Reserve System

Assuming that this were done—and it should be done—the next question is how the Federal Reserve System would be required to bring its own operations and policies within the scope and purposes of the *National Prosperity Budget.* Since it is to be presumed that the Federal Reserve System is generally headed by sensible men, the mere use and popularization of the *Prosperity Budget* would be very helpful in this direction. In any event, the *Prosperity Budget* would enable the Congress more effectively to appraise and determine the general operations of the Federal Reserve System. And it would also enable the President, to the extent that he is willing and able, to bring his own influence to bear. The President should act as Chairman of an overall economic group including the Chairman of the Federal Reserve Board.

The influence of the President upon the Federal Reserve Board is vital. He is the prime initiator of national economic policies, and the Chief Executive of the Nation. In addition, there are many specific short-

term decisions of the Federal Reserve Board which cannot be quickly reviewed nor effectively controlled by the Congress, but which nonetheless need to be brought into line with the great purposes or goals of the Nation. All our history since the establishment of the Federal Reserve System indicates that a President who has the desire to exercise this responsibility can find the means to bring it to bear. If he really needs legislation toward this end, he should have it.

Proposals to make the Federal Reserve Board more responsive

There are some specific steps which should be taken promptly to facilitate the President in this effort.

It might be well to amend the Employment Act of 1946, to require by legislation that the money policy be made a part of the *Economic Reports* of the President along the lines suggested above.

To underscore that the Federal Reserve System should not exercise the degree of "independence" which it has arrogated to itself in recent years, the expenditures of the Federal Reserve Board should be contained within the Federal Budget, and made subject to public audit and control.

To augment this emphasis, the maintenance of surpluses by Federal Reserve banks should be discontinued, and the accumulated amounts should be returned to the Treasury.

It would also be desirable, through legislation, to make sure that the membership of the Federal Reserve Board were more truly representative of the various important groups and interests in our nationwide economic life. The composition of the Board has tended to make it unduly responsive to the particular interests of the banking and financial community. The Chairmanship of the Board should be at the pleasure of the President.

Proposals to amplify and redefine the functions of the System

The Congress should provide to a properly constituted Federal Reserve Board authority to exercise a wide-range of selective controls, because the aggregative approach (for reasons already discussed in full) has been very defective and self-defeating. The Board should enjoy selective authority to regulate consumer credit and housing credit, and also to be selective in its regulation of the use of credit for various types of business investment and public use (e.g. credit available to the States and localities). It is unthinkably shallow and superficial to persist in a money and credit policy which represses the public and private activities which need stimulation before it touches (or even while it stimulates) the lines of activity which need to be restrained.

It would be difficult indeed for the Congress to enact specific guides bearing upon the extent to which the Federal Reserve System should support the Government bond market, without arbitrary "pegging." But the Congress should declare a policy expressing its firm disapproval of the extent to which the System has recklessly abandoned essential support in recent years. And it would also be desirable for the Congress to declare that the money policy should be subsumed under the three great purposes of our economic life—growth, priorities, and justice.

The relative weight which the Federal Reserve System has placed upon open market operations, changes in reserve requirements and changes in discount rates, should be revised. The recent policies have been too generous in their impact upon certain group interests, even while being harshly restrictive in their treatment of other activities needing encouragement.

The so-called policy of "bills only" should be abandoned. It produces undesirable and unnecessary disturbances throughout the whole structure of interest rates.

Private commissions and public responsibilities

The Congress might also turn its attention to the extent to which vital public responsibilities have been delegated to private and *ad hoc* commissions of various sorts. Private research and education are essential aspects of our way of life, and should be encouraged. But private commissions to declare national goals, as recently encouraged by the Administration, cannot substitute for the public performance of those tasks which are explicit in the Employment Act, inherent in our whole concept of public responsibility, and essential to our national safety and progress.

The same comments apply to private inquiries into monetary policy. There is need for a more definitive and conclusive Congressional investigation of monetary policy than those which have occurred in recent years. These have indeed been useful, but they have fallen short of fundamental results.

How "independent" should the Federal Reserve System be?

There is no merit whatsoever in the whole idea that the Federal Reserve System should be dominated by private influence, rather than made largely subject to public influence, in order not to be "political." It should

be well-known that the Federal Reserve Board even now operates neither more or less "politically" than other agencies exercising public functions. More important, the idea that the money power should be privately rather than publicly orientated so as not to be "political" is as alien to the American tradition as would be any proposition that taxation or public regulation of business or price and wage controls during wartime should be privately orientated so as not to be "political."

Needed improvments in debt management proper

Some steps are also desirable at once with respect to debt management proper.

Every available device should be brought to bear upon the objective of a return to lower levels of interest rates. Bonds should be issued with callable features, to enable benefiting by any interest rate drops. Auction methods, applicable to Treasury bills, should be applied to long-term issues.

The 4¼ percent ceiling on long-term Treasury bonds should not be raised. With a genuine long-term policy commitment to lower rather than higher interest rates, with public authorities more independent of private pressures, and with effective support of Treasury operations by the Federal Reserve System, long-term borrowing would be feasible at much lower interest rates than this ceiling. And if this were not so, the Treasury should be forced to engage in short-term borrowing, rather than to "freeze" indefensibly high interest rates for many years ahead by long-term borrowing at these higher rates.

The private grouping which looms so large in trading in public securities should be more carefully scrutinized. Its "exclusive" nature should be modified in order to obtain more competition.

* * *

All of these technicalities are important, but they are not the heart of the matter. If we rise as a Nation and as a Government to the challenge of a long-term purposefulness in our national economic efforts, if we generate the national leadership to galvanize these efforts, and if we employ efficiently toward these ends the basic instrumentalities already in being, technical problems can be worked out successfully as we go along.

But if we do not get started quickly on these big things, a preoccupation with technicalities will merely serve—as it has served too much already—to obscure the great issues, and to enable those not concerned about the great issues to continue their operations injurious to the Nation's interests behind a smoke screen of obscurantism.

[July 1960]

CONFERENCE ON ECONOMIC PROGRESS

THE CONFERENCE ON ECONOMIC PROGRESS is a non-profit, non-political organization engaged solely in economic research, education, and publication of studies related to full employment and full production in the United States.

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INFLATION—CAUSE AND CURE, published July 1959, deals affirmatively with a vital domestic issue confronting the American people: How to combine price stability with the rate of economic progress necessary to assure full employment and production and to provide adequately for essential domestic and international programs.

TOWARD A NEW FARM PROGRAM, published December 1958.

Each of these pamphlets is available at 50 cents a copy.

CONFERENCE ON ECONOMIC PROGRESS
1001 Connecticut Avenue, N. W. Washington 6, D. C.

[1960?]

FACTS ABOUT INTEREST RATES

IN GENERAL:

Interest is a cost item -- it is the price of money.

Higher interest rates increase costs without increasing output. Therefore high interest is inflationary.

The Administration opposes increasing the prices of everything except money.

THE MATHEMATICS OF PUBLIC DEBT:

The increased cost to the taxpayer of a 1/4 of 1% rise in interest on one billion dollars of government bonds is $2.5 million a year; over 20 years it is $50 million.

Between now and December 1960 about $100 billion of Treasury borrowing must be undertaken. Each rise of 1/4 of 1% will add $250 million to the cost of carrying the debt each year; over 20 years it adds $5 billion.

A 1% increase in interest rates on $100 billion will add $1 billion a year, or $20 billion over a 20 year period, to taxpayer burdens.

None of this increased cost gives the taxpayer a dime's worth of additional services! Instead it pushes up the cost of all the other money he borrows.

The cost of interest on the public debt was $4.8 billion in 1946; $5.8 billion in 1952. It was estimated at $8.1 billion for 1960; the President has now raised it to $8.6 billion for 1960 because of interest increases in the past five months. This is more than the entire cost of the Federal government in any New Deal year before World War II. The total Federal budget in 1939 for all purposes was $7.9 billions.

EFFECT ON OTHER DEBT:

Government debt is roughly 1/3 of all federal, state, local, business and consumer debt. Gross debt, public and private, is roughly $900 billion.

Net debt (taking out trust funds, etc.) is over $770 billion.

The economy is paying 8 to 10 billions more this year for the use of money than it would have paid under the rates prevailing in 1952. This is a part of the inflation created by the Administration.

The Federal interest rate is basic to all others. Hence private interest rates and state and local interest rates will go up as the Federal interest rate goes up.

About $100 billion of personal, corporate and state-local debt will be negotiated between now and December 1960.

An increase of 1/4 of 1% will add $250 million to the cost of this debt in the first year; a 1% increase will add $1 billion.

EFFECT ON INDIVIDUALS

Higher interest makes homes more costly. In 1952, a $10,000 government mortgage at 4% interest would be paid off over 25 years at a total cost of $15,840, of which interest was $5,840. In 1959, the same mortgage, now at 5¼% can be paid off over 25 years at a total cost of $18,000, of which interest is $8,000. The increase of $2,160 would have been enough to pay for another bedroom and bath.

The higher income required for a GI to qualify as eligible to make the higher monthly payments means that fewer can afford to purchase homes.

Higher interest makes costs to farmers and small business even higher, and leads to more liquidations and bankruptcies.

Higher interest makes the cost of cars and home appliances more costly. It raises the cost of living and cuts the standard of living.

HISTORY:

The maximum rate of interest of 4-1/4% was fixed by Congress in 1917 in the Liberty Loan Act. The Treasury has operated within that ceiling through World War I, a depression, a boom, the Great Depression, World War II, postwar readjustment, and the Korean incident, down to date. Within that ceiling the Federal debt was pushed in a few brief war years from 45 billion to 270 billion, because the Federal Reserve cooperated with the Treasury.

The Treasury can sell its bonds without an increase in long-term interest rates and without inflation if the Federal Reserve will do what it did before -- demonstrate a willingness to do what it can to preserve the value of government securities and use its reserve requirement, rediscount and open market policies consistently to these ends.

The Federal Reserve notes in your wallet, which carry no interest, always trade at par. It is a sad commentary that government bonds, bearing interest, are permitted by the Federal Reserve to sag indefinitely in value. The Federal Reserve is supposed to provide an orderly market for government bonds. It should do so now. A firm statement by the Federal Reserve that it intends to do so, in a manner sufficient to meet the monetary needs of an expanding economy without inflation, would quickly firm up the market. Increased purchases by the Federal Reserve need not create inflationary pressure. A simple increase in reserve ratio requirements would prevent any inflation.

CONCLUSION:

It is economically sound, historically sound, and a proper discharge of our duties to oppose further increases in interest rates.

[June, 1963]

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AND THE PUBLIC INTEREST

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ADVANCE ECONOMIC AND SOCIAL JUSTICE

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JUNE, 1963

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I. Summary and Theme: Adjusting Tax Policy To Our Vital National Needs

The Administration has sounded the right note

President Kennedy deserves support in his courageous and historic decision to recommend a large deliberate increase in the Federal Budget deficit. Large tax reduction is now desirable, and even overdue. All experience and reason dictate this course, in an economy suffering for many years and now from vast idleness of manpower and plant. Restoration of the American economy to maximum economic performance is very much more important than whether the Federal Budget shows a deficit or surplus. And all experience and reason also make it clear that this restoration is the only safe or sure road toward improvement in the condition of the Federal Budget itself.

This study supports the general thrust of the President's efforts. But the President has also stated, with characteristic open-mindedness and recognition of the very nature of our Federal system, that the Congress may improve his tax proposal substantially. This study seeks to help point the way to this improvement.

The worsening current unemployment situation and outlook

In May 1963, full-time unemployment as officially reported rose to 5.9 percent (seasonally adjusted) of the civilian labor force. This was *higher* than in any month of 1962, despite a much-heralded quickening of the economic upturn thus far in 1963. And despite an economic upturn which started more than two years ago, the average rate of unemployment as officially reported during the first five months of 1963 was 5.8 percent, or considerably *higher* than the 5.6 percent reported for 1962 as a whole. Further, when account is taken of the full-time equivalent of part-time unemployment, and of the concealed unemployment resulting from the repressive effect of scant job opportunity upon the anticipated growth in the civilian labor force, the true level of unemployment during the first five months of 1963 averaged about 9.4 percent (seasonally adjusted) of the civilian labor force. This was slightly higher than in 1962, and contrasted more sharply with 8.5 percent in the non-recessionary year 1959 and only 5.8 percent in the non-recessionary year 1956. Most current forecasts are that unemployment will continue to rise substantially in the foreseeable future, unless stronger counteracting measures are taken.

Impact of unemployment upon the young, and upon racial tensions

Although the official reports show full-time unemployment at 5.9 percent of the civilian labor force in May 1963, the rate of unemployment when so measured was *18* percent among teenagers seeking permanent gainful employment for the first time. This contrasted with 14 percent in May, 1962. The human consequences of conveying to these young people the impression that our economic system can make no utilization of them are incalculable. These consequences go to the very roots of the rising tide of delinquency, crime, and low morale among the young.

Meanwhile, excessively large concentration of denial of economic opportunity among minority groups, and fear that any job gained by a member of a minority group takes a job away from somebody else, is much more at the heart of the rising tide of racial tensions than is usually acknowledged. The lesson we are now learning so painfully, having dealt inadequately with these potential racial tensions until they reached explosive force, should warn us of what may be in the offing if the amount of unemployment itself reaches explosive force—as it certainly will in a few short years if current trends continue.

Continuation of inadequate economic growth rate

The reasons for continuation of the chronic rise in unemployment are that the upward movement of the economy from early 1961 to date has been much too slow, compared with the growth rate required to reduce unemployment, in view of the growth in the labor force and the accelerated pace of automation, technology, and productivity gains. Contrasted with an economic growth rate in real terms of 7.8 percent during 1954-1955,* and 6.7 percent during 1958-1959,** the rate was only 5.4 percent during 1961-1962,*** only 3.3 percent from first quarter 1962 to first quarter 1963, and only 4.1 percent (seasonally adjusted annual rate) during the quickening of the upturn from fourth quarter 1962 to first quarter 1963.

Continuing rise in the production gap

The production gap is the difference between actual production and production at maximum utilization of our productive potentials. Measured

* Following 1953-1954 recession.
** Following 1957-1958 recession.
*** Following 1960-1961 recession.

in uniform 1962 dollars, this production gap rose from 4.5 percent of maximum production in 1956 to 9.2 percent in 1959, 11.6 percent in 1962, and a seasonally adjusted annual rate 11.9 percent in first quarter 1963.* In first quarter 1963, the seasonally adjusted annual rate of the production gap was in excess of 76 billion dollars. The much lower official estimate of this production gap—though still intolerably large—results from underappraisal of the rate of growth needed to achieve economic restoration, and this has been responsible for official overestimates of the expected reduction of unemployment to date.

The way is open for needed policy improvements

Aside from the current tax proposal, it is essential to point out that the disappointing economic developments since the commencement of the upturn from the 1960-1961 recession have not been due primarily to failure to achieve programs thus far recommended. These programs—area redevelopment, training and retraining of workers, public works, and the tax changes of 1962 (both legislative and by Treasury action)—were approved with modifications of no great significance to subsequent economic developments. The monetary policies of the Federal Reserve System during these years have met with the overt approval of the Administration.

The Trade Program was also enacted, partly on the ground that it would measurably help our own economy. Developments since then support earlier warnings that, while the Trade Program was eminently desirable on many grounds, it could not be expected appreciably to reduce domestic unemployment nor substantially to accelerate our rate of economic growth.** Efforts thus far to improve our balance of payments and gold position have not been more successful than forecast by earlier Conference studies. These studies suggested that the approach to this insistent problem has been inadequate.***

Significance of accuracy of previous Conference studies

The recommendations in this study may carry more weight because earlier Conference studies have been vindicated by subsequent events. In mid-1954, the first Conference study pointed to the danger that our average annual rate of economic growth might be only 2.5 percent during the period

* Again, only *non-recessionary* earlier years are contrasted with the current situation.

** See the Conference Study, *Poverty and Deprivation in the U. S.*, April 1962, especially page 2.

*** See *Key Policies For Full Employment*, Sept. 1962, especially Chapter VII.

1953-1960 as a whole.* This turned out to be exactly correct. In early 1961, a Conference study forecast that economic policies then in being and under active consideration were unlikely to achieve an economic growth rate anywhere close to the needed rate; and that early 1963 might well find us with full-time unemployment near 6 percent of the civilian labor force.** This also turned out to be entirely correct. In late 1962, in the face of other more optimistic forecasts, still another Conference study appraised quite accurately the economic developments during the nine months since then.***

The core reason for our poor economic performance

Persistent and chronically rising idle plant and manpower mean essentially that our actual demand for ultimate goods and services is falling far short of our ability to produce them. This actual demand for ultimate goods and services takes two forms: the private spending of almost 190 million consumers, and the public spending of governments at all levels for what we need as a nation but cannot buy individually nor through our private organizations. The core task, therefore, is to expand the volume of this private and public consumption sufficiently to draw forth maximum utilization of our manpower and plants on a sustained basis.

The problem of private business investment

Private business investment is the third component in total economic activity or total national production, the other two being private consumer spending and public outlays. This private investment also needs to expand at a more rewarding rate than it actually has on the *average* during the past decade as a *whole*.

But this long-term deficient average has not been caused substantially by an inadequate level of per-unit profit margins *after taxes,* nor by inadequate availability of other types of funds and saving available for investment. Entirely to the contrary, during each of the three periods of economic upturn following each of the three economic recessions since early 1953, private investment in the plant and equipment which add to our ability to produce has been so ebullient as to cause these means of production to expand far more rapidly than expansion of demand for ultimate

* *Toward Full Employment and Full Production,* July 1954, especially pages 32-34.

** *Jobs and Growth,* May 1961, especially Chapter IX.

*** *Key Policies For Full Employment,* especially Chapter I.

products through private consumption and public outlays. When the "overcapacity" resulting from these relatively excessive investment "booms" became sufficiently large, investment was cut back sharply. And this, along with the much larger deficiencies in demand for ultimate products, brought on the periods of economic stagnation and recession.

We are not now in a period of economic recession. But we *are* in a period approximating stagnation, when our actual growth rate is measured against our needed growth rate at this stage of the restoration process. And the same imbalances between investment and ultimate demand which brought on our earlier difficulties are manifest in the economy today.

Errors in national economic policies, relevant to our poor economic performance

During the period under review, Federal spending has been held too low. The tight money policy and higher interest rates have redistributed scores of billions of dollars in a regressive direction, and also reduced funds available for public spending for constructive purposes, thus contributing to the imbalances between investment and consumption. Many programs, such as the Social Security program, have not been expanded rapidly enough to do their share toward adequate expansion of consumption. Farm income, despite some improvement, has not been brought close enough to parity with other incomes on a *per capita* basis. Popular and public pressures, exerted for the legitimate purpose of preventing wage rate increases from exceeding productivity gains, have in practical consequence resulted in wage rate increases during the most recent years which have lagged far behind productivity gains, thus adding greatly to the private consumption deficiency.

Undesirable trends in national tax policies, 1945-1963

Federal personal income tax changes from 1939 through 1945 had a very progressive effect upon income distribution, in that they helped those at lower levels of income more than those higher up. This was one among many factors which contributed to our phenomenal economic performance during World War II, and to rising living standards despite immense allocation of our resources to war production. But tax changes since 1945, including the tax changes of 1948, 1954, and 1962, have been regressive, in that they have helped those at the higher levels of income more than those lower down. Aimed excessively at stimulation of investment, and insufficiently at stimulation of private consumption, these tax policies have accentuated the imbalances at the center of our economic difficulties. These regressive tax changes have also worked against advancement of economic and social justice.

While tax reductions in 1954 gave a temporary fillip to the economy and helped to reverse the 1953-1954 recession, we at no subsequent time achieved anywhere near full economic restoration. And the Federal tax structure which has existed from 1945 forward has been among the factors in the unsatisfactory economic growth rate 1953-1963, including three recessions.

Regressive nature of State and local taxation

The adverse effects of the trend since 1945 toward a *less* progressive Federal tax policy—which really means a regressive trend—have been greatly aggravated by the absolutely regressive nature of State and local taxation. When *all types of taxes at all levels* are taken into account, our economy is functioning, and our people are living, under a tax system which we do not comprehend at all when we look only at the Federal personal income tax structure.

Main defects in the 1963 tax proposal

Drawing upon this analysis, the main defects in the 1963 tax proposal are:

(1) Without the reforms, and properly taking into account the corporate tax concessions of 1962, this study estimates that the proposal would assign about 8 billion dollars of the total tax cut to the stimulation of investment, and about 7.5 billion to the stimulation of consumption. This estimate necessarily takes into account, not only the corporate tax cuts, but also the proportion of the personal tax cut received by higher income taxpayers which they would be likely to save for investment purposes.* Taking into account the proposed reforms, this study estimates that more than 4½ billion dollars of the total net tax changes would be assigned to the investment function, and less than 6¼ billion to the consumption function. This pattern of allocation between the investment

* If these families were to save much less and spend much more of their tax cuts than this study estimates, which might happen, the very substantial lifting of their living standards concurrently with very little improvement in the living standards of lower income families, by means of tax reduction, would be indeed indefensible on general social grounds.

function and the consumption function, without or even with the reforms, is ill-adjusted to our economic problem today, and repeats errors committed in earlier years;

(2) The proposed personal tax cuts would redistribute income regressively. The personal tax cuts without the reforms would increase the disposable (after-tax) income of the $3,000 income taxpayer by only 0.4 percent; the $5,000 income taxpayer, 1.8 percent; and the $10,000 income taxpayer 3.5 percent. But the disposable income of the $50,000 income taxpayer would be increased 9.7 percent; the $100,000 income taxpayer, 16.3 percent; and the $200,000 income taxpayer 31.1 percent.*

Even with the reforms, the disposable income of the $3,000 income taxpayer would be increased only 2 percent; the $5,000 income taxpayer, 3.1 percent; and the $10,000 income taxpayer, 3.5 percent. But the disposable income of the $50,000 income taxpayer would be increased 6.3 percent; the $100,000 income taxpayer, 11.2 percent; and the $200,000 income taxpayer, 23.8 percent. This kind of distribution of tax reduction would work counter to a sustainable balance between investment and consumption, and is not justifiable on economic or social grounds.

It is no answer to say that, because of the current structure of the Federal personal income tax system, any substantial reduction of tax rates must result in the high income taxpayer receiving a much larger percentage increase in his disposable income than the low income taxpayer. It is perfectly feasible, as will be shown, to reconstruct the proposed personal income tax cuts so as to avoid this consequence. Besides, as will also be shown, programs other than tax reduction should be relied upon more heavily in order to promote the needed economic and social results;

(3) The proposed tax changes are also too small and far too slow to add much toward economic restoration. This study estimates that, for reasonably full economic restoration sometime in 1965, our total national production needs to be about 57 billion dollars higher in 1964, and about 85 billion higher in 1965, than it is likely to rise to if our national economic policies were to remain virtually in *status quo*. Vividly in contrast with these needed additions of 57 billion and 85 billion, respectively, this study estimates that the proposed tax reduction, including all of its indirect effects, would add only about 12.9 billion dollars to what total national production would otherwise be likely to rise to in the first calendar year in

* Assuming a married couple with two children or other dependents. The changes in disposable incomes are what really count. The percentage cuts in tax rates are merely mathematical formulae for arriving at the income results.

which the proposal would be applied, and would add only about 27.6 billion to what total national production would otherwise be likely to rise to in 1965 or 1966, the first year when the tax proposal would be in full effect.

Needed changes in tax plan: 10 billion dollar tax cut now, benefiting mainly the low- and middle-income taxpayers

(1) The first priority immediate tax action should be limited to cutting the 20 percent flat rate, applicable to the first $2,000 of taxable income, to an average rate of considerably less than 15 percent, with much larger reduction in the rate applicable to the first $1,000 than to the second $1,000. For a married couple filing a joint return, the lower of these two rates would be applicable to the first $2,000, and the higher to the second $2,000. In addition, the standard exemption for a family of four, now $2,400, should be lifted to $3,400. Even this would be about 53 percent *lower* in real terms (allowing for the change in the purchasing power of the dollar) than the $3,300 exemption in 1939. This first priority tax reduction would have an annual value of about 10 billion dollars, all of which should take effect at once;*

(2) All other tax action should be deferred until the first priority tax cut is accomplished. The attempt to combine all phases of tax reduction in one extremely complex tax package is almost certain to prevent sufficient focus upon the first priority need, jeopardize some of the desirable tax reforms, lead to enactment of some very undesirable so-called "reforms", and result in a net tax program very poorly adjusted to economic growth, the priorities of our national needs, and economic justice;

(3) Reductions in corporate tax rates are not needed for reasons already stated, and would be wasteful when compared with other great national priorities which could be served through an equivalent increase in Federal domestic public spending. Some slight corporate tax reduction might be desirable, if concentrated upon improving the position of small business;

(4) Personal income tax cuts for those in the upper-middle and higher income groups, beyond the benefits which they would receive from the first priority tax cut suggested above, are not of high urgency on economic grounds, and of no urgency on social grounds. When such tax cuts are undertaken, they and any corporate tax cuts should be compensated for in full by the closing of loopholes.

* A simple alternative method, accomplishing close to the same result, would leave the present tax structure intact, but allow every taxpayer, spouse, and dependent a credit of $1.50 per week against a tax liability computed under present law.

Why tax cuts alone cannot carry the whole load

Even the 10 billion dollar personal tax reduction suggested in this study, including its effects upon the stimulative value of the 1962 tax action, would increase total national production by only about 36 billion dollars in the first full year. As already indicated, this would be much too little. Beyond this, the nature of the unemployment problem requires vigorous additional approaches. Tax reduction at best would stimulate more demand largely for types of goods now being produced by industries where the rate of elimination of jobs by technology and automation is extremely rapid. Because of these industrial trends, expansion of job opportunity in these industries in the years ahead would be severely limited, even if the demand for their products were increased to the maximum limits of feasibility.

Thus, private and public investment must be expanded greatly with respect to those types of goods and services for which our national needs are so huge and pressing that even the trends in technology and automation would not prevent vast job expansion in these areas. These areas include housing and urban renewal, mass transportation, resources development, educational and health services and facilities, and a wide range of other human services. This will require much more Federal spending, not only for purely public programs, but also as a part of new admixtures of public and private spending—such as those required for renewal of urban areas.

Immediately needed 3 billion dollar increase in the Federal Budget for domestic programs

Towards these employment ends, and even more so because of our national needs for the programs themselves, this study proposes an immediate 3 billion dollar addition to the domestic programs now contained in the fiscal 1964 Budget (without reducing any of the items in that Budget for national security and other international purposes, and for space research and technology). As elements in a long-range program to meet adequately the great priorities of our domestic public needs, consistent with our growing economic potentials, this study suggests that *per capita* Federal outlays for education should be almost tripled, comparing calendar 1966 with the fiscal 1964 Budget. Outlays *per capita* for health services and research should be almost doubled, and outlays for housing and community development should be multiplied about eight times.* Outlays *per capita* for all domestic programs (measured in

* In absolute terms, the educational increase would be by far the largest. For elaboration of these and other needs, see the Conference study, *The Federal Budget and "The General Welfare,"* December, 1959.

uniform 1962 dollars) should rise from $186.83 to $221.11.

However, in a properly growing economy, total Federal outlays for all purposes as suggested in this study (allowing also for indicated increases for national security and other international purposes, and space research and technology) would decline from an estimated 16.80 percent of total national production in fiscal 1964 to 15.91 percent in calendar 1966. This means that, even with the suggested tax reduction and spending increase program, we could in the years ahead, as a dividend on adequate economic growth, come much closer to a balanced Federal Budget over the years immediately ahead than during the past decade, and balance the Budget when maximum prosperity is sustained for a few years.

Need for still other expansionary national economic policies

Even the suggested combination of tax reduction and increased public spending would neither fully restore nor adequately maintain maximum employment and production. As already suggested, the whole Social Security program needs to be greatly liberalized. Improved farm legislation is essential. The minimum wage floor needs to be higher, with coverage expanded. Instead of the deplorable current tightening of monetary policy by the Federal Reserve System, we need a much more expansionary monetary policy and much lower interest rates.

With all of this, the major portion of needed growth must come through expansionary action in the private sector of the economy. But the first inducement to this expansionary action would be the concrete assurance by the Federal Government that it is responding fully to its obligations under the Employment Act of 1946.

Improved implementation of the Employment Act of 1946

The basic reason why current policy proposals are not sufficiently attuned to our national capabilities and needs is that they have not been geared adequately to the long-range and short-range quantitative goals for maximum employment, production, and purchasing power called for by the Employment Act of 1946.

Even while Western European countries are achieving high growth rates and low unemployment under "indicative planning", we are not utilizing fully the very Employment Act which initially inspired these efforts overseas.

Even while these countries have learned from us the manifold economic benefits of mass consumption, we are moving away from our earlier prime stress upon this factor in economic growth.

Even while so much of the world has come to associate economic growth with reduction of poverty and advancement of social justice, we are insufficiently recognizing that, especially in view of our unrivaled productive powers, rapid reduction of poverty and advancement of social justice are prerequisites for adequate and sustained economic growth.

And even while the totalitarians, despite some miscalculations and setbacks, are continuing to outpace us in their rates of economic growth, we have not marshalled that national purposefulness about which we talked so much after the first Sputnik in 1957—an all-embracing purposefulness applied just as vigorously to our great domestic needs as to maintaining our national security and landing on the moon.

This study has been directed by Leon H. Keyserling, with the assistance of Mary Dublin Keyserling, Philip M. Ritz, and Nettie S. Shapiro.

II. What Is Tax Policy Really For?

Our three great economic purposes

Much of the current conflict and perplexity about tax policy arises from not keeping clear the vital distinction between means and ends. Unlike rising living standards and opportunities to do useful work, no tax policy is an end objective, good for its own sake. Tax policy is merely the means to some other end. We therefore cannot discern desirable changes in tax policy, without gearing these changes to our great economic ends or purposes as a Nation and a people. These three great purposes are:

(1) *To achieve steady and optimum economic growth.* This means calling forth maximum use of our manpower and brains, technology and science, and natural resources, in accord with the "maximum employment and production" objectives of the Employment Act of 1946. The more effectively we do this, the stronger we become in an economic sense, and the better able to afford what we need to do;

(2) *To apportion total national production in accord with the relative priorities of our needs.* Utilization of our total resources is now so slack that to talk about a "choice" between more consumer goods and more schools is a fundamental misstatement of our current problem. Nonetheless, we must always make sure that we do not get more gimcrack gadgets and not enough defense, education, and medical care;

(3) *To advance the frontiers of economic and social justice.* The economic growth purpose might be attained, and a substantial part of the priority purpose attained, even while large portions of our population were denied fair participation in the fruits of this progress.

Prevention of inflation is not a fourth great economic purpose. Inflation should be prevented because it imperils these three great purposes.

These three great purposes are also interdependent. In the nature of the American economy and our free institutions, we cannot meet the priorities of our national needs without maximum economic growth. Nor can we maintain maximum growth without meeting the great priorities of our national needs, or without a distributive system which expands economic and social justice.

Economic requirements for achieving these three great purposes

Our people, their various privately organized efforts, and their public institutions, are admirably endowed to move steadfastly toward these three great purposes. But the central economic requirement, *by no means yet*

achieved, is that there be balanced growth of (a) investment in the means of expanding production, and (b) the demand for ultimate products in the form of both private and public consumption (public demand for goods and services). If (a) seriously exceeds (b), idle resources, recessions, and low growth result; if (b) seriously exceeds (a), inflation takes its toll.

It is essential also that the composition of investment be well-balanced; that the distribution between private and public consumption be consistent with serving sufficiently the great priorities which depend upon public programs; and that the distribution of both private consumption and public services be compatible with justice.

How well these economic requirements are met depends upon the volume and distribution of purchasing power through private and public spending. This is what is meant by the "maximum purchasing power" objective of the Employment Act.

The proper role of Federal public spending and taxation

This flow and distribution of purchasing power is affected by all important private and public economic policies, and very powerfully affected by Federal public spending and taxation.

Contrary to some thought and action, the prime purpose of Federal spending is *not* to help maintain a sufficiently high level of economic activity, although it has that important function among others. The towering central purpose of Federal spending is this: to serve those great priorities of our national security and domestic needs which cannot be served at all, or cannot be served as well, in some other way. This means that the level of Federal spending should be determined by estimating what the total output of our economy would be under maximum production, and then deciding as a matter of national policy what part of this maximum output should be allocated through Federal spending to these great priority purposes.

If the national economy as a whole is producing far below maximum levels and has large slack resources, this is certainly no reason to reduce or hold Federal spending to levels below those arrived at by the method just set forth. We should never sacrifice great national priorities when idle resources are available to serve them, just because a slack economy is not yielding enough tax revenues to cover all of the bill. In that event, deficit financing should be used to help take up the economic slack. To permit this slack to continue is bad even for the Federal Budget in the long run.

On the other hand, if our economy is faced by severe pressures upon its productive resources (i.e., severely inflationary conditions), Federal spending should in general be held at levels arrived at by the method suggested above. If inflationary pressures make it desirable that we cut back somewhere, appropriate measures should be adopted to reduce or restrain other types of spending of lower priority than the Federal Budget, so that the great purposes of our national economic life may not be sacrificed to secondary purposes.

Taxation (unlike public spending for needed purposes) has little or no creative value in itself. Thus, *after* the level of Federal spending is appropriately determined as indicated above, tax rates should be high enough to run a budgetary surplus when we are threatened with excessive inflationary pressures, and low enough to result in a substantial deficit when we suffer from large unemployment of plant and manpower. Beyond this, the distribution of the tax burden has great bearing upon relative rates of private investment and consumption, and also upon economic and social justice.

Deficiencies in current approaches to tax policy

These comments have large bearing upon the inadequacy of current efforts to activate the economy by tax reduction, *without* first acting upon the fact that much higher levels of Federal spending (in addition to defense, space, and international) are imperative to serve the greatly neglected priorities of our domestic public needs. Even with such accelerated Federal spending in appropriate amounts, the current and foreseeable economic situation would call for substantial tax reduction. But the nature of the proposed tax reduction is not well adjusted to promoting a workable balance between investment and consumption, and therefore not well adjusted to accelerating economic growth. Moreover, the proposal is regressive in its impact upon an income distribution structure which still needs much progressive improvement in order to serve the great priorities of our national needs and to advance economic and social justice.

Admittedly, changes in tax policy are now being proposed with the intent of furthering these purposes, especially to accelerate growth. But we are now in grave danger of going wrong on tax policy (and on other economic policies as well), because we are not gearing these means sufficiently to our great economic ends or purposes. To appreciate why this is so, it will be helpful next to examine our national tax policies during the past quarter-century in the perspective of the great purposes which tax policy should serve.

III. The Progressive Nature of National Tax Policy, 1939-1945

Distribution of increased personal tax burden, 1939-1945

Due to World War II, the burden of Federal personal income taxes was very much higher in 1945 than in 1939. This increased burden (as the term "increased burden" is used in this discussion) is not measured by the total increase in taxes collected, much of which was due to the vast expansion of production, employment, and incomes. The increased burden is measured rather by the increases in tax collections due to higher tax rates.

How was this increased burden distributed? This question may be answered by showing how much more taxes people in various income groups paid in 1945 than they would have paid in 1945 if effective tax rates had remained the same as they were in 1939.

In 1945, as shown by the first chart following this chapter, those with incomes under $3,000 comprised more than 55 percent of all tax returns filed, but paid less than 32 percent of the total tax increase attributable to the increases in tax rates. The 2.8 percent of all those filing returns who had incomes of $10,000 and over paid 27.4 percent of the tax increase attributable to the tax rate increases; the 0.91 percent with incomes of $20,000 and over paid 17.2 percent; and the 0.16 percent with incomes of $50,000 and over paid 5.7 percent. This indicates that the higher income people, relative to their number, bore a larger share of the increase in the tax burden, and the lower income people a smaller share. In other words, the distribution of the increase in the tax burden was progressive.

It is also revealing to look at the impact of the increased tax rates upon the disposable (after-tax) incomes of taxpayers at various income levels.* In this connection, a very erroneous impression results from focusing upon the percentage increases in tax rates; as shown on the second chart following this chapter, the $5,000 income taxpayer had a 2,000 percent increase in his tax rate,** while the $200,000 income taxpayer had only a 73.6 percent increase. But more realistically, in terms of the change in disposable income which is the ultimate economic and social result of any change in effective tax rates, the $3,000 income taxpayer suffered a disposable income decrease of only 6.9 percent; the $5,000 income taxpayer, 12.1

* In this and similar discussion, the taxpayer is assumed to be married and have two children or other dependents; a flat 10 percent deduction is allowed for taxes, interest, contributions, etc.

** The increase in the tax rate of the $3,000 income taxpayer cannot be computed, because he paid no tax in 1939.

percent; the $10,000 income taxpayer, 17.0 percent; the $50,000 income taxpayer, 37.3 percent; the $100,000 income taxpayer, 45.3 percent; and the $200,000 income taxpayer, 51.2 percent. These data show more clearly that the tax rate changes had a progressive effect upon income distribution.

Changes in corporate and other tax rates, 1939-1945

It is unnecessary, for the purposes of this study, to examine the changes in corporate and other non-personal tax rates in detail, because problems as to the distribution of the increased tax burden with respect to these types of taxes are not of significance comparable to the significance in the case of personal taxes. Subsequently in the discussion, the general significance of the changes in these types of taxes are dealt with. Suffice it to say at this point that corporate tax rates were immensely higher in 1945 than in 1939. A heavy excess profits tax was also imposed. Estate and gift taxes were also raised substantially.

Economic and social effects of 1939-1945 tax changes

Although many other powerful factors influenced the economy, it is nonetheless feasible to evaluate the economic effects of these tax changes. Despite heavy increases in both personal and corporate tax rates, growth in total national production out-distanced the most optimistic expectations. Business and personal initiative was augmented, not repressed. High economic growth and full employment led generally to rising living standards, despite the extremely high allocation of output to direct war purposes. The numbers and percentages living in poverty were reduced at an unusually rapid rate. The progressive redistribution of after-tax income, through the changes in tax policy, abetted both economic growth and social progress.

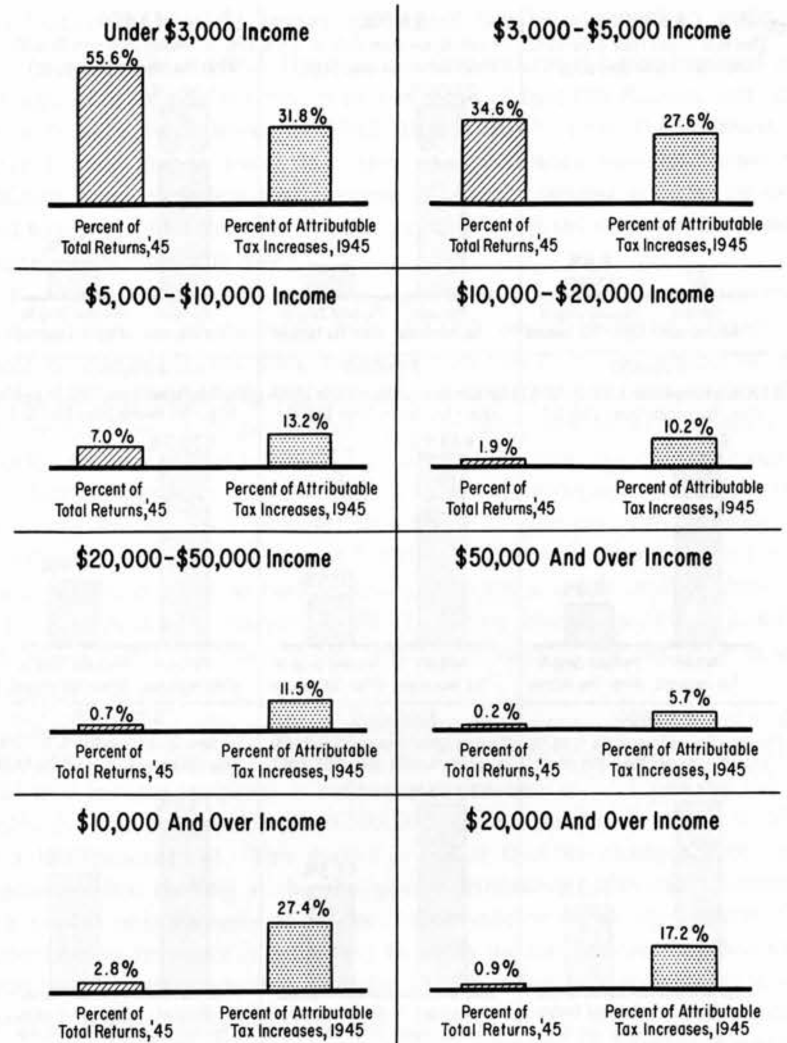
Tax increases during World War II may have been too small

The only important criticism of our national tax policies from 1939 through 1945 might be that taxes were not lifted enough. About half of the increased public costs resulting from World War II was financed by borrowing rather than by the increased tax take. This built up huge wartime savings, which tended to increase inflationary pressures in the immediate postwar years when these savings were injected into the spending stream too rapidly because of the premature abandonment of controls. But on balance, the utilization of these savings helped to prevent the kind of serious economic downturn which occurred during 1921-1922 following World War I, and which many had expected after World War II.

The two following charts relate to this discussion.

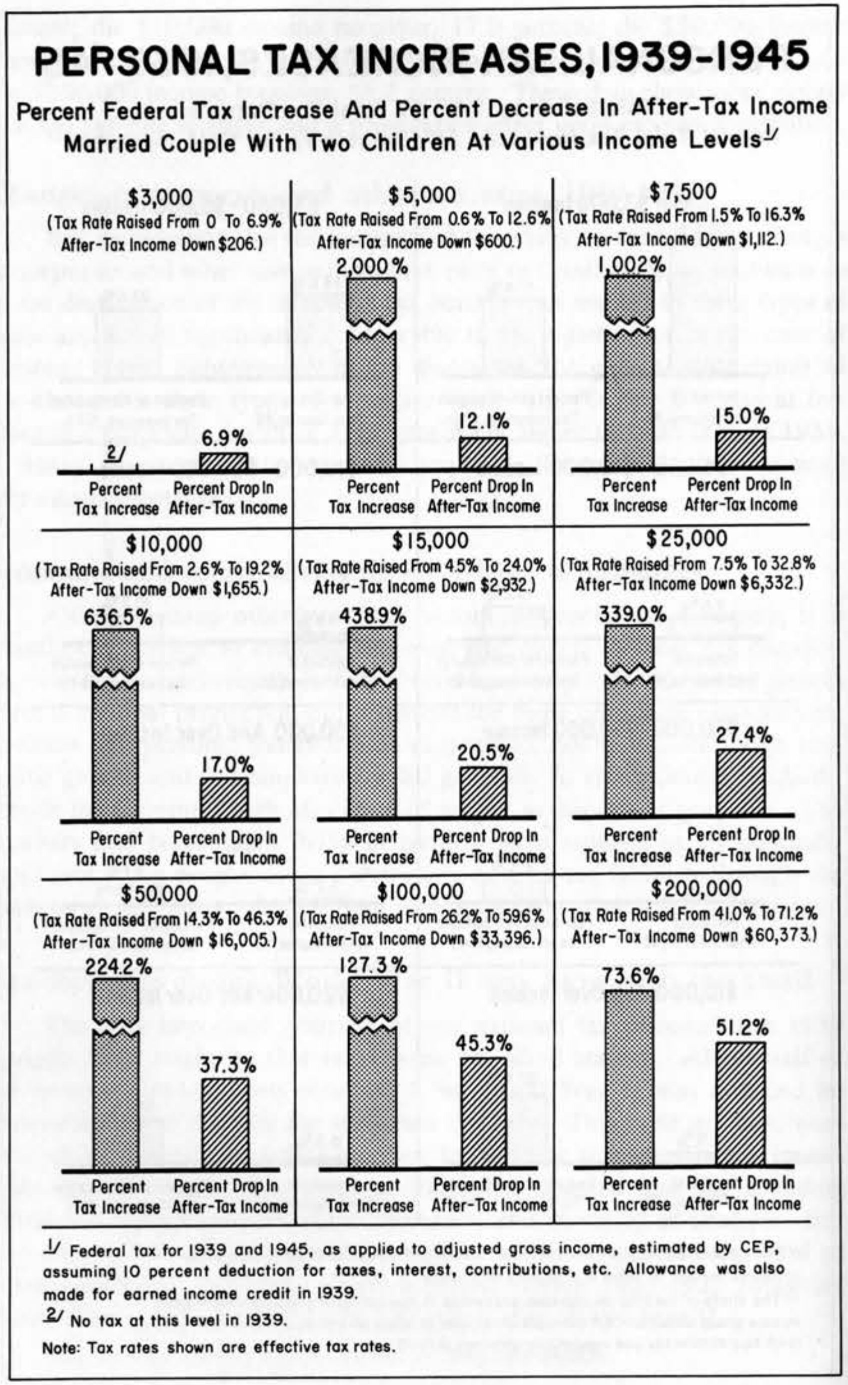
PERSONAL TAX INCREASES, 1939-'45

Distribution In 1945 Of Total Tax Returns[1/] And Of Total Tax Increases Attributable To Tax Rate Increases[2/]



1/ Percent distribution of 1945 tax returns (taxable and nontaxable) by income group estimated by CEP on basis of Treasury Dept. data.

2/ The share of the total tax increase applicable to the adjusted gross income of each income group based on CEP estimate of amount of taxes which would have been paid in 1945 had 1939 rates and regulations obtained in 1945.



IV. Regressive Trends In National Tax Policy, 1945-1963

Distribution of the decreased personal tax burden, 1945-1963

The end of World War II properly set in motion the trend toward tax reduction, and, despite a reversal of the trend during the Korean war, tax rates were very much lower by 1963 than in 1945. How the decrease in the tax burden due to lower tax rates was distributed may be shown by examining how much less taxes people in various income groups are estimated to pay in 1963 than they would pay in 1963 if tax rates had remained the same as they were in 1945.

For 1963, as shown by the first chart following this chapter, it is estimated that those with incomes under $3,000 would comprise almost 33 percent of all tax returns filed, but would receive only 3.4 percent of the total tax cut attributable to the decreases in effective tax rates (below the 1945 level). The 12.29 percent of all those filing returns with incomes of $10,000 and over would receive 57 percent of the total tax cut attributable to the decreases in tax rates; the 1.87 percent with incomes of $20,000 and over would receive 24.8 percent; and the 0.31 percent with incomes of $50,000 and over would receive 8.7 percent. This indicates that the lower income people, relative to their number, enjoyed a much smaller share of the decrease in the tax burden, while the higher income people enjoyed a much larger share. In other words, the distribution of the decrease in the tax burden was regressive.

Turning to the effect upon a taxpayer at a given income level,* the second chart following this chapter shows that, comparing 1963 with 1945, the $3,000 income taxpayer is estimated to receive a 70.9 percent cut in his effective tax rate, while the $200,000 income taxpayer would receive only a 19.1 percent cut. This makes it appear that the changes were very progressive. But looking at the changes in disposable (after-tax) incomes, which are the only changes of practical economic or social significance, the $3,000 income taxpayer is estimated to enjoy an increase of only 5.2 percent in his disposable income, and the $5,000 income taxpayer only a 4.8 percent increase; the $10,000 income taxpayer would enjoy a 6.7 percent increase; the $50,000 income taxpayer, 26.7 percent; the $100,000 income taxpayer, 36.9 percent; and the $200,000 income taxpayer, 47.2 percent. It is thus made even clearer that the 1945-1963 reductions in tax rates

* Using same assumptions as to family size and deductions as in previous chapter.

were highly regressive in their effects upon income distribution.

Some may argue that the same considerations which made the distribution of the increase in the tax burden progressive when taxes were being sharply increased during the period 1939-1945 appropriately made the distribution of the decrease in the tax burden regressive when taxes were sharply reduced during the period 1945-1963. This argument would be correct only if the distribution of the total Federal personal tax had become too progressive as of 1945, from the viewpoint of its impact upon economic growth and incentives. (It was certainly not too progressive from the viewpoint of economic and social justice, considering the vast disparities in disposable (after-tax) incomes even in 1945, and the many millions of families and individuals still living in poverty and deprivation.) But, as shown in the previous chapter, the distribution of the tax burden as of 1945 was entirely consistent with our fantastic growth achievements and high economic incentives during World War II. And as is shown subsequently in Chapter VII, the much less progressive distribution of the tax burden more recently has worked against adequate economic growth. It has done this mainly by creating periodic maladjustments between (a) investment in expanding the means of production and (b) private consumer demand. It follows that the necessary reduction of taxes after 1945 should not have moved so far in the direction of less progressive taxation.

Changes in corporate tax treatment, 1945-1963

The Revenue Act of 1945 repealed the excess profits tax as of January 1, 1946, and also reduced the corporate surtax rates. The 1954 Revenue Act permitted, as of the end of 1953, the expiration of the excess profits tax imposed during the Korean war. The same Act introduced a liberalized treatment of depreciation allowances, and also liberalized some other business allowances. This trend was carried considerably further by Congressional and Treasury action in 1962. The excessively favorable tax treatment of business investment and its consequences are discussed fully in Chapter VII.

But it should be noted at this point that, even in early 1957, when "overcapacity" relative to demand for ultimate products was abundantly apparent, the Administration and the Federal Reserve System both urged restraint upon consumption and more emphasis upon investment, although the portents of the oncoming recession were in full view. The further tax concessions to investors by legislative and administrative action in 1962, while not yet succeeeded by another recession, evidenced a similar misplacement of emphasis.

Misinterpretation of consequences of 1954 tax reductions

Some analysts say that the tax changes of various sorts contained in the Revenue Act of 1954, when combined with the very large automatic reductions of tax rates in 1954 under earlier legislation, contributed mightily to the economic recovery after the 1953-1954 recession. But these analysts overlook that the deficiencies in the tax structure after 1945 and on into 1953 were among the factors inducing this recession.* Further, the deficiencies in the tax structure from 1954 forward (including the tax changes in that year) were among the factors which prevented the recovery following this recession from bringing us back at any time to conditions anywhere near maximum employment and production. Thus, these 1954 tax changes, even while they gave the economy a temporary "shot-in-the-arm," in the longer run were not of the type suited to maintain adequate economic growth. This lesson has great relevance to the current tax proposal. To illustrate, although we had a big upturn in 1954-1955, our economic growth rate in real terms was only 2.1 percent from 1955 to 1956, and only 1.9 percent from 1956 to 1957. Thus, the assertion by the Council of Economic Advisers and others that our chronic problem of an inadequate growth rate commenced in 1957 rather than in 1953 is questionable. And of course, deficiencies in the tax structure continued to be one of the important factors which induced (a) the recessions of 1957-1958 and 1960-1961, and (b) our very unsatisfactory growth rates even during the non-recessionary periods between 1958 and 1963.

Summary of overall effects of tax trends, 1945-1963

There can be no doubt that the huge tax reductions immediately following World War II, coupled with the tremendous accumulation of savings which resulted from the method of financing the war and other reconversion policies, helped very much in smoothing out the transition from war to peace. Even so, the tax changes which commenced as World War II ended resulted by the time of the 1954 tax changes in a tax structure ill-suited to our economic and social needs during the past decade.

The difference between the tax structure from 1954 forward through 1963, and the tax structure as it was in 1945, had a regressive effect upon income distribution. Especially during the past decade, our progress towards reducing poverty and deprivation among scores of millions of Americans has slowed down to a snail's pace.** Our rate of economic

* By distorting the relationship between investment and consumption. The recession of 1949 was also due in part to errors in national economic policy, including the regressive trends in tax policy from 1945 forward.

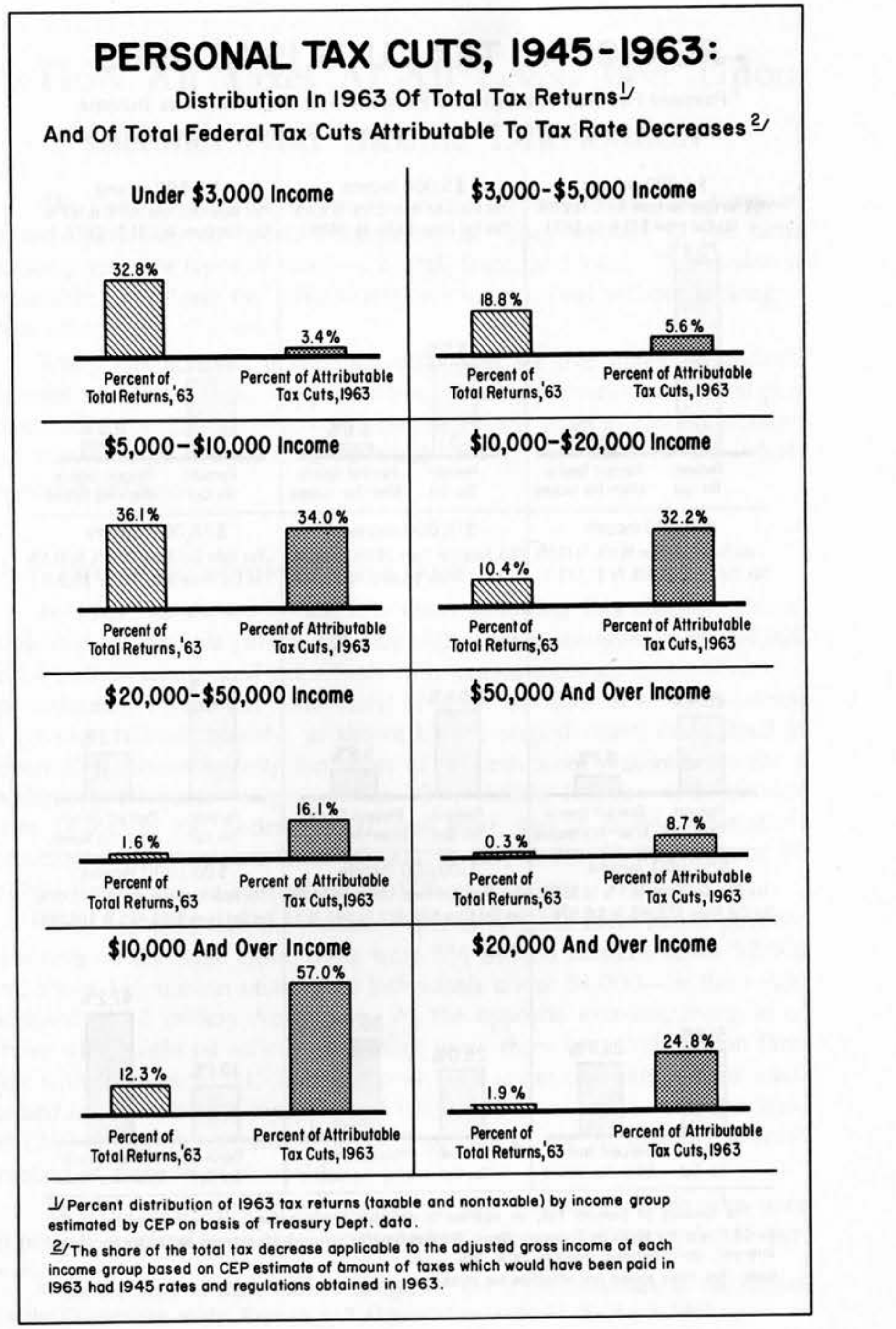
** As treated more fully in Chapter V.

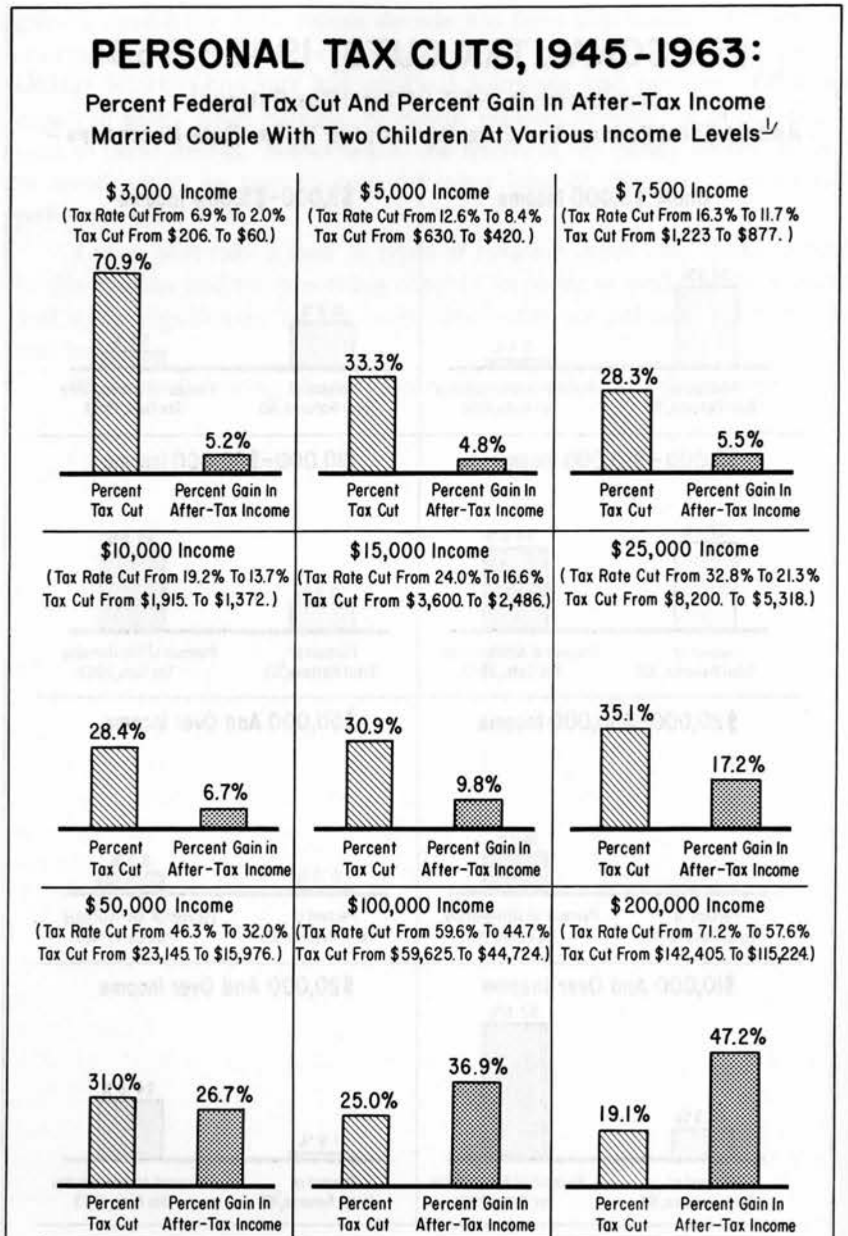
growth during the most recent decade has been abysmally low,* involving enormous harm to our private and public priorities at home, and also serious effects upon our international purposes and prestige. Of course, errors in many other national economic policies besides tax policy contributed to these results. Nonetheless, the trends in tax policy should be borne in mind, when we turn to consider what kind of changes in national tax policy we need now.

Let us next take a look at types of taxation other than those discussed in this chapter and the preceding chapter, in order to evaluate the economic and social significance of our total nationwide tax policies, Federal, State, and local.

The two following charts amplify the materials in this chapter.

* As detailed in Chapter VI.





1/ The amount of Federal tax, as applied to adjusted gross income, was estimated for 1945 by CEP and for 1963 by Treasury Dept. Both estimates assume 10 percent deduction for taxes, interest, contributions, medical care, etc.

Note: Tax rates shown are effective tax rates.

V. How All Taxes At All Levels Bear Upon Incomes And Income Distribution

The Federal personal income and corporate tax policies just discussed do not operate in an isolated compartment. They operate in the same economy as other types of taxes—Federal, State, and local. This makes it impossible to evaluate the Administration's tax proposal without looking at these other types of taxes.

When this is done, it becomes clear that we live under an entirely different tax system than is apparent from looking primarily at Federal personal and corporate tax rates—different especially in its effects on incomes and income distribution, both of which are at the heart of our whole economic problem.

U. S. income distribution before taxes

In 1961, as shown by the first chart following this chapter, almost 10½ million multiple-person families with annual incomes under $4,000 and 4 million unattached individuals with annual incomes under $2,000—approximately 38 million Americans, or about one-fifth of a nation—lived in poverty. Simultaneously, as shown by the second chart, there lived in deprivation, above poverty but short of the minimum requirements for a moderately adequate budget, almost 10⅓ million families with incomes from $4,000 to just under $6,000, and more than 2 million unattached individuals with incomes from $2,000 to just under $3,000—about 39 million Americans, or more than one-fifth of a nation.

With less than half the income required to place them above poverty, as shown on the same chart, there were 3⅕ million families under $2,000 and about 1⅘ million unattached individuals under $1,000—in the neighborhood of 12 million Americans. At the opposite extreme, living at or above what might be called the affluent level, there were 3½ million families with incomes of $15,000 and over, and about one-half million unattached individuals with incomes of $7,500 and over—in the neighborhood of 13⅓ million Americans, or about 7 percent of the population. A small fraction of these lived in wealth.*

In 1961, the close to 21 percent of the American people who lived in poverty received less than 7 percent of total personal income; the 43 per-

* For the basis of these income categories, and a full discussion of the subject, see the Conference study, *Poverty and Deprivation in the U. S.*, April 1962.

cent who lived in poverty or deprivation received 21 percent; and the 7 percent who lived in affluence or wealth nearly 24 percent.

Recent slowdown in reduction of poverty

During the three decades 1929-1960, the total number of Americans living in poverty was reduced at an average annual rate of 2.2 percent. From 1935-1936 to 1947, the average annual rate of reduction was 4.8 percent, due to the permanent economic reforms of the 1930's when united with the transition from the Great Depression years to the great economic expansion of the World War II era. During the years 1947-1953, also characterized in general by reasonably high economic growth and employment, the average annual rate of reduction was 2.7 percent. But during the years 1953-1960, marked by very low economic growth and chronically rising idleness of manpower and plant, the average annual rate of reduction in the total number of Americans living in poverty dropped to 1.1 percent. There was no reduction in the number of families with incomes of less than half the amount needed to lift them above poverty, and practically no reduction in the number of unattached individuals living in poverty.*

The period of reasonably high economic growth and employment from the start of World War II to 1953 showed progressive trends in income distribution. But during the period of low economic performance 1953-1960, distribution of income worsened slightly. The shares of total personal income flowing to the lowest income fifth of all consumer units, to the second lowest, and to the third lowest, all declined. Meanwhile, the share flowing to the two highest income fifths rose. By 1961, the highest 5 percent of all consumer units received almost 20 percent of total personal income, or very much more than the 15½ percent of income received by the lowest 40 percent of all consumer units (families and unattached individuals).**

Effect of Federal personal income tax on income distribution

The progressive nature of the Federal income tax has meant that distribution of income after this tax has been more favorable to the bulk of the people than distribution before this tax. But even looking at the after-tax picture, as shown by the third chart, the 13.3 percent of all consumer units who had incomes under $2,000 in 1961 received only 2.4 percent of total

* These findings take account of changes in the value of the dollar, and thus of the changing number of dollars required over the years to lift people above the poverty or deprivation level.

** These data are consistent with those earlier cited, as measurement by consumer units and measurement by all people or by families yield somewhat different distribution pictures.

personal income; the 34.9 percent under $4,000 received only 13 percent; the 13.9 percent with incomes of $10,000 and over received 34.6 percent; and the 4.5 percent with incomes of $15,000 and over received 16.6 percent. And this takes no account of the regressive effects of other types of taxes, shortly to be discussed.

Although the Federal personal income tax still has a progressive impact upon income distribution, there has been (as indicated earlier) a marked decline in the degree of this progressiveness—which in effect is a regressive trend—during the years after World War II. This is shown by the fourth chart following this chapter.

In examining this chart, the important think to look at is not the changing shares of total personal income before and after taxes received by taxpayers at various income levels over the years. For these changing shares, in their entirety before taxes, and for the most part after taxes, are not due to the changes in tax rates, but rather to the changes in the relative number of taxpayers at the various income levels. For example, as incomes in general rise, large numbers of taxpayers move upward in the income structure.

The important thing to look at, in measuring the effect of the tax rate itself upon income distribution, is to compare the changes over the years in the ratio between the after-tax share and the before-tax share of total personal income received by taxpayers at the various income levels. If the effect of the changes in tax rates is to increase the ratio of the after-tax share to the before-tax share received by low- and middle-income taxpayers, and to decrease the ratio of the after-tax share to the before-tax share received by high-income taxpayers, the changes in tax rates are making income distribution more progressive. In contrast, if the effect of the changes in tax rates is to reduce the ratio of the after-tax share to the before-tax share in the case of low- and middle-income taxpayers, and to increase the ratio of the after-tax share to the before-tax share in the case of high-income taxpayers, the changes in tax rates are serving to make the tax system less progressive, and are therefore moving in a regressive direction.

In 1939, taxpayers with incomes under $10,000 received 80.02 percent of total personal income before taxes, and 82.47 percent of total personal income after taxes. In 1945, taxpayers with incomes under $10,000 received 86.03 percent of total personal income before taxes, and 89.83 percent of total personal income after taxes. This represented a progressive enlargement in the ratio of the after-tax to the before-tax share of low- and middle-income taxpayers. In 1963, taxpayers with incomes under $10,000 are estimated to receive 65.57 percent of total personal income before taxes, and 67.87 percent of total personal income after taxes. This represented, in 1963 compared with 1945, a regressive reduction in the ratio of the after-tax share to the before-tax share in the case of low- and middle-income taxpayers. Applying the current tax proposal to the current structure of returns and incomes, taxpayers with incomes under $10,000 would receive 67.43 percent of total income after taxes without the reforms, and 67.75 percent with the reforms, thus representing a slightly further regressive movement toward less progressive taxation.

Sharply in contrast, the taxpayers in 1939 with incomes of $50,000 and over received 5.13 percent of total personal income before taxes, but only 3.41 percent of total personal income after taxes.* By 1945, the $50,000 and over group received 3.29 percent of total personal income before taxes, but only 1.70 percent of total personal income after taxes.** Thus, the tax changes from 1939 to 1945 were serving progressively to reduce greatly the ratio of the high-income taxpayer's share in after-tax income to his share in before-tax income. But in 1963, taxpayers expected to file returns with incomes of $50,000 and over would receive an estimated 3.27 percent of total personal income before taxes, and 2.45 percent of total personal income after taxes.*** Thus, the changes in tax rates from 1945 to 1963 served regressively to increase greatly the ratio of the after-tax share to the before-tax share in the case of high-income taxpayers. The current tax proposal would move slightly further in the same direction, when there is need for a sharp reversal of the trend which set in after 1945.

The regressive nature of other types of taxation—Federal, State, and local

Insufficient research into the impact of the tax system as a whole has resulted in a woeful scarcity of useful data. But a study made in 1955 containing estimates for the year 1954 is very revealing. The fifth chart shows that spending units with incomes below $2,000 paid on the average only 2.7 percent of this income in the form of the Federal personal income tax. But they paid 13.7 percent in the form of total Federal taxes (including excises and social insurance taxes and corporate profits taxes); they paid 9.8 percent in the form of total State and local taxes; and they paid 23.4 percent in the form of all taxes at all levels. Spending units with incomes of $10,000 and over paid 14 percent of their incomes for Federal personal income taxes; 31.8 percent for total Federal taxes; 7.4 percent for

* These taxpayers in 1939 were only 0.15 percent of all persons filing returns in that year.

** These taxpayers in 1945 were only 0.09 percent of all taxpayers filing returns.

*** These taxpayers in 1963 are estimated at 0.31 percent of all persons filing returns in that year.

total State and local taxes; and 39.2 percent for all taxes at all levels. The impression that one would get when contrasting (1) the 2.7 percent figure with the 14 percent figure (related to the Federal personal income tax) is extraordinarily different from the true picture which is revealed by contrasting (2) the 23.4 percent figure with the 39.2 percent figure (related to all taxes). The first comparison creates the impression that the spending units with incomes of $10,000 and over pay more than five times as large a part of this income in taxes as the spending units with incomes under $2,000. But taking all taxes into account, the higher income spending units pay, as a percentage of their incomes, only about two-thirds more in taxes than the lower income spending units. For the groups in between those with incomes below $2,000 and those with incomes of $10,000 and over, the data on the same chart show even more sharply the regressive effects of taxes other than the Federal personal income tax. It should be noted also that total State and local taxes are highly regressive, with a smaller portion of income being paid for these taxes as income rises.

The sixth chart shows, also for estimated 1954, the percent of total income received and the percent of total taxes paid by spending units within various income categories. Looking at the Federal personal income taxes alone, spending units with incomes below $2,000, receiving 6 percent of total personal income, paid only 1.6 percent of such taxes, while spending units with incomes of $10,000 and over, receiving 20 percent of total income, paid 34.3 percent of such taxes. But looking at total taxes of all kinds, the spending units with incomes below $2,000 paid 4.6 percent of all taxes, while the spending units with $10,000 and over paid 31.2 percent. These data show that taxes in addition to Federal personal income tax multiplied almost three times the percent of total taxes paid by the under-$2,000 spending units, but reduced substantially the percent of total taxes paid by the $10,000 and over spending units.

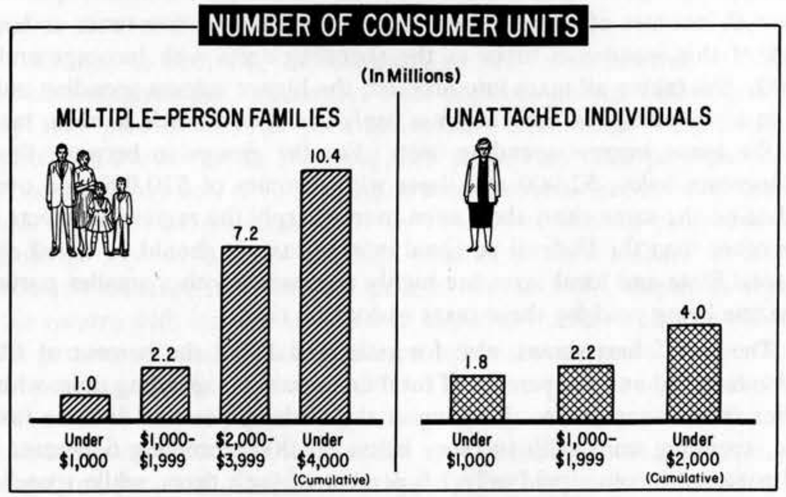
Although sufficiently comprehensive data are unavailable, it is certain that the trends since 1954 have made the situation much worse than it was then. Practically all types of taxes other than Federal have risen greatly, and practically all of these other taxes are highly regressive. And today, the Federal personal income tax is not as progressive as it was before the 1954 changes.

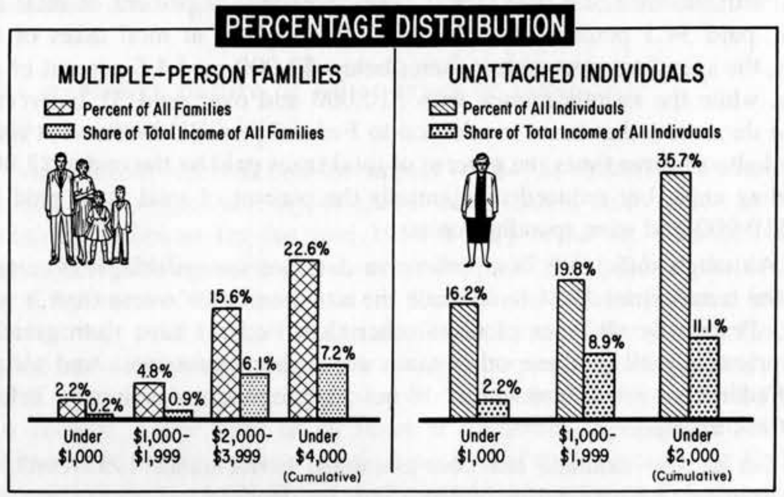
Let us now examine our poor economic performance 1953-1963, as shaped in part by national tax policies thus far depicted.

The next six charts amplify the foregoing discussion.

AMERICANS LIVING IN POVERTY AND THEIR SHARE OF INCOME, 1961

Annual Incomes, Before Taxes[1]



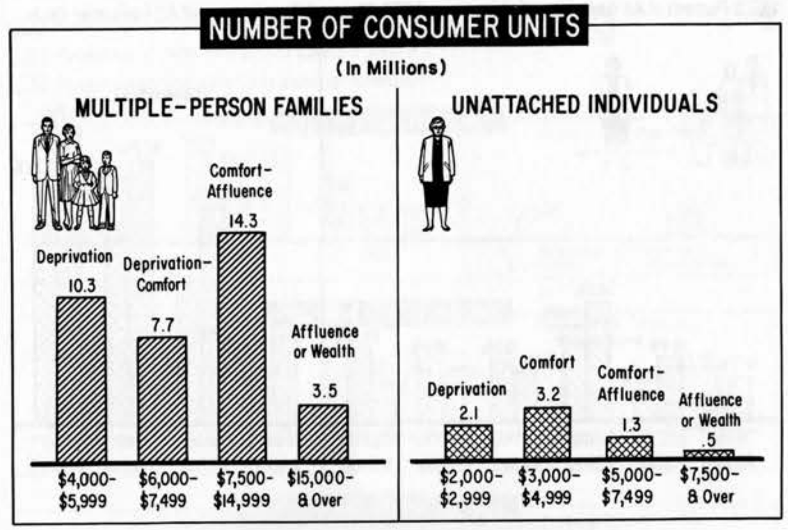


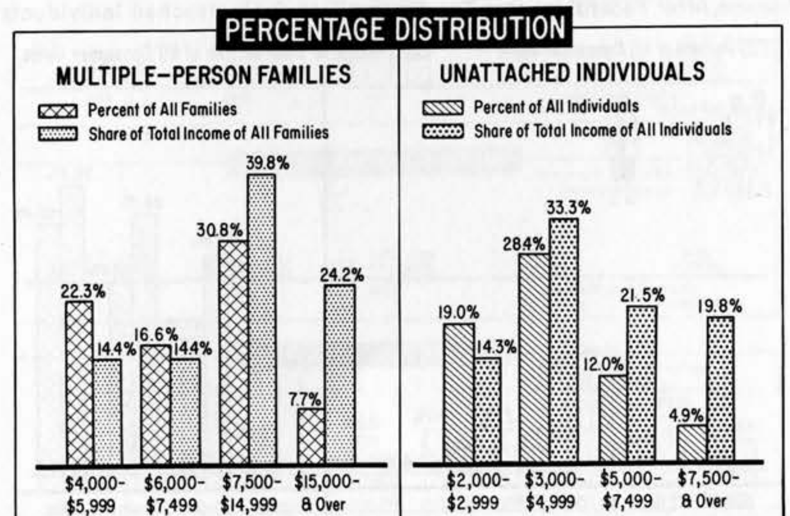
[1] Includes, in addition to cash income, the monetary value of food and fuel produced by farm families for their own use, and other nonmoney income.

Data: Department of Commerce, except that numbers of consumer units in "under $1,000" and "$1,000-$1,999" groupings are estimated by CEP on basis of Commerce Department data for families and individuals with incomes "under $2,000".
CEP has also estimated shares of income for "under $1,000" and "$1,000-$1,999" groupings.

AMERICANS LIVING ABOVE POVERTY AND THEIR SHARE OF INCOME, 1961

Annual Incomes, Before Taxes[1]





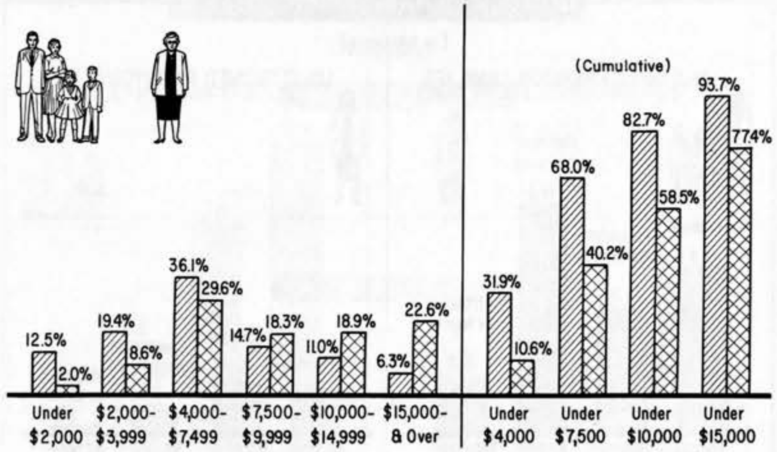
[1] Includes in addition to cash income, the monetary value of food and fuel produced by farm families for their own use, and other nonmoney income.

Data: U. S. Dept. of Commerce (O. B. E.)

DISTRIBUTION OF PERSONAL INCOME OF ALL CONSUMER UNITS, 1961

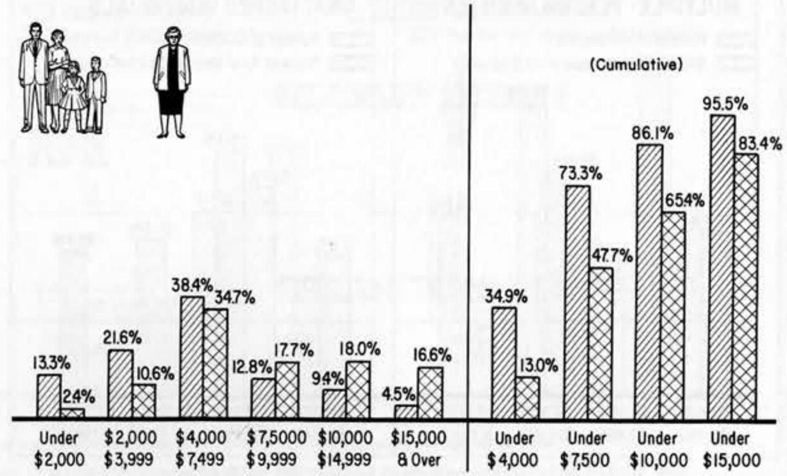
Income, Before Federal Income Tax, Of Families & Unattached Individuals 1/

Percent of All Consumer Units — Share of Total Income of All Consumer Units



Income, After Federal Income Tax, Of Families & Unattached Individuals 1/

Percent of All Consumer Units — Share of Total Income of All Consumer Units



1/ Includes, in addition to cash income, the monetary value of food and fuel produced by farm families for their own use, and other nonmoney income.

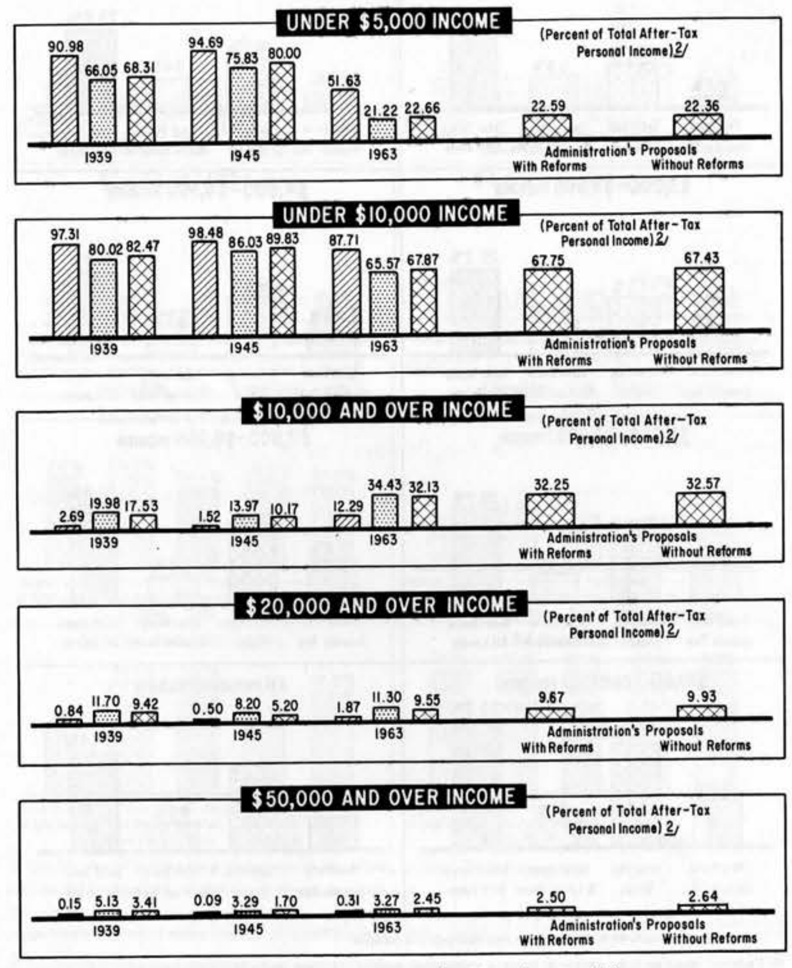
Data: U.S. Dept. of Commerce (O.B.E.)

EFFECT OF FEDERAL INCOME TAX ON INCOME DISTRIBUTION, 1939, '45 & '63 AND UNDER ADMINISTRATION'S PROPOSAL

Percentage of all personal tax returns 1/

Percentage of total before-tax personal income 1/

Percentage of total after-tax personal income 1/

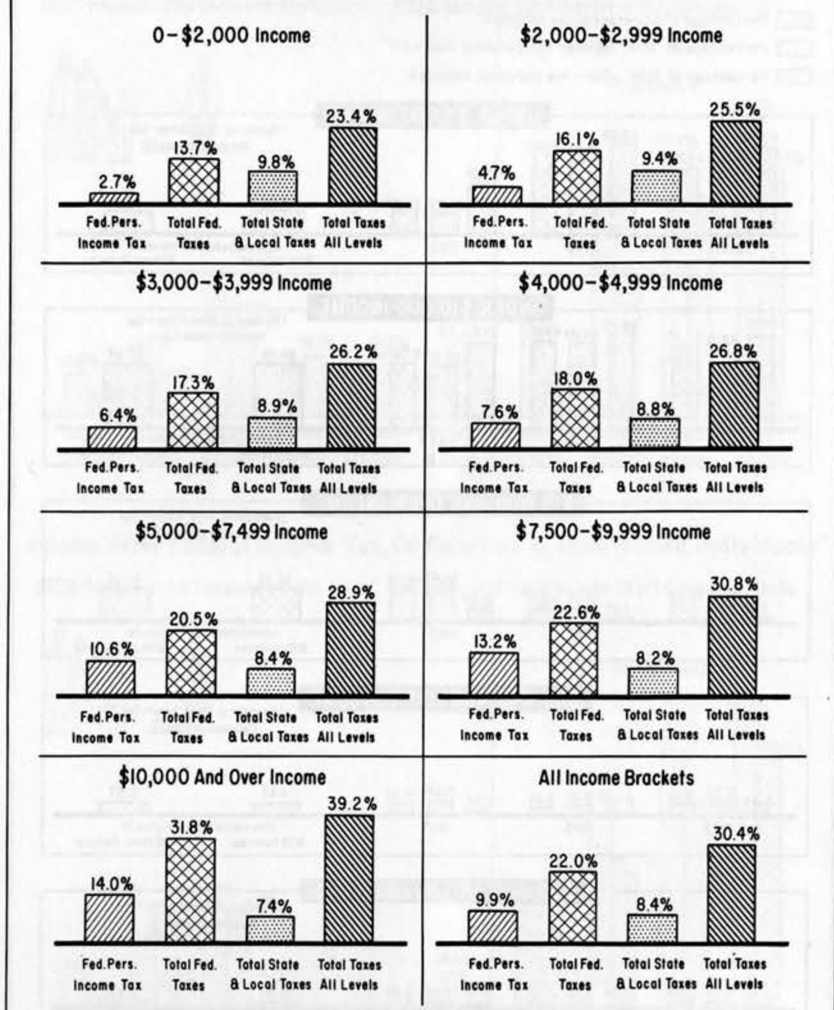


1/ 1939 and 1945, U.S. Treasury Dept. data for all returns (taxable and nontaxable). 1963 based on estimated taxable returns as reported in President's 1963 Tax Message, and CEP estimated nontaxable returns. Adjusted gross income.

2/ Estimated by applying proposed 1965 tax rates to the returns and incomes as of 1963.

TAXES PAID BY SPENDING UNITS[1] AT VARIOUS INCOME LEVELS, 1954

Taxes[2] Shown As Percent Of Income[3]



[1] Spending units include families plus unattached individuals.

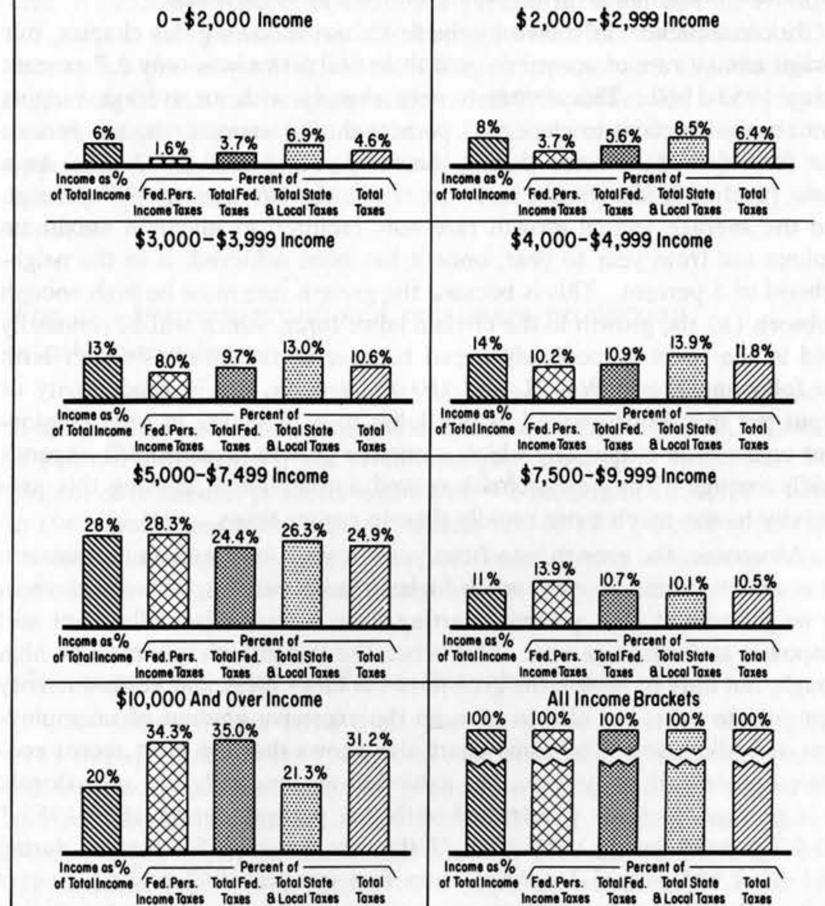
[2] Federal taxes include personal income, corporate profits, excises and social insurance taxes. State and local taxes include personal income, excise, sales, and property taxes.

[3] Adjusted money income and non-money income.

Data: Estimates by R. Musgrave, in Nov. 9, 1955 publication of Joint Economic Committee.

INCOMES[1] AND TAXES[2] OF SPENDING UNITS[3] AT VARIOUS INCOME LEVELS, 1954

Percent Of Total Income Received By, And Percent Of Each Type Of Tax Paid By, Spending Units At Various Income Levels



[1] Distribution of total income by income levels, money income. Other income data include adjusted money income and non-money income.

[2] Federal taxes include personal income, corporate profits, excises and social insurance taxes. State and local taxes include personal income, excise, sales, and property taxes.

[3] Spending units include families plus unattached individuals.

Data: Income distribution of total income by spending units, Michigan Survey Research Center Study, Fed. Res. Bulletin, June 1956. Tax payments estimated by R. Musgrave, in Nov. 9, 1955, publication of Joint Economic Committee.

VI. Our Poor Economic Performance, 1953-1963

The very low economic growth rate to date

The past decade to date has shown a consistent pattern of recessions, upturns insufficient to restore maximum prosperity, and periods of stagnation or low economic growth leading into the next recession.

In consequence, as shown by the first chart following this chapter, our average annual rate of economic growth in real terms was only 2.7 percent during 1953-1962. This contrasts very sharply with an average ranging from above 4 percent to close to 5 percent during various relevant periods since World War I. Even during the forty-year period 1922-1962 as a whole (excluding depression and war eras), the average was 3.7 percent. And the average annual growth rate now required to maintain maximum resource use from year to year, once it has been achieved, is in the neighborhood of 5 percent. This is because the growth rate must be high enough to absorb (a) the growth in the civilian labor force, which will be unusually rapid in the years immediately ahead because of the unusually high birth rate following World War II, and (b) the growth rate in productivity or output per man-hour worked, which leads to a reduction in total employment unless total output (by which economic growth is measured) expands rapidly enough. The new technology and automation is causing this productivity to rise much more rapidly than in earlier times.

Moreover, the growth rate from year to year until maximum resource use is achieved must be very much higher than 5 percent, or somewhere in the neighborhood of 8 percent, starting from a base when idle plant and manpower are as high as now. This is because this growth rate must be high enough, not only to absorb the growth in the labor force and in productivity from year to year, but also to take up the excessive amount of unemployment and idle plant. The same chart also shows that the most recent economic upturn, still in process, has exhibited an unusually low growth rate for a recovery period. Contrasted with 7.8 percent during 1954-1955,* and 6.7 percent during 1958-1959,** the rate was only 5.4 percent during 1961-1962,*** only 3.3 percent from first quarter 1962 to first quarter 1963, and only 4.1 percent (at a seasonally adjusted annual rate) during the much-heralded quickening of the upturn from fourth quarter 1962 to first quarter 1963. Even the most optimistic forecasts do not indicate for the foreseeable future a sufficient growth rate to reduce idle manpower and plant much below current levels; most forecasts expect unemployment to rise.

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* Following the recessionary period 1953-1954.

** Following the recessionary period 1957-1958.

*** Following the recessionary period 1960-1961.

The chronic rise of unemployment is still continuing

Indeed, as shown by the second chart, the chronic rise of unemployment has continued in 1963. In 1953, although a recession started shortly after mid-year, full-time unemployment was only 2.9 percent of the civilian labor force. Looking only at some of the subsequent years in which there was *no* recessionary movement, unemployment so measured was 4.4 percent in 1955, 5.4 percent in 1959, 5.5 percent in 1962, and an average of 5.7 percent (seasonally adjusted) during the first four months of 1963. It rose to 5.8 percent in May, 1963.* Taking into account (a) the full-time equivalent of part-time employment, and (b) the concealed unemployment resulting from a growth in the labor force repressed by inadequate job opportunity, the true level of unemployment (seasonally adjusted) averaged 9.4 percent of the civilian labor force during the first four months of 1963.

The gap between actual and maximum production is still increasing

As shown on the same second chart, there has also been a chronic rise in the gap between actual production and maximum production. Measured in uniform 1962 dollars, this production gap, nominal in 1953, rose to 2.8 percent of maximum production in 1955, 9.2 percent in 1959, 11.6 percent in 1962, and a seasonally adjusted annual rate of 11.9 percent in first quarter 1963 (when actual production was running at a seasonally adjusted annual rate 76.4 billion dollars below maximum production).**

The staggering losses suffered over the decade

As shown by the third chart, for the period from the beginning of 1953 through first quarter 1963, total man years of employment were 27½ million lower, and total national production (measured in uniform 1962 dollars) about 439 billion dollars lower, than if we had maintained the maximum prosperity which is our declared national objective under the Employment Act. These losses have impacted substantially upon practically all groups. But unemployment has hit hardest the young people, the

---

* These percentages in some instances are very slightly less than those in the official Government reports, as this study estimates a civilian labor force augmented by the estimated amount of concealed unemployment.

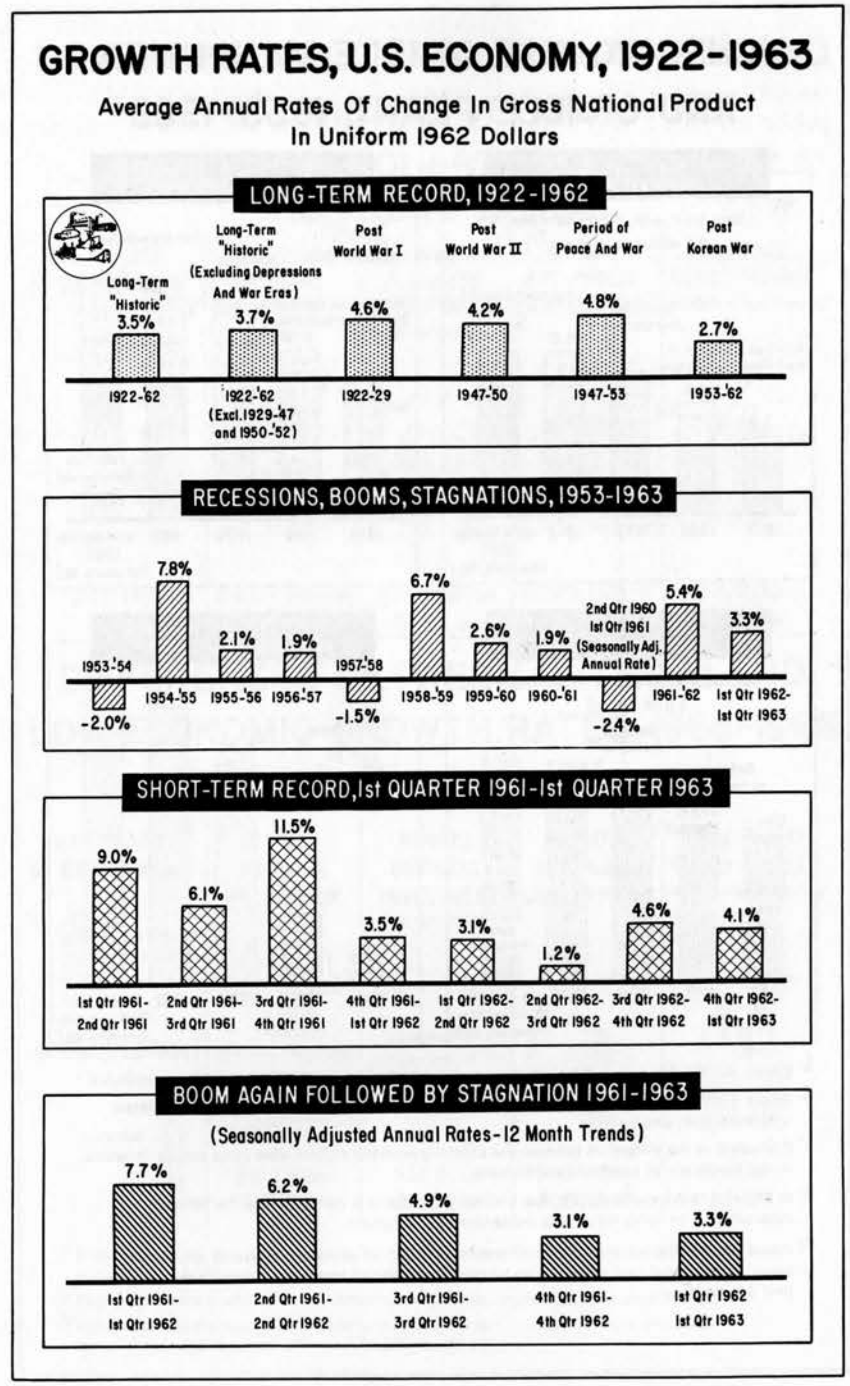
** For a full explanation of why Conference studies estimate the production gap at far higher levels than the estimates of the Council of Economic Advisers, see especially Chapter V of the Conference study, *Jobs and Growth*, May 1961.

older workers, and the Negro. Meanwhile, the adverse effects of low economic growth upon tax collections at all levels of government, at any given tax rates, have led to the progressive undernourishment of essential domestic public programs which also enter into living standards and economic and human progress.

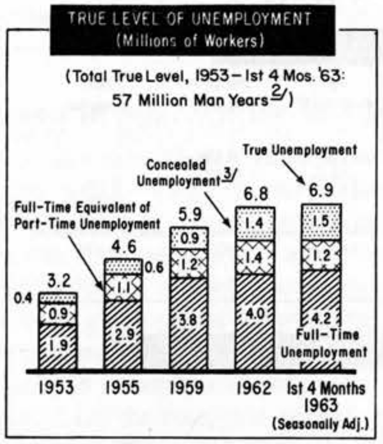
Losses in future, if the low growth rate persists

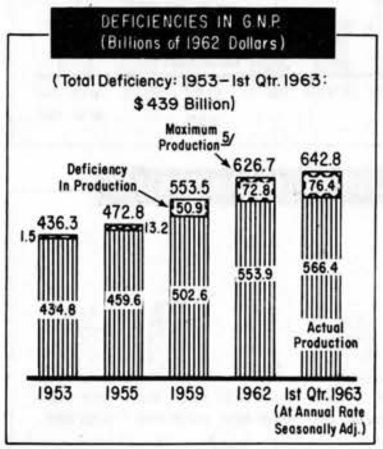
The third chart estimates also the losses which we shall suffer in the years shortly ahead, if our economic growth rate is not lifted far above what seems likely under policies now under active consideration. If the low growth rate averaged in recent years should persist, the four-year period 1963-1966 as a whole would register an estimated 16 million fewer man-years of employment opportunity, and an estimated 276 billion dollars less of total national production, than would be yielded over the same period by sustained maximum employment and production. The average American family, for the four-year period as a whole, would forfeit about $6,800 in family income.

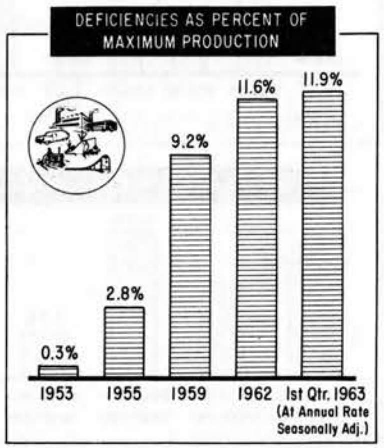
The three following charts amplify this discussion.



CHRONIC RISE OF IDLE MANPOWER AND OF IDLE PLANT, 1953–1963 1/







1/ Except for the base year 1953, no year during which a recession was in process is included.

2/ About 29.5 million man-years of unemployment (true level) would have been consistent with maximum employment.

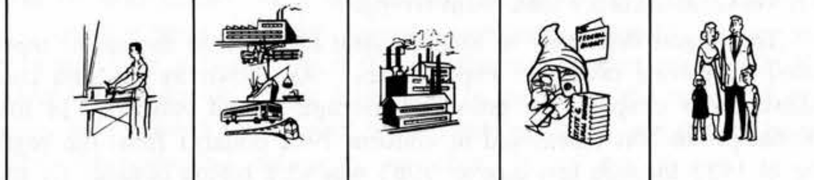
3/ Estimated as the difference between the officially reported civilian labor force and its likely size under conditions of maximum employment.

4/ In deriving these percentages, the civilian labor force is estimated as the officially reported civilian labor force plus concealed unemployment.

5/ Based upon sufficient annual rate of growth in G.N.P. to provide full use of growth in labor force, plant and productivity under conditions of maximum employment and production.

DIFFERENCES BETWEEN ACTUAL GNP AND GNP GROWING AT OPTIMUM RATE 1953–1st QUARTER 1963

Dollar figures in 1962 dollars

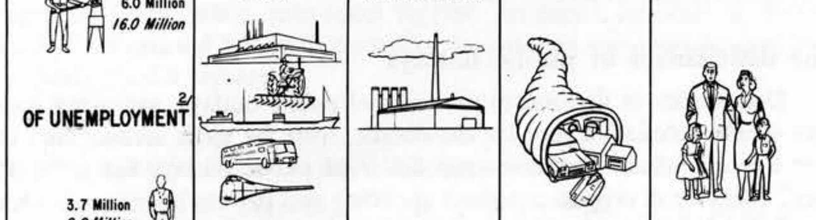


MAN YEARS OF EMPLOYMENT	*TOTAL NATIONAL PRODUCTION (GNP)*	*PRIVATE BUSINESS INVESTMENT (Incl. Net Foreign)*	*PRIVATE AND PUBLIC CONSUMPTION*	*AVERAGE FAMILY INCOME (Multiple-Person Families)*
27.5 Million Too Low	$439 Billion Too Low	$110 Billion Too Low	$329 Billion 1/ Too Low	$6,800 Too Low

DIFFERENCES BETWEEN OPTIMUM AND LOW ECONOMIC GROWTH RATES, 1963–1966

Bold face – Difference in 1966; *Italics – Difference for four year period as a whole*

Dollar figures in 1962 dollars



MAN YEARS OF EMPLOYMENT 2/ / OF UNEMPLOYMENT 2/	TOTAL NATIONAL PRODUCTION (GNP)	PRIVATE BUSINESS INVESTMENT (Incl. Net Foreign)	PRIVATE AND PUBLIC CONSUMPTION	AVERAGE FAMILY INCOME (Multiple-Person Families)
Employment: **6.0 Million** *16.0 Million*; Unemployment: **3.7 Million** *9.9 Million*	**$107 Billion** *$276 Billion*	**$32 Billion** *$83 Billion*	**$75 Billion** *$193 Billion 3/*	**$1,200** *$3,600*

1/ Includes personal consumption expenditures plus government (Federal, state, and local) expenditures. (286 and 43 billions, respectively).

2/ High growth rate would draw more persons into the labor market than low growth rate.

3/ Includes personal consumption expenditures plus government (Federal, state, and local government expenditures). (159 and 34 billions, respectively).

VII. The Reasons For The Poor Economic Performance

The deficiencies in private consumer expenditures rank first

When actual production of goods and services for a decade runs persistently lower than our productive capabilities, it must be because the total demand for goods and services falls seriously short of the amounts required to use these productive capabilities fully. By comparing actual developments during the past decade with a balanced "model" representing the conditions needed for maximum performance, it is feasible to detect with workable accuracy what went wrong.

The largest deficiency in total demand has been in the sector represented by private consumer expenditures. As shown by the first chart following this chapter, the estimated average annual deficiency in total national production (measured in uniform 1962 dollars) from the beginning of 1953 through first quarter 1963 was 42.8 billion dollars. Of this, the average annual deficiency in private consumer expenditures was about 27.8 billion. In first quarter 1963 (seasonally adjusted annual rate), the deficiency in total national production was 76.4 billion, and in consumer expenditures 55.7 billion.*

The chart also shows that the growing deficiencies in private consumer spending have resulted primarily from inadequacies in total consumer disposable (after-tax) income. The distribution of disposable consumer income also has an important bearing upon the important relationship between consumer spending and saving for investment purposes, as low- and middle-income families spend a much larger percentage of their incomes than higher income families.

The deficiencies in public outlays

Deficiencies in demand in the form of public outlays, averaging more than 4 billion dollars a year for the decade, were far more serious than the bare figures indicate, because each dollar of public outlays has a "multiplier" effect upon private consumer spending and private investment. And the Federal Government was responsible for all these deficiencies; the States and localities have been lifting their outlays and debts at a rapid rate, measured against their taxing powers and borrowing capabilities.**

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* These figures and many others are stated so precisely because they are drawn from a balanced and internally consistent "model." Otherwise, these precise figures are intended merely to indicate reasonable approximations.

** For more details, see Chapter X.

The deficiencies in private investment and their cause

Private investment also creates demand for goods and services, and adds to employment and economic growth. The deficient levels of private and public demand for ultimate products exerted, from time to time, a very discouraging effect upon private investment in expanding the means of production. In consequence, for the decade *viewed as a whole,* this type of private investment was much too low. For the period from the beginning of 1953 through first quarter 1963, as shown by the second chart following this chapter, there was an *average* annual deficiency of 5.1 billion dollars in private investment in plant and equipment (this being the type of private investment which accounts for most of the expansion in the means of production). But this deficient average for the decade as a whole resulted from the sharp periodic investment cutbacks leading into the recessionary periods. And these cutbacks occurred because of the confirmed tendency of private investment in expanding the means of production far to outrun the demand for ultimate products, and thus to create serious "overcapacity," during the so-called "boom" periods.

This is clearly illustrated on the same chart. During the "boom" period preceding the 1957-1958 recession, private investment in plant and equipment advanced more than three times as rapidly as the demand for ultimate products (composed of both private consumption and public outlays). During the "boom" period preceding the 1960-1961 recession, this type of investment advanced considerably more than four times as rapidly as demand for ultimate products. Comparing the second half of 1962 with the first half of 1961, investment in plant and equipment advanced at an annual rate of 7.6 percent, or more than 50 percent faster than the 5 percent advance in the demand for ultimate products. And from first quarter 1962 to first quarter 1963, investment in plant and equipment (even while restrained by the persistent amount of "overcapacity") increased 5.1 percent, while the demand for ultimate products increased only 4.3 percent.

Detailed examination of price-profit-investment trends

As shown in the third chart following this chapter, very large price increases, and still larger increases in profits *after taxes,* fed the extreme investment "boom" during the period preceding the 1957-1958 recession—a "boom" which carried this investment further and further out of line with the demand for ultimate products. The fourth chart shows how a relatively excessive and therefore nonsustainable investment "boom" in plant and equipment occurred again before the 1960-1961 recession, despite substantially reduced prices and profits—albeit from levels that were too high. This demonstrates again that the main influence upon this type of investment is not trends in prices and profits after taxes, short of drastic developments which have not even threatened. The dominant influence, rather, is investor appraisal with respect to current and prospective levels of demand for ultimate products.

The fifth chart shows that, despite slightly declining prices, profits after taxes rose very fast during the period from first quarter 1961 through fourth quarter 1962 (no adequate comparable profit data are yet available for the still later period).* Investment in plant and equipment in general (though not in all instances) advanced considerably less than profits. This demonstrates once again that even very large improvements in profits do not spark a corresponding investment enthusiasm in the face of (a) serious plant "overcapacity" which has persisted for a long time and (b) the unlikelihood of enough expansion of demand for ultimate products to take up the slack. But even during this most recent period, the rate of investment has been rising faster than the demand for ultimate products—even through first quarter 1963.

Other data showing current adequacy of profit margins after taxes

The sixth chart indicates how high and rewarding profits *after taxes* now are in most of our key industries, having risen to new peaks in 1962 despite very large unused capacities. The seventh chart shows the satisfactory trends in profit-sales ratios. The eighth chart (which also has an important bearing upon funds available for investment purposes without further tax concessions) reflects the very distinct tendency of American corporations, during the past decade, to finance larger portions of their total requirements out of sources which represent a combination of depreciation and amortization and retained profits and depletion allowances. All of these data show that investors do not now need higher after-tax profit margins per unit of sales, nor tax concessions pointed toward increasing these margins. They need only a higher volume of sales, which means higher private and public demand for their products.

Investment, productivity, growth, and our international balance of payments and gold problem

It is sometimes argued that additional tax concessions are needed to

* We do know, however, that profit trends in general in first quarter 1963 continued to move upward.

stimulate a higher rate of investment in plant and equipment, so that our rate of productivity growth may be faster. It is said that this enlarged productivity growth is the source of real economic growth at home; and that it would, by reducing real production costs and by modifying price increases, improve our "competitive" position overseas, and thus help to relieve our international balance of payments and gold problem. But as already shown, a higher and more sustainable rate of investment in plant and equipment, with beneficial results for productivity growth, does not require the proposed tax concessions. It requires, instead, changes in tax policies and in many other national economic policies which would focus almost entirely upon expansion of demand for ultimate products in order that our productive resources may be more fully used. This is also the surest road to further productivity improvement, which is repressed by high economic slack and encouraged by maximum utilization of productive resources, as shown by the ninth chart.*

Investment, productivity, and wage rates

A shift of our resources to more stress upon investment is frequently urged on the ground that this will help productivity to keep up with an alleged tendency of wage rates to rise faster than productivity, with inflationary consequences. But as shown by the tenth and eleventh charts, one of the most serious problems in recent years, and increasingly now, is the tendency of increases in wage and salary rates to lag far behind increases in productivity.** This is the main factor in the growing consumption deficiency. Thus, to place emphasis upon direct tax concessions to investors, rather than upon tax policies pointed toward more vigorous expansion of consumer spending and incomes (to which adequate wage and salary rate increases make a vital contribution) would aggravate the dominant consumption deficiency. The impact of this aggravation upon the whole economy would be damaging to profits, investment, and productivity in the long run.

Do we need a higher ratio of investment to GNP?

It is also argued that a higher rate of economic growth requires a higher *ratio* of investment to our gross national product than during the past five years. But even if it is assumed that the ratio of private investment to GNP has been too low during the most recent years, this might

* For full discussion of the balance of payments and gold problem, see Chapter VII of the Conference study, *Key Policies For Full Employment,* September 1962.

** For fuller discussion of wage-price-profit and investment-consumption relationships, see Chapter V of *Key Policies For Full Employment.*

well have been expected during a period of very low economic growth. And as already shown, the forces which have repressed investment unduly during this period have not been burdensome taxes nor inadequate profit margins after taxes, but rather the high "overcapacity" and the dominant deficiency in demand for ultimate products.

Moreover, the idea is not correct that a higher average annual overall growth rate than the "historic" long-term average of 3.5 percent requires a higher ratio of investment to GNP than this growth rate would require.* The appropriate (sustainable) ratio of investment to GNP is not determined by the desired rate of GNP growth in an economy like the United States. It is determined rather by the ratio which will keep the expansion of production and the expansion of ultimate demand in balance at maximum resource use. If we want to lift the rate of overall economic growth far above 3.5 percent (which is urgently needed), we need to take measures accordingly, but these would not change the sustainable ratio of investment to GNP. In view of the increased productivity of capital, which means that each dollar of new investment tends to add more to the output potential than it used to, we may well need a lower ratio of investment to GNP than was averaged during other periods of adequate total resource use.

The relatively high ratio of investment to GNP during the relatively high economic growth period 1949-1957 was governed by many factors, including the deliberately rapid build-up of the investment base during the Korean war. Such a build-up was not sustainable then, but rather an emergency measure. Advocating a higher ratio of investment to GNP now, when currently and for the foreseeable future we are confronted with such large unused plant capacity, is manifestly the wrong course.

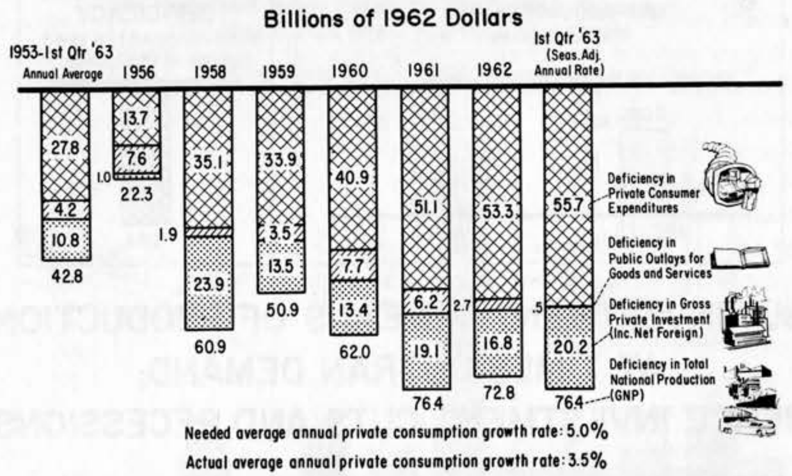
Of course, profits and investment in plant and equipment would be still higher than now, and growing still more favorably, in a fully prosperous American economy. But what is needed for this purpose is a prompt and huge expansion of demand for ultimate products, not further tax concessions to increase after-tax profits at current or now prospective levels of ultimate demand. The latter course might well provide but little stimulus to private investment, in view of existing "overcapacity." And if it did provide substantial stimulus, this would simply add to the current imbalances between our productive capabilities and the demand for ultimate products, thus hastening the next recession.

Drawing upon this analysis of how our economic troubles have arisen and how they may be cured, let us now turn to an evaluation of the Administration's tax proposal.

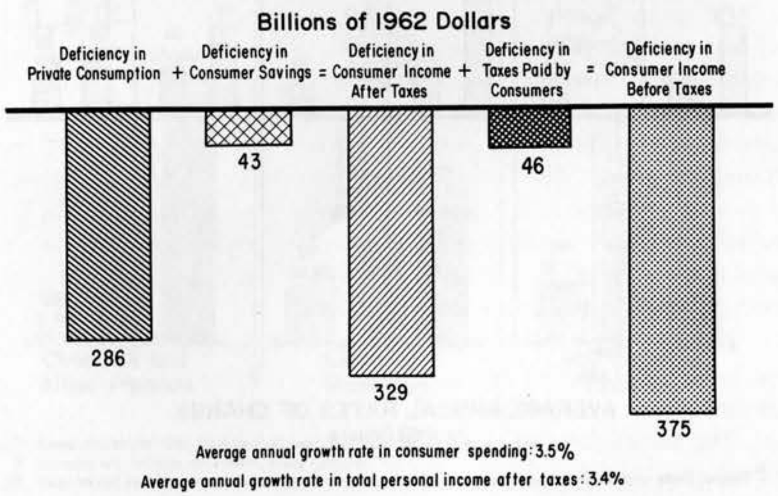
The eleven following charts illustrate the chapter just concluded.

* The Council of Economic Advisers, on occasion, has expounded this idea.

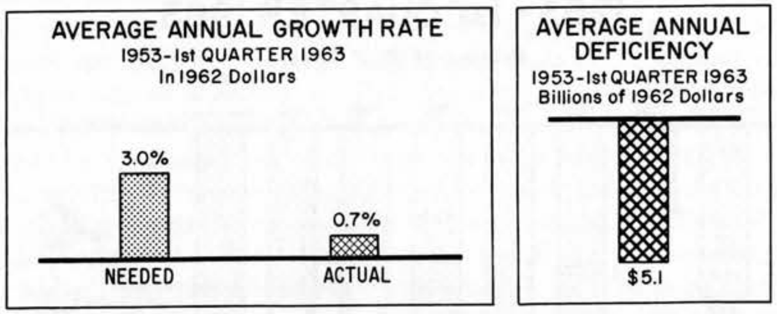
LOW PRIVATE CONSUMPTION MAIN FACTOR IN LOW TOTAL ECONOMIC PERFORMANCE 1953 - 1st QUARTER 1963



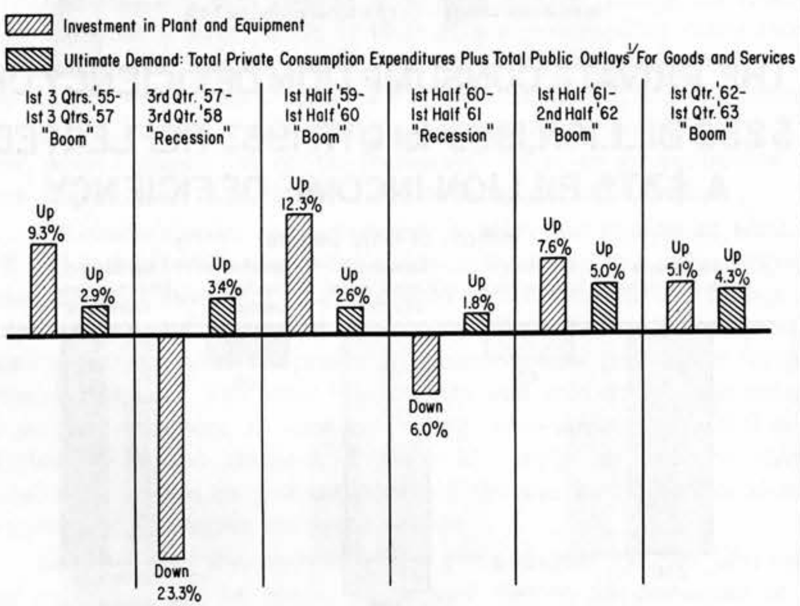
THE PRIVATE CONSUMPTION DEFICIENCY OF $286 BILLION, 1953-1st QTR. 1963 REFLECTED A $375 BILLION INCOME DEFICIENCY



INVESTMENT IN PLANT AND EQUIPMENT WAS DEFICIENT –1953-1st QTR. '63 AS A WHOLE



BUT INVESTMENT IN MEANS OF PRODUCTION AT TIMES OUTRAN DEMAND; HENCE INVESTMENT CUTS AND RECESSIONS

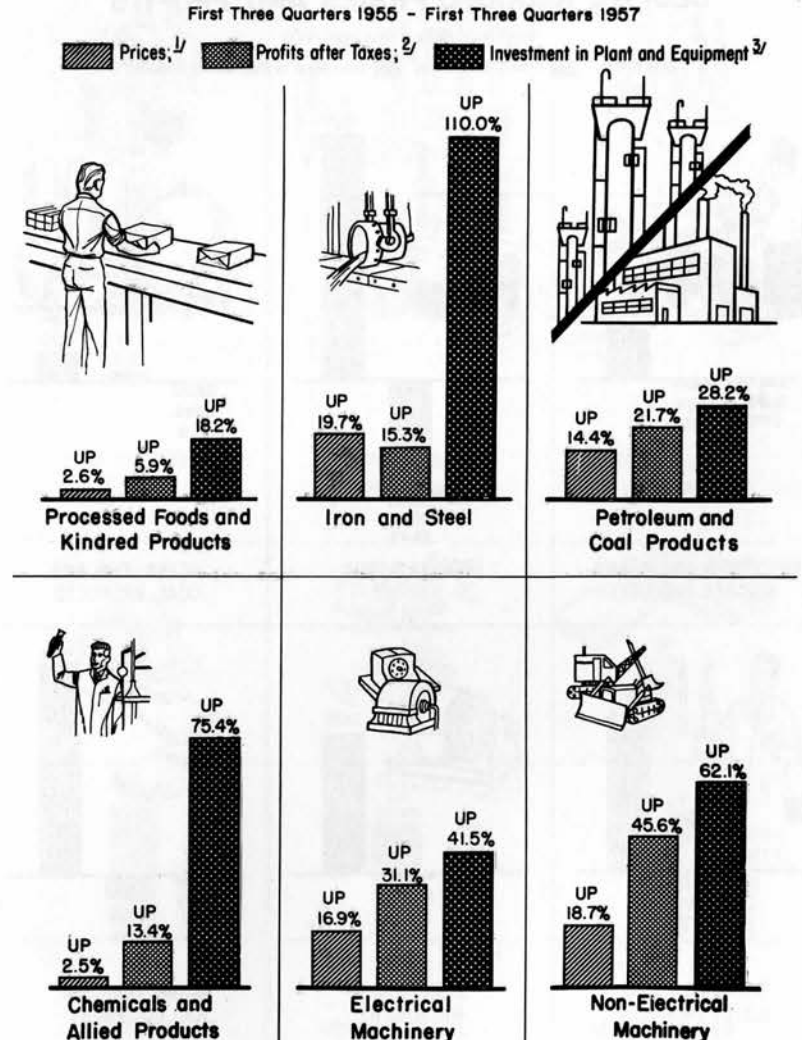


AVERAGE ANNUAL RATES OF CHANGE
In 1962 Dollars

[1] Federal, State and local.

RISING PRICES, PROFITS, AND INVESTMENT BEFORE THE 1957 – 1958 RECESSION

The Investment Boom Before the 1957-1958 Recession
First Three Quarters 1955 – First Three Quarters 1957

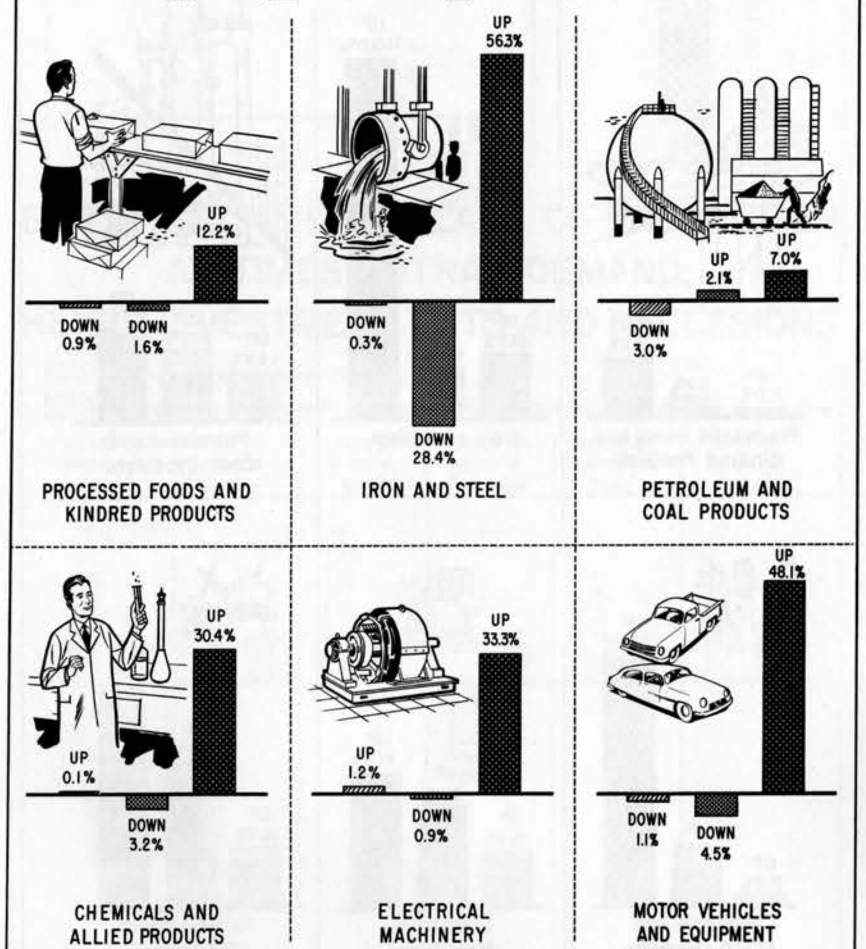


[1] Bureau of Labor Statistics, (U.S. Dept. of Labor), Commodity Wholesale Price Indexes.
[2] Securities and Exchange Commission, Profit Estimates.
[3] Securities and Exchange Commission estimates of expenditures for plant and equipment.

INVESTMENT BOOM OCCURRED AGAIN BEFORE THE 1960-1961 RECESSION DESPITE REDUCED PRICES AND PROFITS

First Half 1959 – First Half 1960

Prices;[1/] Profits after Taxes;[2/] Investment in Plant and Equipment[3/]

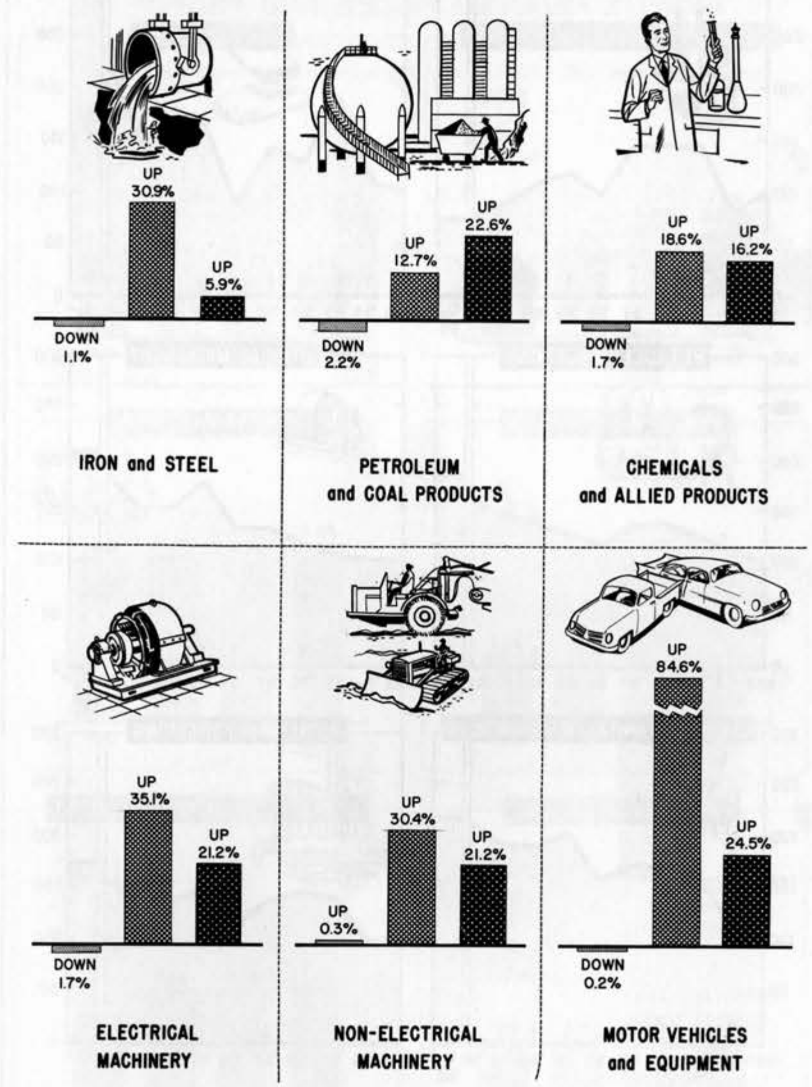


1/ U. S. Dept. of Labor, Bureau of Labor Statistics, commodity wholesale price indexes.
2/ Securities and Exchange Commission, profit estimates.
3/ Securities and Exchange Commission, estimates of expenditures for plant and equipment.

PRICE, PROFIT AND INVESTMENT TRENDS DURING CURRENT ECONOMIC UPTURN

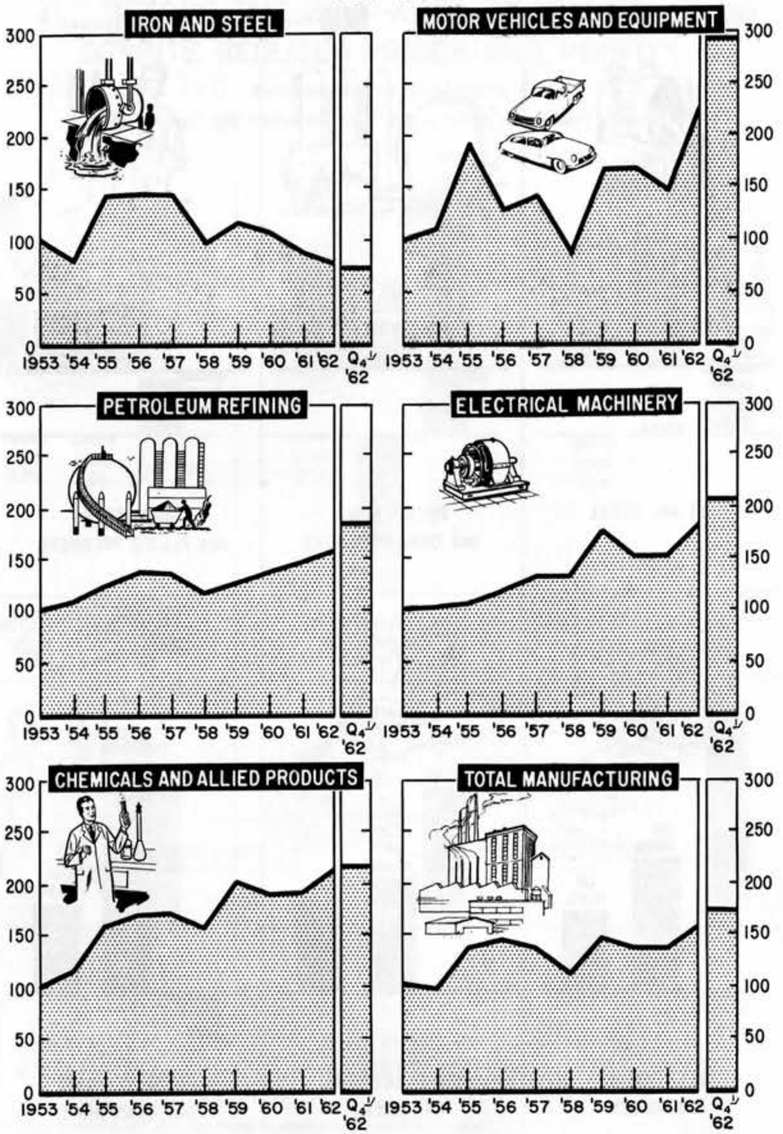
Annual Rates 1st Quarter 1961 - 4th Quarter 1962

Prices;[1/] Profits after Taxes;[2/] Investment in Plant and Equipment[3/]



1/ Data: U.S. Dept. of Labor, wholesale commodity price indexes.
2/ Data: Federal Trade Commission–Securities and Exchange Commission.
3/ Data: U.S. Dept. of Commerce and Securities and Exchange Commission; seasonally adjusted.

DESPITE SUBSTANTIAL IDLE CAPACITIES PROFITS AFTER TAXES RISE TO NEW PEAKS

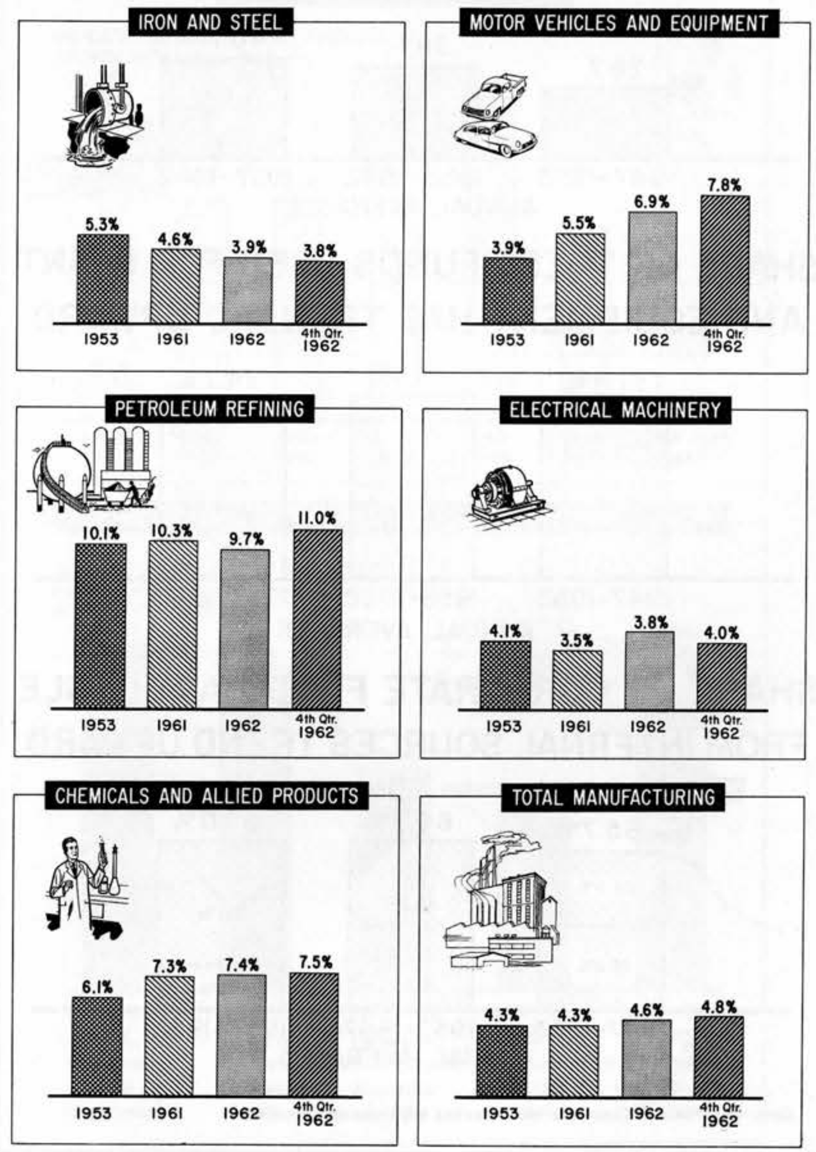


1/ Fourth quarter, 1962 shown at annual rate, not seasonally adjusted.

Data: Federal Trade Commission – Securities and Exchange Commission.

PROFITS-SALES RATIOS ARE GOOD AND GENERALLY ARE REACHING NEW PEAKS DESPITE SUBSTANTIAL IDLE CAPACITIES

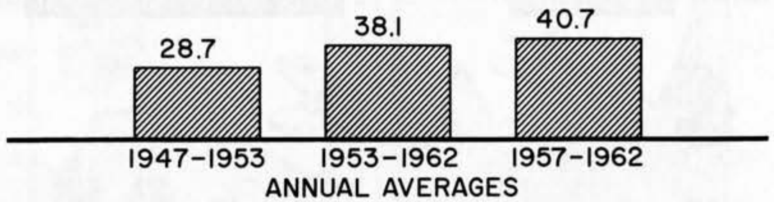
Manufacturing Corporations' Profits after Taxes, as Percent of Net Sales



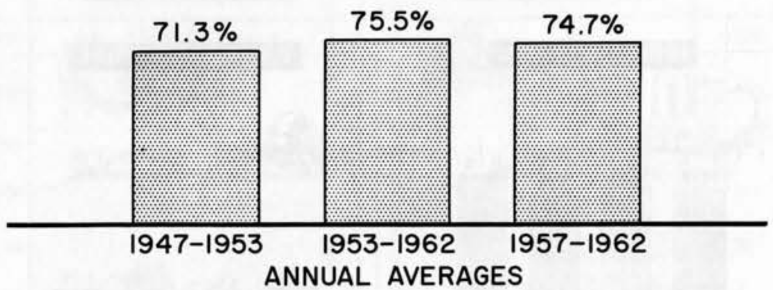
Data: Federal Trade Commission, Securities and Exchange Commission.

TOTAL FUNDS USED BY CORPORATIONS HAVE INCREASED GREATLY, 1947-1962

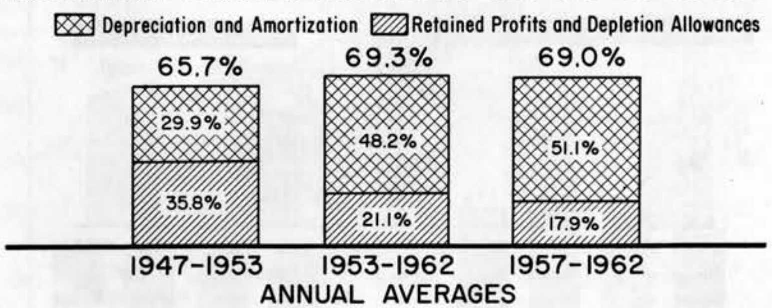
Billions of Current Dollars



SHARE OF THESE FUNDS USED FOR PLANT AND EQUIPMENT HAS TRENDED UPWARD



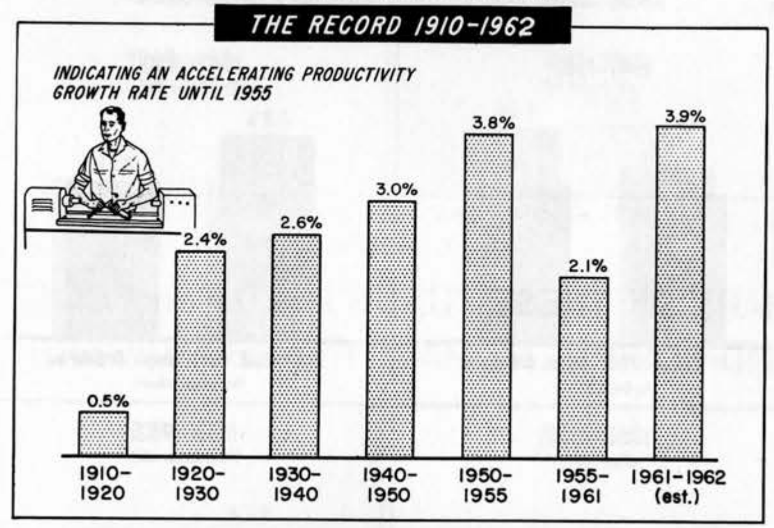
SHARE OF CORPORATE FUNDS AVAILABLE FROM INTERNAL SOURCES TREND UPWARD

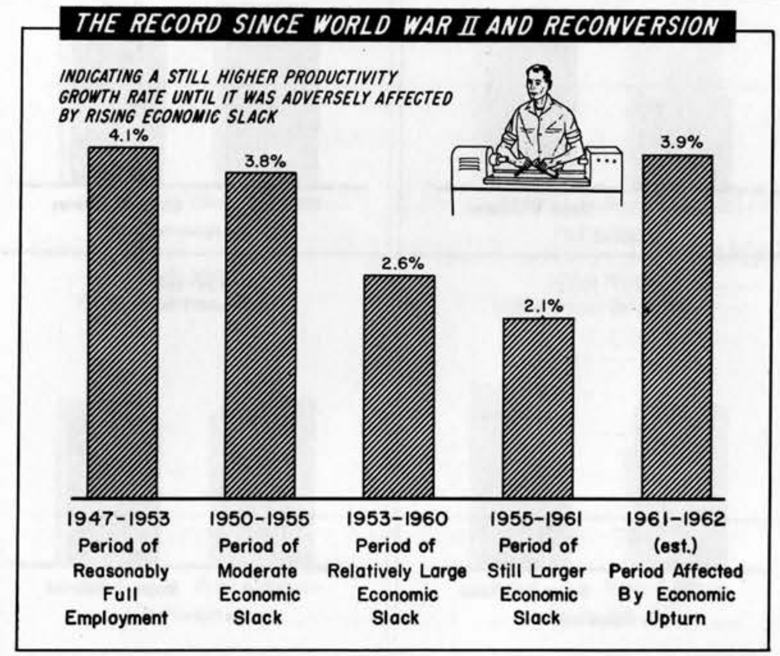


Data: Department of Commerce and Securities and Exchange Commission.

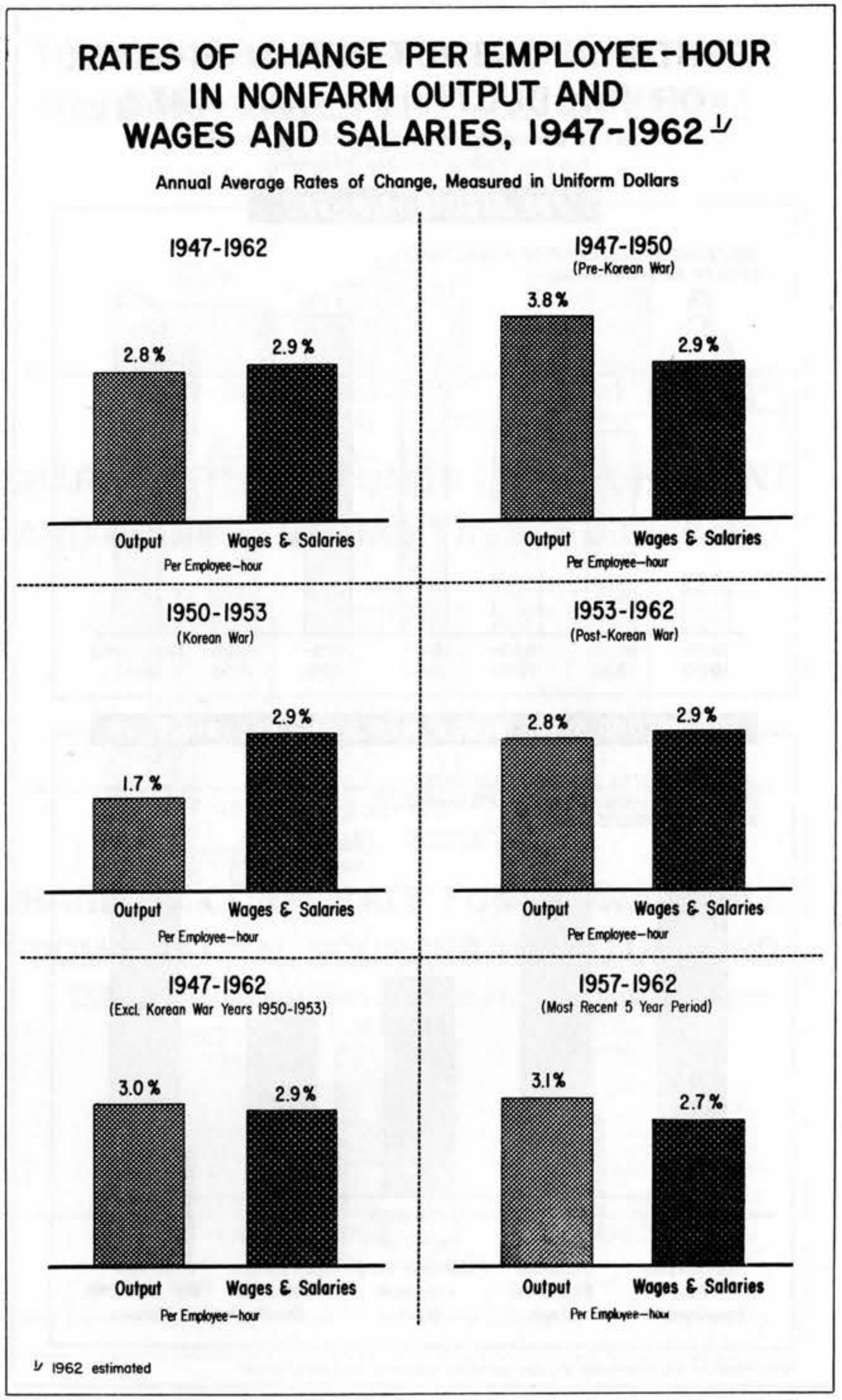
TRENDS IN OUTPUT PER MAN-HOUR -OR PRODUCTIVITY-1910-1962

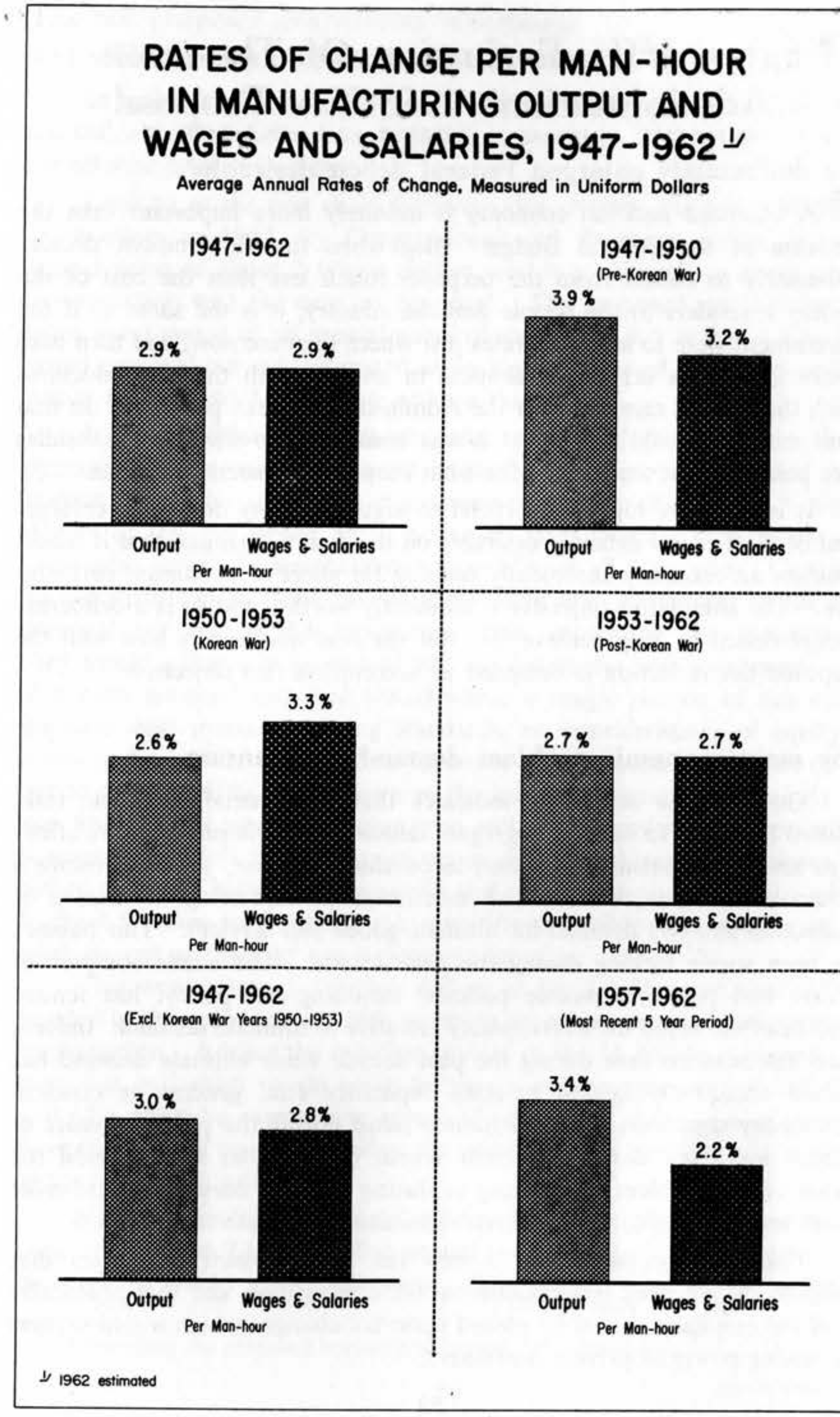
Average Annual Rate of Productivity Growth for the Entire Private Economy





Note: Based on U.S. Department of Labor estimates, relating to man-hours worked.


RATES OF CHANGE PER EMPLOYEE-HOUR IN NONFARM OUTPUT AND WAGES AND SALARIES, 1947-1962 1/
Annual Average Rates of Change, Measured in Uniform Dollars
1947-1962
2.8%
2.9%
Output
Wages & Salaries
Per Employee-hour
1947-1950
(Pre-Korean War)
3.8%
2.9%
Output
Wages & Salaries
Per Employee-hour
1950-1953
(Korean War)
1.7%
2.9%
Output
Wages & Salaries
Per Employee-hour
1953-1962
(Post-Korean War)
2.8%
2.9%
Output
Wages & Salaries
Per Employee-hour
1947-1962
(Excl. Korean War Years 1950-1953)
3.0%
2.9%
Output
Wages & Salaries
Per Employee-hour
1957-1962
(Most Recent 5 Year Period)
3.1%
2.7%
Output
Wages & Salaries
Per Employee-hour
1/ 1962 estimated


RATES OF CHANGE PER MAN-HOUR IN MANUFACTURING OUTPUT AND WAGES AND SALARIES, 1947-1962 1/
Average Annual Rates of Change, Measured in Uniform Dollars
1947-1962
2.9%
2.9%
Output
Wages & Salaries
Per Man-hour
1947-1950
(Pre-Korean War)
3.9%
3.2%
Output
Wages & Salaries
Per Man-hour
1950-1953
(Korean War)
2.6%
3.3%
Output
Wages & Salaries
Per Man-hour
1953-1962
(Post-Korean War)
2.7%
2.7%
Output
Wages & Salaries
Per Man-hour
1947-1962
(Excl. Korean War Years 1950-1953)
3.0%
2.8%
Output
Wages & Salaries
Per Man-hour
1957-1962
(Most Recent 5 Year Period)
3.4%
2.2%
Output
Wages & Salaries
Per Man-hour
1/ 1962 estimated

VIII. Evaluation Of The Administration's 1963 Tax Proposal

Is a deliberately enlarged Federal deficit desirable?

A balanced national economy is infinitely more important than the condition of the Federal Budget. But when the Government decides deliberately to collect from the taxpayer much less than the cost of the services it renders to the people and the country, it is the same as if the Government were to leave tax rates just where they are now, and then mail checks to various taxpayers identical in amount with the tax reductions which they would receive under the Administration's tax proposal. In that event, nobody would argue that it was immaterial to whom the subsidies were paid, in what amount, or for what economic or social purposes.

It is therefore highly superficial to argue that *any* deliberate enlargement of the Federal deficit is desirable on the asserted ground that it would stimulate an economy chronically running far short of maximum performance. The stimulative objective is eminently worthy, and so is a deliberate Budget deficit to help achieve it. But the real question is how well the proposed tax reduction is designed to accomplish this objective.

The main economic problem demanding attention

The previous discussion indicates that our crucial economic task, granted the need to expand aggregate demand, is to improve the relationships among the main components in purchasing power, so as to restore a sustainable balance between (a) investment in expanding the means of production and (b) demand for ultimate goods and services. This balance has been sorely lacking during the past decade. The whole complex of private and public economic policies, including tax policy, has tended periodically to result in "overcapacity" relative to ultimate demand. Indeed, there has been no time during the past decade when ultimate demand has pushed excessively against existing capacities (the general or classical inflationary situation). The economic trend during the past two years of upturn, and even during the most recent months, has not reversed the nature of the problem confronting us during the past decade. These most recent trends, already reviewed, confirm and accentuate this problem.

This calls insistently for a new tax policy which recognizes that investors do not need large additional tax concessions, and that practically all of the emphasis should be placed upon tax changes which would expand the buying power of private consumers.

The tax proposal overstresses investment and understresses consumption

In evaluating the tax proposal, it is necessary to examine it both without and with the reform elements which it contains. The proposal without the reforms is examined first.

Looking at the first chart following this chapter, the tax concessions to investors in 1962, by Congressional and Treasury action, have an annual value of about 2 billion dollars, and it is essential to consider this in connection with the new tax proposal. The proposed cut in corporate taxes is estimated at an annual value of more than 2.5 billion. The proposed personal tax cut, estimated at an annual value of 11 billion dollars, brings the total to 15.5 billion without the reforms.

It is very difficult to estimate what portion of the 11 billion dollar personal tax cut would be spent immediately by consumers, and what portion would be saved for investment purposes. But about 5 billion dollars of this cut would go to taxpayers with incomes of $10,000 and over, who constitute approximately one-fifth of all taxpayers. Certainly, no argument can be made for assigning more than 45 percent of the total personal tax cut to the top-income fifth, except on the ground that they would utilize a large part of this cut for saving and investment. For if it were assumed that they would utilize a major portion of this cut to improve their immediate living standards, no considerations of equity or social justice would countenance failure to give a much larger part of the cut to the four-fifths lower down in the income structure, particularly the two-fifths of our total population who still live in poverty or deprivation. Assuming therefore that the taxpayers in the top fifth would use about 3.5 billion of their 5 billion cut for saving and investment purposes, this, added to the 4.5 billion in corporate tax cuts, lifts to 8 billion the portion of the total tax cut assigned to the investment function.

This would leave 1.5 billion dollars of the 5 billion personal tax cut granted to the upper-income fifth available for enlargement of their personal consumption. Adding the 6 billion dollars of the 11 billion proposed personal tax cut which would go to taxpayers with incomes below $10,000, and who might be expected to spend all or most of it for immediate consumption, brings up to 7.5 billion the portion of the total tax cut assigned to the consumption function.

Next, let us take account of the proposed reforms,* as depicted on the same chart. The 2 billion dollar annual value of the 1962 tax concessions to investors would remain the same. The annual value of the proposed

* Including the proposed revisions in capital gains taxation.

corporate tax cut would be about 0.8 billion, and of the proposed personal tax cut about 8 billion, bringing the total to about 10.8 billion. Of this, about 4.6 billion should be assigned to the investment function (the 2.8 billion corporate cut and about 1.8 billion of the 2.5 billion cut in personal taxes for taxpayers with incomes of $10,000 and over). About 6.2 billion would thus be assigned to the consumption function (0.7 billion of the personal tax cut for the $10,000 and over taxpayers, plus the 5.5 billion personal tax cut for those under $10,000).

In view of the actual nature of our economic difficulties, such a pattern of tax change might well provide some temporary quickening of the rate of economic activity, both on economic and psychological grounds. But in the longer run, the imbalances which this pattern of tax change would maintain or even augment would offer but slight realistic prospect of improving our long-term economic growth rate. Without the reforms, of course, the imbalance would be greatly worse than with the reforms.

The faulty distribution of the proposed personal tax cuts

Excluding the proposed tax reforms, the second chart following this chapter shows that only 3.7 percent of the total personal tax cut would go to the 32.8 percent of all those filing tax returns whose incomes are below $3,000. The 12.3 percent who have incomes of $10,000 and over would receive 45.5 percent of the tax cut; the 1.9 percent with incomes of $20,000 and over would receive 21.1 percent; and the 0.3 percent with incomes of $50,000 and over would receive 8.3 percent.

Even with the reforms, as shown by chart three, those with incomes below $3,000 would receive only 6.7 percent of the total tax cut; those with incomes of $10,000 and over would receive 36.2 percent; those with incomes of $20,000 and over would receive 13.9 percent; and the 0.3 percent of all taxpayers filing returns with incomes of $50,000 and over would receive 4.5 percent.*

Effect of the proposed tax cuts upon disposable incomes

Superficially, it may be argued that the foregoing distribution results inevitably from the fact that, under the current tax system, the higher income people pay progressively higher tax bills, and therefore should

* These data do not take account of the proposed revisions relating to capital gains, as it is not feasible to estimate fully how these revisions would impact upon various income groups. However, as these revisions have an estimated value of only about 0.7 billion, their inclusion in these data would not significantly change the import of the analyses.

receive progressively larger shares of the tax cut. But it is essential to look more carefully at what the tax cuts really mean. Without the reforms, as shown on the fourth chart, taxpayers in the various income brackets would receive tax rate reductions of about the same size, measuring the proposed tax rate against the existing tax rate. Thus, the effective tax rate for the $3,000 taxpayer would be reduced 20 percent, and the tax rate for the $200,000 taxpayer 22.8 percent. But the so-called tax reduction indicated by this customary measurement is merely a mathematical formula for determining *how much actual tax reduction each taxpayer gets.* What really counts, both economically and socially, is *the effect of the tax cuts upon disposable (after-tax) incomes.*

Measured in this proper way, as shown also on the fourth chart, without the reforms the $3,000 income taxpayer would receive an increase in disposable income of only 0.4 percent; the $5,000 income taxpayer, 1.8 percent; the $10,000 income taxpayer, 3.5 percent; the $50,000 income taxpayer, 9.7 percent; the $100,000 income taxpayer, 16.3 percent; and the $200,000 income taxpayer, 31.1 percent.*

With the reforms, as shown on the fifth chart, the $3,000 income taxpayer would have his tax rate cut 100 percent, and the $200,000 income taxpayer only 17.5 percent. This looks progressive indeed. But the $3,000 income taxpayer would have his disposable income increased only 2.0 percent; the $5,000 income taxpayer, 3.1 percent; the $10,000 income taxpayer, 3.5 percent; the $50,000 income taxpayer, 6.3 percent; the $100,000 income taxpayer, 11.2 percent; and the $200,000 income taxpayer, 23.8 percent.**

It neglects entirely the realities of our economic and social needs, to say that these enormously disproportionate gains in the disposable incomes of the very high income families are "inevitable" because the $3,000 taxpayer receives only a 2 percent increase in disposable income when his tax is removed entirely. If tax reduction must "inevitably" result in these obviously undesirable results, then methods other than tax reduction should be resorted to in the pursuit of more desirable results.*** Besides (as will be shown later on), there are available methods of tax reduction which would be progressive rather than regressive.

These grave defects in the composition of the proposed tax cuts are worsened by the inadequate magnitude and improper timing of the proposal.

* Using the same assumptions as to family size and deductions as in earlier chapters.

** See footnote on page 60.

*** These other methods are set forth fully in Chapter X.

Magnitude of needed tax action: economic growth needs and prospects

The Employment Act of 1946 establishes maximum levels of employment and production as a prime national objective. Not having enjoyed such levels for a decade, we should at least strive for their attainment by early 1965—more than a year and a half from now.

This requires that, measured from a 1962 base, man-years of employment be 5.2 million higher in 1964. This would absorb the net additions to the civilian labor force, and be consistent with reducing the true level of unemployment from about 6.8 million in 1962 to the neighborhood of 3 million by early 1965, thus reducing full-time recorded unemployment to close to the 3 percent of the civilian labor force consistent with maximum employment. Thereafter, completely to restore maximum employment and to absorb further growth in the labor force, employment in 1965 should rise about 2.2 million above the 1964 level.

Total national production (measured in uniform 1962 dollars) needs to rise above the 1962 base by about 87 billion dollars, or about 16 percent, for 1964 as a whole, bringing the figure up to 641 billion. This would be enough to bring us close to maximum production by early 1965, by closing the production gap existing in first quarter 1963, and absorbing further growth in the labor force and productivity. With maximum production not fully restored by early 1965, the growth rate from 1964 to 1965 should be close to 7 percent, to a 1965 level of 685.5 billion dollars.*

Before measuring the tax proposal against a job of this size, let us appraise the outlook if national economic policies were to be left approximately in *status quo*. In that event, it appears reasonable to project an average annual growth rate somewhat below 3 percent for the few years following 1962.** Applying such a low growth rate uniformly year by year, the result would be a GNP of about 584 billion dollars in 1964,*** and

* These projections factor in a much lower production "gap" in first quarter 1963 than the 76.4 billion dollar annual rate referred to earlier. While this 76.4 billion dollar "gap" is a proper measurement of how much more we would have been producing in first quarter 1963 if we had maintained maximum economic growth from 1953 forward, this does not mean that taking up all of the current economic slack would increase total national production by anywhere near this much. Due to a decade of economic slack, some of our productive potentials have been permanently lost.

** The various reasons are stated in Chapter VI.

*** This uniform projection for several years ahead, at an average annual growth rate somewhat less than 3 percent, results in a GNP projection for 1964 which may well be somewhat below the actual level achieved in that year (in accord with some current forecasts). But such a development, under current policies, would in the view of this study reduce the growth rate in later years.

about 600 billion in 1965 (measured in uniform 1962 dollars). Such developments would be about 57 billion below the goal suggested above for 1964, and about 85 billion below for 1965.*

The tax proposal is too weak, with respect to size and timing

Earlier in this chapter it has been estimated that the tax proposal including the reforms, when fully effective in 1965 (or 1966) would result in allocation of 6.2 billion dollars to the consumption function, and 4.6 billion (including the 2 billion dollar value of the 1962 corporate tax concessions) to the investment function. It is assumed that practically all of the estimated allocation to the consumption function would actually be spent, for the 6.2 billion estimate itself excludes that portion of the 8 billion personal income tax cut estimated to be saved for investment purposes. Using the "multiplier" of about three, which is widely accepted, the 6.2 billion dollars of increased consumer spending in 1965 (or 1966) would add about 18.6 billion to total national production in the same year.

But the estimated allocation of 4.6 billion dollars to the investment function in 1965 (or 1966) would not all flow promptly into investment, especially in view of still-existent "overcapacity" and still-existent insufficiency of private and public demand for ultimate products even by that year. Some of this 4.6 billion dollar amount would be saved, both by individuals in the higher income brackets and by business. Thus, it is estimated that only about 3 billion dollars would flow reasonably promptly into investment. (Even if the allowance for saving seems high, it should be noted that the estimated investment stimulus counts in the 2 billion dollar 1962 corporate tax concessions in evaluating the stimulative effects of the 1963 tax proposal, even though these concessions are not part of the 1963 tax proposal). Again using the "multiplier" of three, this 3 billion dollar investment flow would add about 9 billion dollars to total national production in 1965 (or 1966). Adding to this 9 billion the 18.6 billion estimated in the preceding paragraph, the whole estimated stimulus to total national production, by virtue of the tax proposal, comes to 27.6 billion as of 1965 (or 1966).

This 27.6 billion dollar figure needs to be contrasted with the 85 billion dollar difference, as set forth above, between needed total national production in 1965 and the estimate of where national production would then be if our national economic policies remain about in *status quo*—that

* For the consequences of this, see especially third chart following Chapter VI.

is, if the tax program were not put into effect.*

For the first calendar year to which the tax proposal would be applied, similar analysis yields these estimates: Allocation to the consumption function, 2.3 billion dollars, with total national production stimulative result of 6.9 billion; allocation to the investment function, about 3 billion (including the 2 billion 1962 tax action), reduced to about 2 billion by estimated saving, with total national production stimulative result of about 6 billion. Thus, the effect of both the added consumer spending and the added investment upon total national production would be about 12.9 billion in the first calendar year to which the tax proposal would be applied. This figure would be a very small portion of the 57 billion dollars by which we need to lift total national production in 1964 above the 1964 level likely to result if policies were left about as they would be without the proposed tax action.

Moreover, the trivial impact of the tax proposal during the first year to which it would be applied has a vital bearing upon its value when in full operation. Obviously, if a patient needs an injection of 100 units now, the same result is not obtained by giving him 33 units now, and similar amounts a year and two years from now. Thus, an editorial in *Business Week* on February 9, 1963 said this:

> "The fact is that the tax program, as it stands, will not do what President Kennedy himself has been talking about—remove the drag that an outdated tax structure has put upon the economy. The tax reductions it proposes are too small and too slow to give a substantial lift to production and employment for several years, if at all."

The President's Council of Economic Advisers states in its 1963 Annual Report that the full tax program over three years would only *"set us on a path toward* our interim employment target; and *that it will lay the foundation for* more rapid long run growth" (italics added). This is a commendably candid admission that, by 1965 or 1966 or even 1967, we would not reach even the *interim* unemployment target of 4 percent, set forth by the Council in early 1961 as a target for early 1963.

All this makes it very clear that the current tax proposal needs to be very substantially revised, in order to comport with our three great economic purposes as a Nation and a people—maximum economic growth, serving the priorities of our needs, and economic justice.

The five following charts amplify this chapter.

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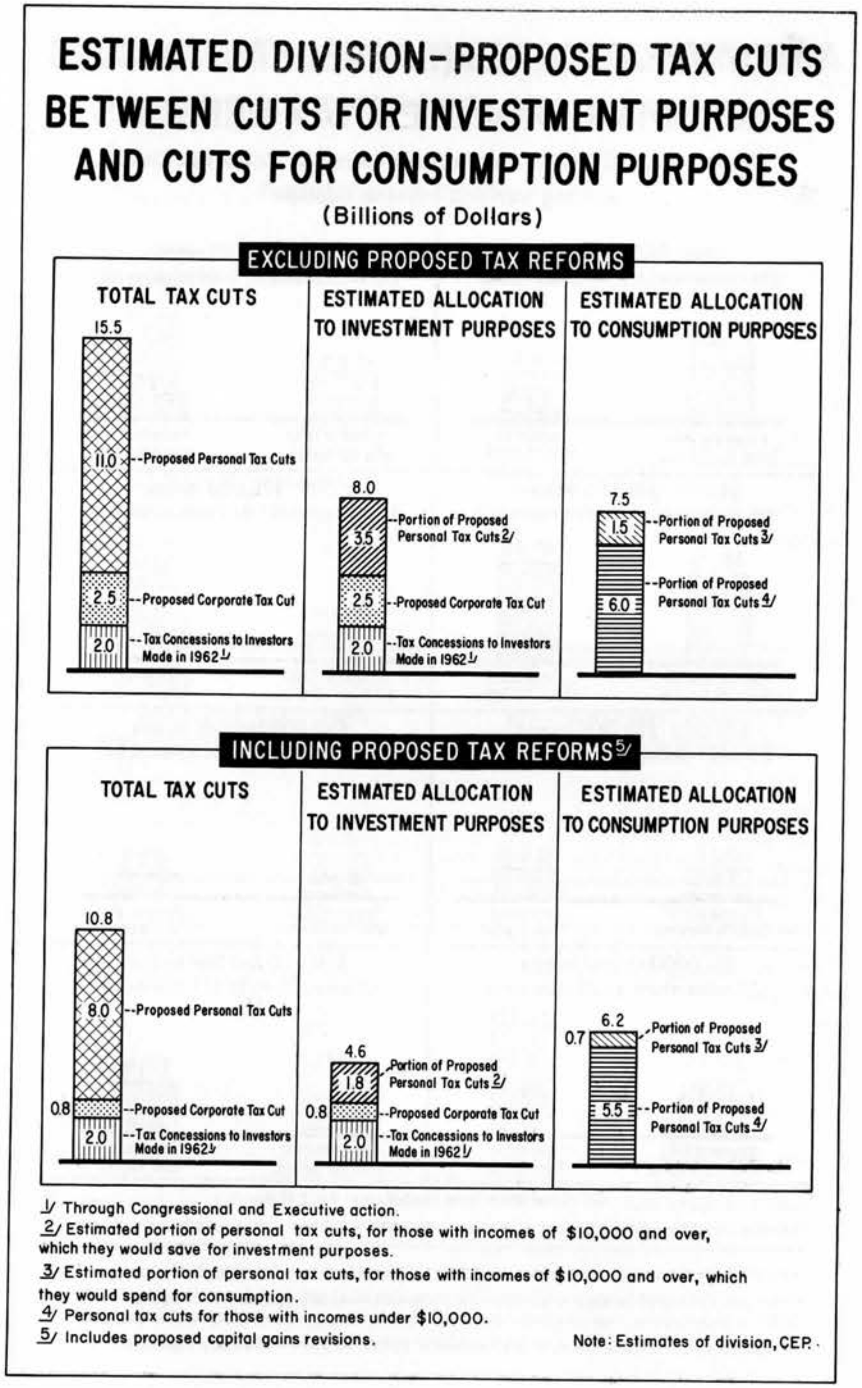
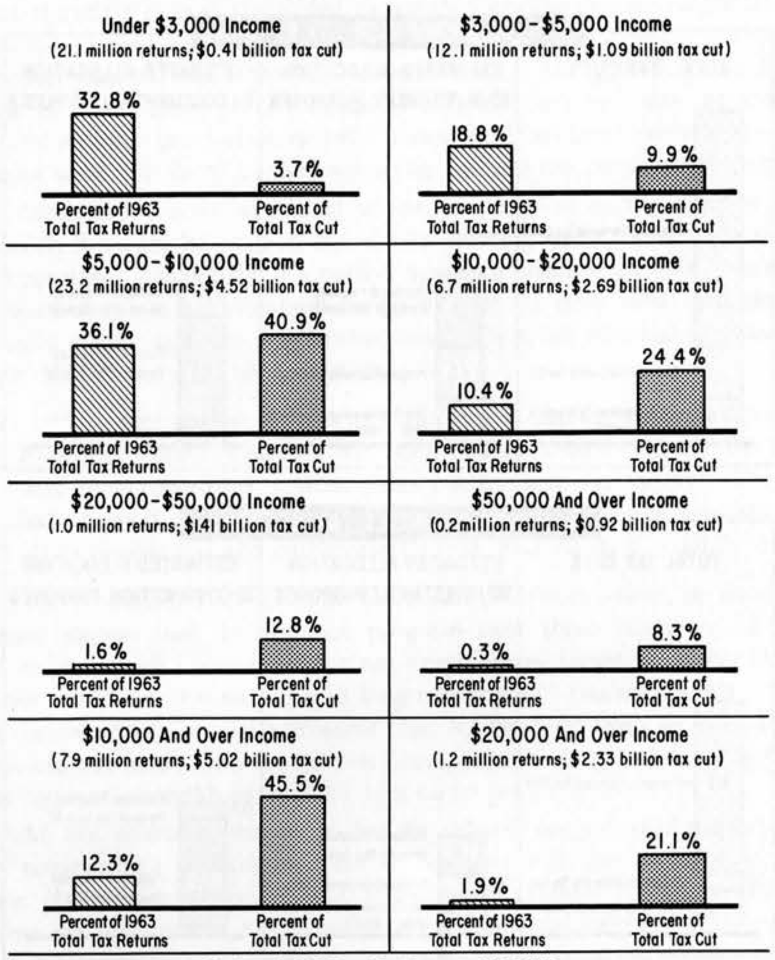
* If the proposed tax program did not take full effect until 1966, the difference between its effects and the needed GNP level would be very much bigger.



ADMINISTRATION PLAN, PERSONAL TAX CUTS EXCLUDING PROPOSED TAX REFORMS

Distribution Of Total Tax Returns 1/ And Of Total Tax Cuts 2/ Among Various Income Groups 3/



Estimated 1963 Total Tax Returns - 64.3 Million

Estimated 1963 Tax-$47.4 Billion; Proposed Tax-$36.4 Billion; Proposed Tax Cut-$11 Billion

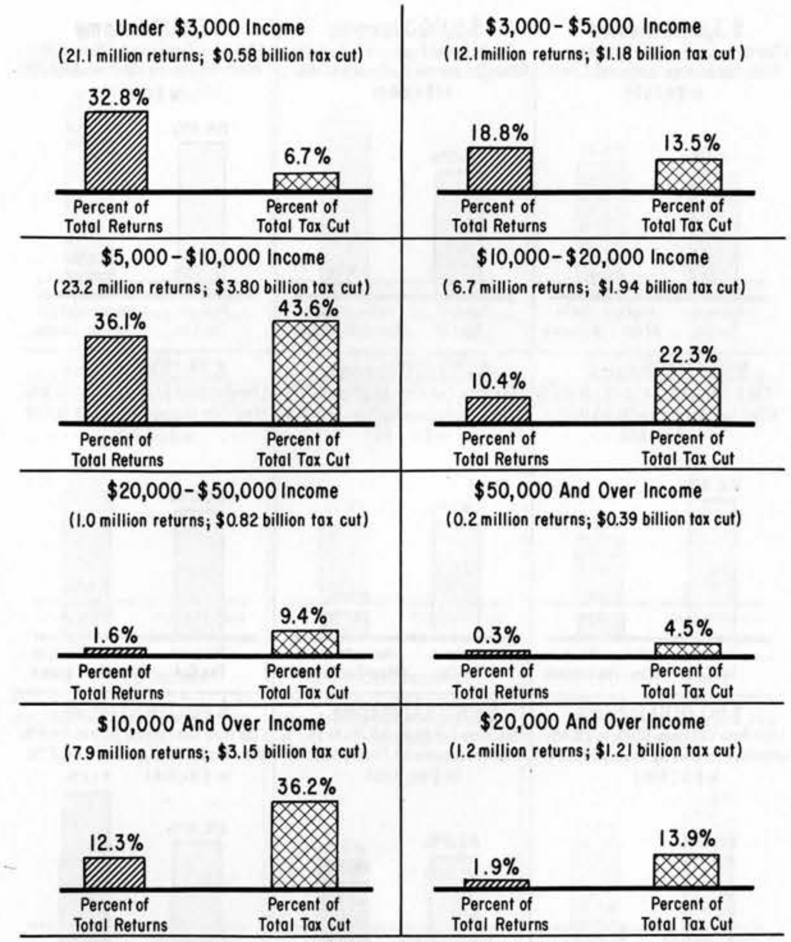
1/ All 1963 returns (taxable and nontaxable). CEP estimates based on Treasury Dept. data.

2/ Tax cuts as of 1965 (when plan would become fully effective) as proposed in President's 1963 Tax Message and Treasury Dept. data as of Feb. 6, '63, applied to 1963 income structure.

3/ Adjusted gross income levels as of 1963, estimated by CEP on basis of Treasury Dept. data.

ADMINISTRATION PLAN, PERSONAL TAX CUTS INCLUDING PROPOSED TAX REFORMS

Distribution Of Total Tax Returns 1/ And Of Total Tax Cuts 2/ Among Various Income Groups 3/



Estimated 1963 Total Tax Returns-64.3 Million

Estimated 1963 Tax-$47.4 Billion; Proposed Tax-$38.7 Billion; Proposed Tax Cut-$8.7 Billion.

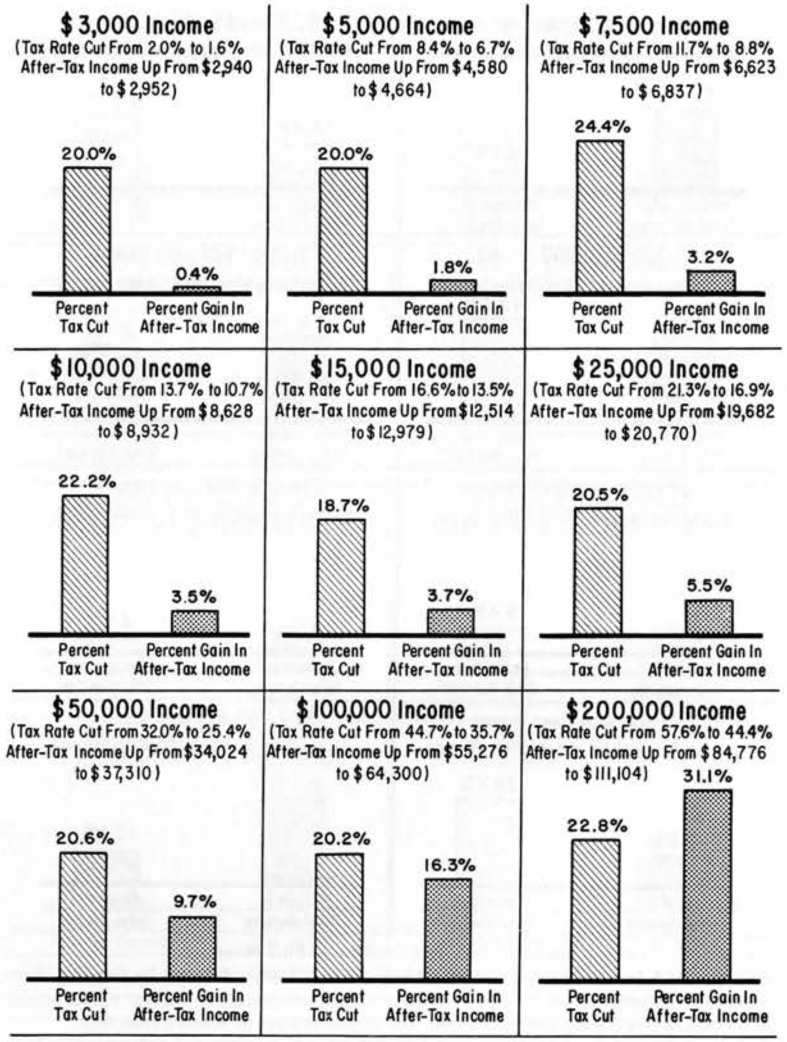
1/ All 1963 returns (taxable and nontaxable). CEP estimates based on Treasury Dept. data.

2/ Tax cuts as of 1965 (when plan would become fully effective) as proposed in President's 1963 Tax Message and Treasury Dept. data as of Feb. 6, 1963, applied to 1963 income structure. Effect of capital gains revision excluded.

3/ Adjusted gross income levels as of 1963, estimated by CEP on basis of Treasury Dept. data.

ADMINISTRATION PLAN, PERSONAL TAX CUTS EXCLUDING PROPOSED TAX REFORMS

Percent Tax Cut And Percent Gain In After-Tax Income
Married Couple With Two Children At Various Income Levels[1]

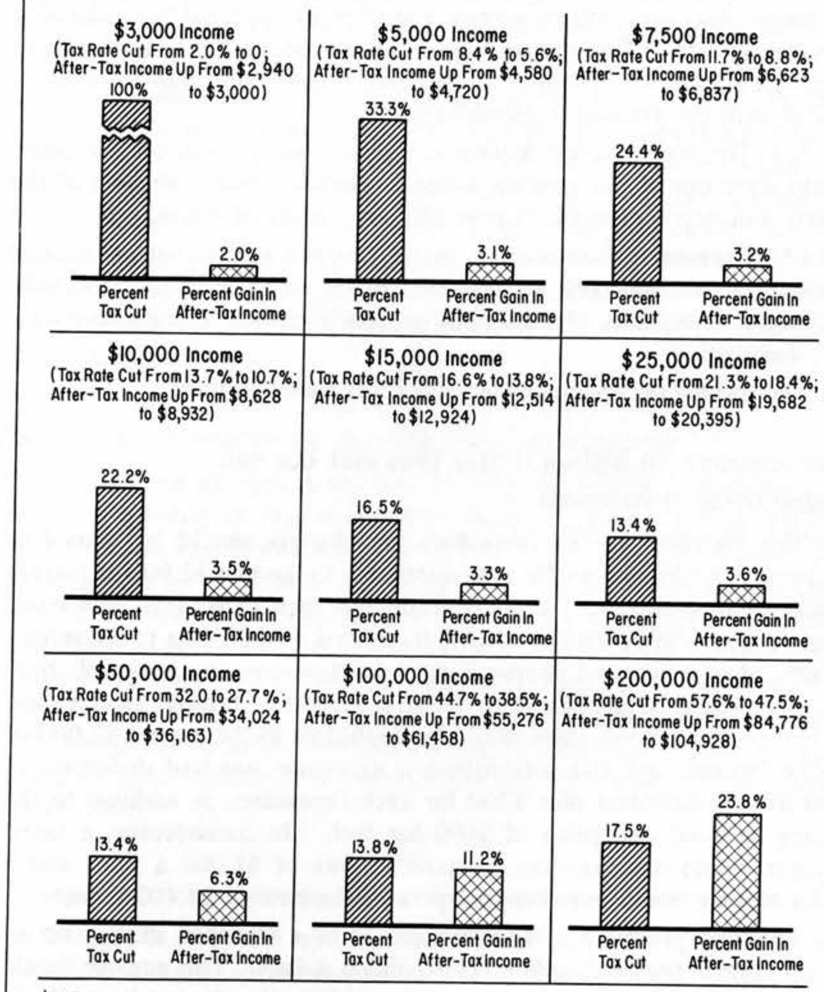


[1] Adjusted gross income levels.

Note: Present and proposed tax based on assumption of 10 percent deductions for taxes, interest, contributions, medical care, etc. Proposed tax based on the President's proposal, and Treasury Dept. data, as of Feb. 6, '63.

ADMINISTRATION PLAN, PERSONAL TAX CUTS INCLUDING PROPOSED TAX REFORMS

Percent Tax Cut And Percent Gain In After-Tax Income
Married Couple With Two Children At Various Income Levels[1]



[1] Adjusted gross income levels.

Note: Present tax based on assumption of 10 percent deduction for taxes, interest, contributions, medical care, etc. Proposed tax based on the President's proposal, and Treasury Dept. data, as of Feb. 6, '63.

IX. Toward A Tax Policy Geared To Growth, Priorities, And Justice

All of the preceding discussion results in these three basic findings:

(1) The proposed tax program is too small and too slow to make an appreciable dent upon idle manpower and plant by appreciably accelerating economic growth. This shortcoming is intensified by the composition of the program, which is ill-suited to bringing consumption into better relationship with our productive capabilities;

(2) The proposed distribution of the tax reductions is not calculated to help serve one of our greatest national priorities: swift reduction of the poverty and deprivation which now afflict two-fifths of a nation;

(3) Because of these defects, the tax proposal is inadequately attuned to criteria of economic and social justice, which are served by the mutually re-enforcing conditions of maximum economic growth and improved income distribution.

The specific tax recommendations of this study are these:

First priority: 10 billion dollar personal tax cut, progressively distributed

The first priority and immediate tax changes should be limited to (a) cutting the 20 percent flat rate, applicable to the first $2,000 of taxable income, to an average rate of considerably less than 15 percent, with much larger reduction in the rate applicable to the first $1,000 than to the second $1,000. For a married couple filing a joint return, the lower of these two rates would be applicable to the first $2,000 of taxable income, and the higher of these two rates would be applicable to the second $2,000 of taxable income, and (b) establishing a minimum standard deduction of $400 for an individual plus $200 for each dependent, in addition to the existing personal exemption of $600 for each. In consequence, a single taxpayer would have tax-free personal income of $1,000 a year, and a family of four would have tax-free personal income of $3,400 a year.

This first priority tax reduction should be a one-shot affair, with an annual value in the neighborhood of 10 billion dollars. This amount should be much larger, were it not for the non-tax additional programs immediately needed.* This suggested tax reduction would fall far below the 13.5 billion

* Detailed in the final chapter.

representing the Administration's program without the reforms, and would be somewhat more than one billion higher than the 8.8 billion representing the Administration's proposed tax programs including the proposed reforms.* However, concentration of this economic stimulus within a one-year period, which is essential, would be enormously more effective than spreading it out over three years. Also, the composition of this suggested tax action would be much better adjusted to balanced and adequate economic growth, meeting our national priorities, and advancing economic and social justice.

The income improvements and the immediate losses in Federal revenues which would result from these suggested tax changes are entirely consistent with the *American Economic Performance Budget* which all Conference studies use as a guide to analysis and policy recommendations. The purpose of this *Performance Budget* is to develop, in accord with the intent of the Employment Act of 1946, a balanced and sustainable relationship among various types of economic activities and income flows, compatible with sustained maximum employment, production, and purchasing power.

The modest character of the suggested exemptions

Allowing for changes in the cost of living, the $3,400 exemption suggestion for a family of four would have about 53 percent less purchasing power than the $3,300 exemption for a family of four in 1939, while the current exemption of $2,400 has 67 percent less purchasing power than the 1939 exemption. Moreover, according to widely accepted standards, it now takes an income in the neighborhood of $2,000 a year before taxes to lift an individual living alone above poverty, and an income of $4,000 a year before taxes to lift a family of average size above poverty. And taxes should not be collected from millions of people in amounts which force them much farther downward in the poverty-income category than they are now.

All other tax changes should be held back for later action

Changes in corporate tax rates, any further reduction of personal tax rates of those higher in the income structure, and all of the reform proposals, should be deferred until this first priority suggestion is enacted into

* Both figures are exclusive of the about 2 billion dollar annual value of the corporate tax concessions in 1962, through legislative and executive administrative action.

law. This first priority action would do the most economic good, and the most quickly. It is really the most important of all tax reforms, because no "reform" is so truly worthy of the name as that which makes our tax system more progressive and therefore more compatible with economic and social justice. Simultaneous consideration of other tax proposals tends to prevent sufficiently intense focus of analysis upon the first priority need—and might even jeopardize it. Processing to date by the Congress of an excessively complex tax package indicates that some of the desirable proposed reforms may be lost (and some highly undesirable reforms added). If this should happen, the net result of enactment of the proposed tax cut features would be very harshly regressive.

The need for corporate tax cuts is relatively negligible or non-existent

As shown throughout this study, corporations in general need larger markets, not additional forms of preferential tax treatment piled on top of those provided in 1962 (in the neighborhood of a 10 percent cut). A corporate tax cut having an annual value of about 2.56 billion dollars without the proposed reforms, and 0.8 billion dollars with these reforms, would have very minimal benefits to the economy or the people (and even to our business system proper), compared with alternative utilization of similar amounts at other points in the Federal Budget. To take one striking example, the 2.56 billion dollar figure is 66 percent higher than the 1.537 billion dollar figure for education in the fiscal 1964 Budget. Lifting the current educational item by this amount would bring it within a few hundred million dollars of the 4.5 billion figure to which educational outlays should be lifted by calendar 1966, in order to reflect an appropriate contribution by the Federal Government towards meeting this towering priority of our domestic public needs. Even the 0.8 billion dollar figure, representing the annual value of the corporate tax reduction with reforms, could be used in part to lift the fiscal 1964 Budget allowance for housing and community development from 276 million dollars to the one billion dollars which would be an appropriate allotment for fiscal 1964; and the approximately 76 million dollars left over could be a very minimal addition to the 414 million dollar item now provided in the 1964 fiscal Budget for labor and manpower. Perhaps some slight reduction in corporate tax rates might be desirable, if focused almost exclusively upon improving the after-tax position of small business.*

* For fuller discussion of these domestic public needs, see Chapter X.

Substantial net tax reduction for upper-middle and higher-income groups has very low priority

Substantial tax reduction for everybody is indeed pleasant and even desirable, other things being equal. But other things are not equal now. With the popular psychology committed so largely to holding Federal deficits as low as feasible, the opportunity to facilitate our economic objectives through deliberate deficits in the Federal Budget are seriously limited. So long as this condition persists, the amounts involved in substantial *net* tax reductions for upper-middle and higher-income taxpayers should be devoted to other programs. These other programs are much more worthy on equitable and social grounds, and far more contributory to economic balance and economic growth. If we restore quickly and maintain steadily a maximum economic growth rate, the added volume of gross private domestic investment would be 74 billion dollars for the period 1963-1966 as a whole. The added volume of non-corporate business and professional income would be 17.5 billion, and of corporate profits more than 27 billion. The preponderance of these benefits would flow to upper-middle and higher-income groups.

The argument that upper-middle and higher-income groups need large tax reductions in order to induce more saving for investment purposes has already been disposed of. There is a redundance of such saving now; and adequate demand for ultimate products always generates enough or relatively more than enough saving and investment in expanding the means of production.

Lower tax rates for upper-middle and higher-income groups should be compensated for fully by concurrent loophole-closing

The only tenable argument for substantial reductions in tax rates applicable mainly to upper-middle and higher-income groups is that these tax rates are now so high that they encourage evasion or avoidance, or that they are so high that they have generated a wide variety of undesirable loopholes. The argument that they are so high as to "discourage investment initiative" is insupportable.

Thus, when the time comes to consider this type of tax reduction, its net immediate cost to the Federal Budget should immediately be recouped in full by those types of tax reforms which are pointed toward the closing of loopholes. But legislative effort toward this end is likely to be effective only if undertaken after the suggested first priority tax program is enacted. When the two are processed together, the task is so complex, and the competing pressure so intense, that any sound tax program is endangered.

Some of the Administration's reforms do not go far enough; others are pointed in a regressive direction. But for this study to go into these matters in detail would violate the very principle of action urged. It would take our eyes off what should be done first on the tax front. And it would also distract attention from other types of national economic action of higher priority than the second suggested stage of tax action, and of quite as high priority as the first stage.*

* The effect of the entire suggested tax program upon the Federal Budget is discussed in Chapter X.

X. Other Changes In National Policies Are As Urgent As Tax Reduction

Preoccupation with tax reduction has led to neglect of other changes in national economic policies which are quite as important and urgent, or even more so. Any plea that we should "concentrate upon one thing at a time" is not nearly good enough; the economic task confronting us is so broad and imperative that it requires a powerful *combination* of policy changes. In preparing to fly across the ocean, no one would concentrate only upon whether the plane had satisfactory landing gear, and neglect to check whether it had enough gas. Besides, whether any particular change in tax policy is desirable depends upon the blend of other policy changes with which it is combined to achieve the total economic objectives which we set for any given time span.

Even this study's suggested tax reduction could not do the whole job

This study's suggested immediate 10 billion dollar tax reduction would provide immensely more stimulus to the economy than the Administration's proposed tax program. But as estimated in the preceding chapter, for full economic restoration we need to lift total national production to a 1964 level about 57 billion dollars higher, and a 1965 level about 85 billion higher, than the levels likely to result in each of these two years if our national economic policies were to remain approximately in *status quo*. Using a "multiplier" of three, and with almost all of this suggested tax reduction being pointed to where it would be spent promptly, it is clear that even the 10 billion dollar immediate tax reduction suggested in this study would accomplish only about 36 billion dollars (allowing in view of so powerful a tax reduction about 6 billion for the effect of the 1962 tax concessions) of the 57 billion restorative task for 1964. Moreover, in each succeeding year the stimulative value of tax reduction of this size would become smaller, relative to the actual and needed size of total national production.

If the suggested 10 billion dollar tax reduction cannot do the whole job, why not a still bigger tax reduction? The answer is that some of our most crucial economic problems cannot be dealt with primarily by tax reduction. And this is especially true of the unemployment problem, which calls for fundamental changes in the structure of demand.

Needed changes in the structure of demand, which tax reduction cannot accomplish

It is true that the chronically high and rising level of unemployment is not due primarily to deficiencies in the training and aptitudes of the labor force. Granted that training and retraining programs are needed, the overwhelmingly important reason for unemployment (above levels consistent with maximum employment) is the insufficiency of total jobs. As we learned during World War II, even people without any training were trained very quickly for difficult jobs when the jobs were there. But the chronically high and rising level of unemployment, and the task of restoring and then maintaining maximum employment, *do* relate very closely to the structure or composition of ultimate demand for goods and services.

Let us examine why this is so. It is estimated that there is need, during the next decade, to increase the total number of jobs now available by more than 16 million net. This includes close to 4 million needed to reduce the current true level of unemployment to a level consistent with maximum employment, and more than 12 million needed to absorb the additions to the civilian labor force which will result from population growth and from the changing age composition of the population due to the high birth rate shortly after World War II.

But it would be virtually impossible to achieve this 16 million net increase in employment opportunity wholly or even mainly in accord with the current structure of demand for goods and services. This is because of the very rapidly accelerating advance of technology in agriculture and of automation in most of the mass production industries which turn out a large part of all goods. As an illustration of the speed of these accelerating changes, it has been estimated that, a decade hence, 8-10 million fewer workers than are now employed could turn out our current volume of production.

To achieve a sufficient increase of job opportunity in line with the current structure of demand would mean that output in these mass production industries and in agriculture would rise very much faster than is likely to be in accord with any foreseeable pattern of consumer demand, even assuming adequate consumer incomes in the aggregate. And even if the consumer demand for these particular types of products were to rise sufficiently rapidly by the sole test of job requirements, we would have relative overconsumption of these products, when measured against some of the highest priorities of our national needs (for example, education, health, and housing) which are now being relatively neglected, and which are likely to be even more neglected in the years ahead, unless there are drastic changes in the structure of demand.

Thus, the only way to deal effectively with the job problem, as well as the only way to meet our needs for goods and services in ways which approximate a reasonable regard for our priorities of need, is this: There must be a recasting of private investment so that much more of it will flow, both absolutely and relatively, into those areas where our real needs for the resultant products are so great now and during the years ahead that not even the rate of advance in technology and automation will stand in the way of vast expansion of employment. This recasting of private investment depends upon programs other than tax reduction, including increased public spending, as the following analysis shows.

Key areas for redirection of private investment: housing, urban renewal, mass transportation

By far the most important opportunity for restructuring the flow of private investment is in the field of housing and urban renewal. This field has room for immense and sustained increases in such investment, and there is also an unusually high ratio between each dollar invested in housing and urban renewal and other dollars of private investment stimulated thereby. Another challenge of immense proportions is offered by the opportunity to improve and expand our mass transportation facilities. This need exists not only in urban and suburban areas. Transportation facilities throughout the Nation have grown inadequately, in response to the deficient rate of overall economic growth.

Neither a steel industry receiving corporate tax cuts, nor high-income families receiving large personal tax cuts, would start housing and urban renewal programs. Nor would tax cuts for the railroads spark the great changes needed in dealing with mass transportation. Sufficient expansion of private investment in these areas, and in others as well, requires changes in national economic policies quite different from tax reduction. A movement toward lower interest rates and more ample credit is essential. Especially in the case of housing and urban renewal, there is also need for Federal legislation providing new admixtures of private and public effort. This is needed to expand the production of suitable housing for middle-income families, who are not now reached adequately by conventionally financed private housing (including housing insured by FHA and VA) nor by public housing for lower-income families. A very large expansion of Federal financial assistance to the public housing program, and to slum clearance and urban renewal, is also an inescapable component in any "model" for growth, priorities, and justice. All of these programs, and many others, require large expansion of both private and public spending.

Deficient level of Federal spending for our domestic public priorities

In addition to the increased public spending required for the restructuring of demand set forth in the preceding paragraphs, the needed changes in the structure of demand require also that a much larger part of the labor force be drawn into a wide variety of service occupations, notably educational and health services. And the rapid expansion of these services is among the highest priorities of our national needs, quite aside from the unemployment problem. To expand these services requires not only more personnel, but also more facilities. The need extends also to many other human welfare programs, and to the further development and conservation of our natural resources. None of these efforts would be appreciably accelerated by the kind of tax reduction now proposed, nor adequately accelerated by any kind of tax reduction. Such acceleration requires, on a long-range basis, an admixture of private and public efforts, and, at the very core of this, vast and progressive increases in Federal public outlays.

Vividly contrasting with these needs, the first chart following this chapter shows that total Federal Budget outlays, measured by one appropriate test as a percentage of our total national production, have declined from 18.66 percent in fiscal 1954 to 16.80 percent in the official Budget for fiscal 1964.* These total Budget outlays *per capita*—an appropriate test in terms of needs—have declined (measured in uniform 1962 dollars) from $544.36 in fiscal 1954 to $505.86 in the fiscal 1964 Budget. *Per capita* outlays for all domestic programs (which exclude outlays for national security, all international purposes, and space research and technology) rose from $150.96 in fiscal 1954 to $189.82 in fiscal 1963, a grossly inadequate increase in view of our national needs and the decline of larger size in *per capita* outlays for the non-domestic items. More pertinent today, the fiscal 1964 Budget *reduces these per capita domestic outlays* to $186.83. And the proposed tax reduction is accompanied by official assurance that every effort will be made to hold aggregate domestic public outlays in the Federal Budget at the currently deficient level in the years immediately ahead. Even holding them at the current aggregate level would mean reduction *per capita* as our population grows.

Goals for domestic public outlays in the Federal Budget

The second chart following this chapter depicts a Federal Budget geared to our economic growth needs and our great domestic priorities.

* GNP for fiscal 1964 estimated.

This Budget is derived within the balanced and integrated framework of a "model" for maximum employment, production, and purchasing power, which sets balanced goals in accord with the intent of the Employment Act of 1946. Consistent with these goals, the chart indicates that, comparing the fiscal 1964 Budget with suggested goals for calendar 1966, outlays *per capita* for all domestic programs (measured in uniform 1962 dollars) should rise from $186.83 to $221.11; outlays *per capita* for education should be increased almost three times; outlays for health services and research should be almost doubled; and outlays for housing and community development should be multiplied about eight times.* With proper allowance for our other domestic needs, and accepting the expert judgment as to our national security, space, and international needs, total Federal outlays *per capita* (measured in uniform 1962 dollars) should rise from $505.86 in the official Budget for fiscal 1964 to $577.89 in calendar 1966. Yet, measured as a percentage of total national production in a properly growing economy, these total outlays would decline from an estimated 16.80 percent in fiscal 1964 to 15.91 percent in calendar 1966.

Consistent with these long-range goals, this study recommends an immediate increase in the Federal Budget, above the official fiscal 1964 Budget, in an amount of about 3 billion dollars for domestic programs.

Effect of recommendations upon the condition of the Federal Budget

This increased spending would not militate against the suggested tax reduction, even in terms of the financial condition of the Federal Budget (which is not of importance comparable to the condition of the national economy). As shown by the third chart following this chapter, our Federal Budget deficits have grown with our national economic deficiencies, despite almost constant efforts to maintain a balanced Budget. And as shown by the fourth chart, a maximum prosperity economy during the calendar years 1953-1962 would have yielded an aggregate Budget surplus (calendar years) estimated at 17 billion dollars, even with appropriately larger Federal outlays and allowing for some needed tax reduction. When this is contrasted with the actual aggregate Budget deficit of 36.9 billion during this period, it appears that an effective maximum prosperity program would have placed the Federal Budget itself in a more favorable position by about 54 billion dollars.

* In dollar amounts, however, the outlays for education would be twice as high as, and the outlays for health services and research more than 40 percent higher than, the outlays for housing and community development.

Why the States and localities cannot assume more of the load

The need for this additional spending by the Federal Government is accentuated by trends at State and local levels. Comparing fiscal 1962 with fiscal 1952, as shown on the fifth chart, Federal Budget expenditures increased 34.4 percent, while State and local government expenditures increased 131.8 percent. Meanwhile, comparing fiscal 1962 with fiscal 1952, the net Federal debt outstanding (at end of year) increased 15.1 percent, while the net State and local debts outstanding increased 179.1 percent. Another factor to be taken into consideration is this: Insofar as public spending is financed by taxation, Federal tax policy is progressive (though not progressive enough) in its impact upon income distribution, while State and local taxation in the overall is extremely regressive. This, too, has an important bearing upon the proper distribution of the public spending load among the three levels of government, from the viewpoint of the effects upon economic growth, priorities, and justice.

Need for still other Federal programs

Taking appropriate "multipliers" into account, the suggested 3 billion dollar immediate increase in the annual rate of Federal public spending, together with the suggested 10 billion dollar immediate tax reduction, would stimulate the annual rate of total national production about 40½ billion dollars.* With this amount of expansion, the 2 billion dollar tax concessions of 1962 would have a stimulative effect of about 6 billion, bringing the whole stimulative effect upon total national production up to about 46½ billion in the first year. But even these amounts would not be nearly enough to close the estimated 57 billion dollar gap in 1964, and 85 billion in 1965, between needed total national production and that estimated to result if our national policies remained substantially in *status quo*.

This is merely another way of saying that the Federal Budget, including taxation and expenditure, cannot do the whole job. Many public programs, not involving public spending, need also to be expanded greatly. A large percentage of our more than 18 million senior citizens live in poverty or deprivation; social security needs expansion. Minimum wage legislation needs much improvement, with respect to both coverage and amount. Effective Federal programs to enlarge the income and living

* "Multiplier" of 3 for tax reduction, and 3½ for increased Federal spending.

standards of the farm population are also urgent, and these may entail less Federal spending for agriculture than the current rate.*

Encouraging private economic adjustments: improved utilization of the Employment Act of 1946

Even with all of this, the major portion of the expansionary force must come from private economic decisions. Changes in price and wage policies, as well as in investment decisions and per-unit profit-margin targets, can result in a better balance between expansion of the means of production and expansion of private consumption. The recommended changes in national economic policies would, if adopted, contribute greatly toward these private adjustments, by the improved psychological climate which would result from the firm display of determination to achieve the objectives of the Employment Act of 1946.

In addition, without any scintilla of resort to direct intervention in the processes of business decisions or collective bargaining, the setting forth of appropriate quantitative goals under the Employment Act would by reason rather than by fiat improve the quality of major private decisions. By drawing upon our functioning private economic groups, through the consultation process, in the formulation of goals and policies under the Employment Act, we would achieve the larger unity of purpose and the improved cooperation between responsible free enterprise and responsible free Government which our domestic needs and the world situation so insistently call for.

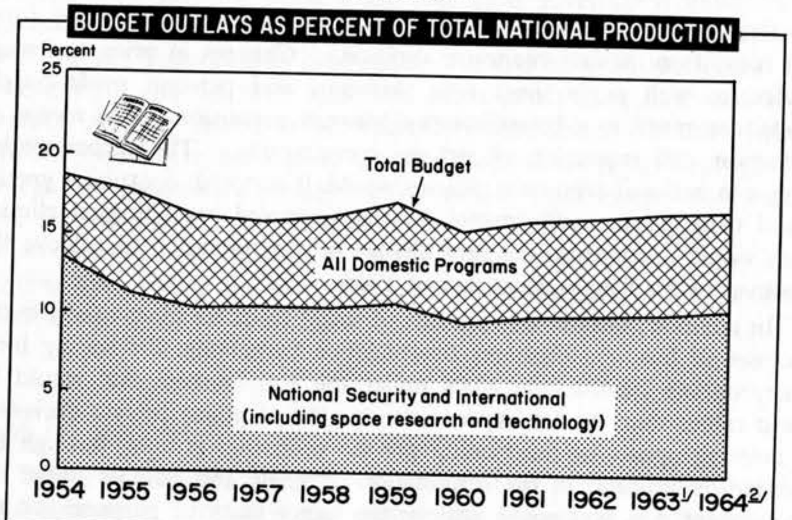
There is no short cut nor easy road to growth, priorities, and justice. The Employment Act provides a wonderful instrumentality, consistent with our traditions, for moving forward. But this Act is not now being fully used to project on a short-range and long-range basis the balanced and integrated quantitative goals for maximum employment, production, and purchasing power which are not only called for by the Act itself, but which are absolutely essential to the development of national economic policies geared to these objectives. The tax proposal in its current form is but one poignant illustration of what happens when policies are reshaped without being geared adequately to the specifics of growth, priorities, and justice. The much improved utilization of the Employment Act is therefore the first *sine qua non* for the forward movement.

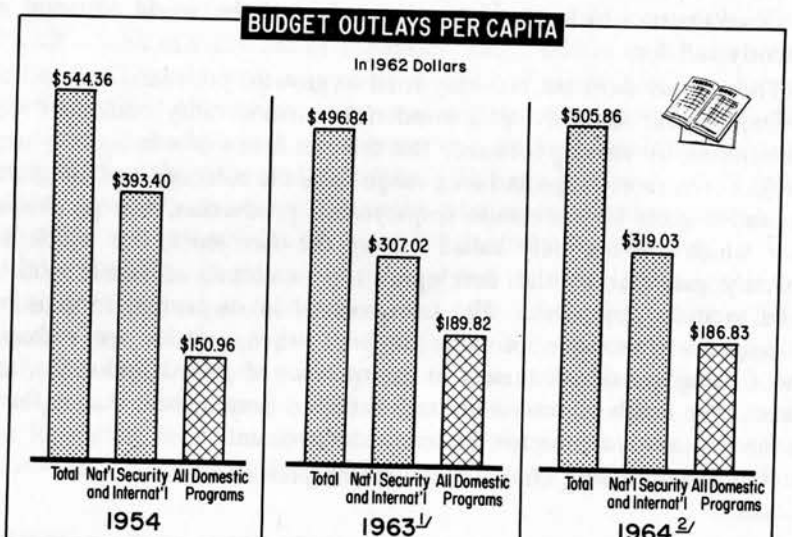
The five following charts complete the presentation.

* For full discussion of poverty among our senior citizens, among workers paid substandard wages, and among farm families, see Chapters VII and VIII of the Conference study, *Poverty and Deprivation in the U. S.*

FEDERAL BUDGET HAS SHRUNK RELATIVE TO SIZE OF ECONOMY AND NEEDS, 1954-'64

Fiscal Years





[1] Preliminary. G.N.P. estimated at $565 billion, CEP.
[2] Administration's proposed Budget as of Jan. 17, 1963. G.N.P. estimated at $588 billion, CEP.

GOALS FOR A FEDERAL BUDGET GEARED TO ECONOMIC GROWTH AND PUBLIC NEEDS

1964, Fiscal Year; 1966, Calendar Year
Per Capita Outlay in 1962 Dollars

TOTAL FEDERAL OUTLAYS

Year	% of Total Output	Per Capita
1964 Adm.[1]	16.80	505.86
1964 Goal	16.29	521.20
1966 Goal	15.91	577.89

NATIONAL DEFENSE, SPACE TECHNOLOGY AND ALL INTERNATIONAL

Year	% of Total Output	Per Capita
1964 Adm.[1]	10.59	319.03
1964 Goal	10.16	325.11
1966 Goal	9.82	356.78

EDUCATION

Year	% of Total Output	Per Capita
1964 Adm.[1]	.26	7.87
1964 Goal	.32	10.24
1966 Goal	.62	22.61

HEALTH SERVICES AND RESEARCH

Year	% of Total Output	Per Capita
1964 Adm.[1]	.28	8.41
1964 Goal	.32	10.24
1966 Goal	.44	16.08

PUBLIC ASSISTANCE

Year	% of Total Output	Per Capita
1964 Adm.[1]	.51	15.48
1964 Goal	.51	16.38
1966 Goal	.51	18.59

LABOR AND MANPOWER, AND OTHER WELFARE SERVICES

Year	% of Total Output	Per Capita
1964 Adm.[1]	.16	4.85
1964 Goal	.16	5.12
1966 Goal	.15	5.53

HOUSING AND COMMUNITY DEVELOPMENT

Year	% of Total Output	Per Capita
1964 Adm.[1]	.05	1.42
1964 Goal	.16	5.12
1966 Goal	.31	11.06

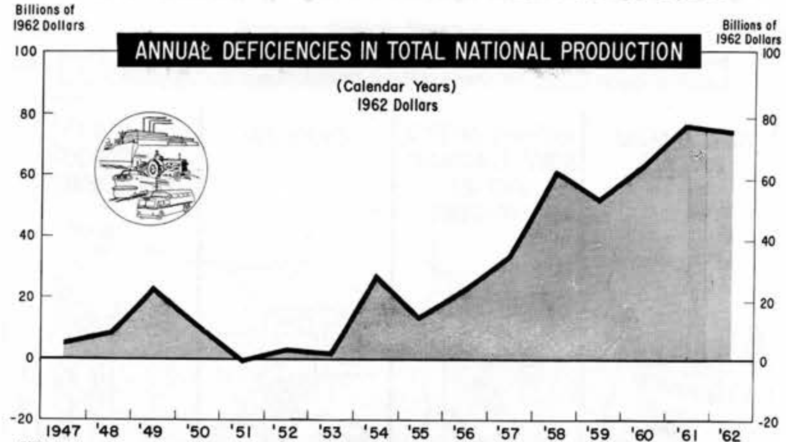
ALL DOMESTIC PROGRAMS AND SERVICES

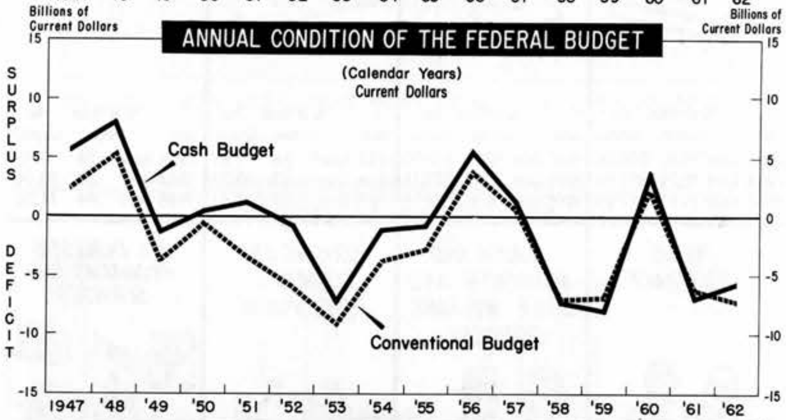
(Includes also Agriculture; Natural Resources; Veterans; Commerce; Interest; General Government, etc.)

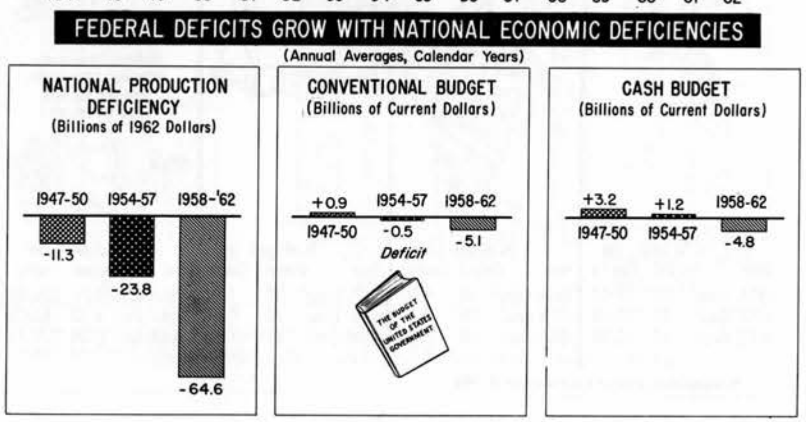
Year	% of Total Output	Per Capita
1964 Adm.[1]	6.21	186.83
1964 Goal	6.13	196.09
1966 Goal	6.09	221.11

[1] Administration's proposed budget as of Jan. 17, 1963.

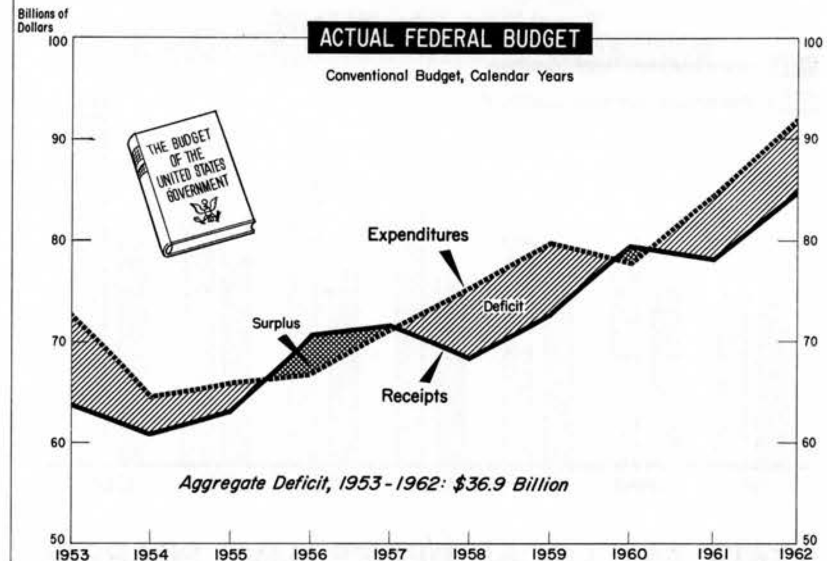
THE FEDERAL BUDGET REFLECTS NATIONAL ECONOMIC DEFICIENCIES

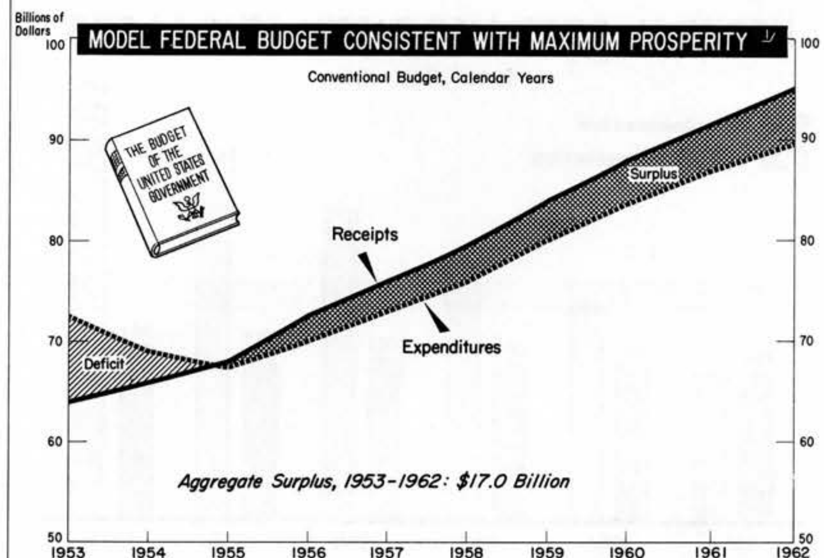




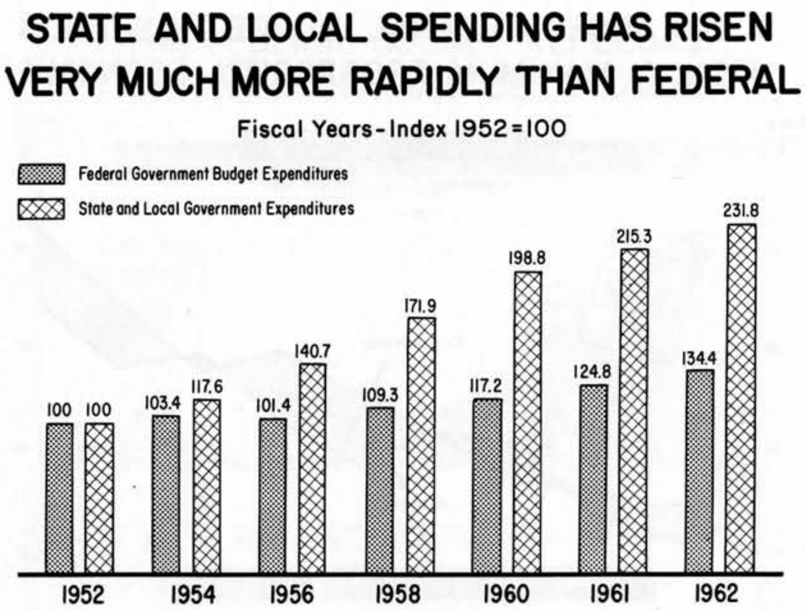


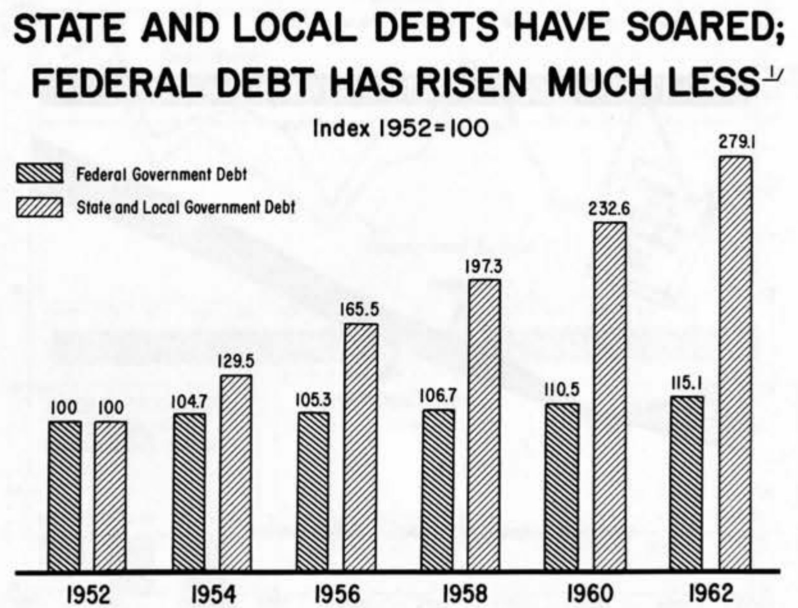
A BALANCED FEDERAL BUDGET DEPENDS UPON A MAXIMUM PROSPERITY ECONOMY





1/ Expenditures are shown as actual expenditures plus estimated deficiencies in expenditures during the period. Receipts are estimated by applying actual tax rates to maximum prosperity levels of economic activity.





[1] Net debt outstanding as of June 30.

Data: Treasury Dept., Bureau of the Budget and Commerce Dept.

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J.S.
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August 13, 1963

PERSONAL AND CONFIDENTIAL

Honorable Hubert H. Humphrey
United States Senate
Washington, D.C.

Dear Hubert:

Many thanks for your letter of August 9, enclosing a copy of your talk on taxes and civil rights. I am particularly encouraged that you included in your talk the statement that the tax cut should concentrate as heavily as feasible upon consumers in the low and middle income groups, and that especially if the so-called reforms are deferred in whole or in part, the distribution of the tax cuts will need to be sufficiently different from those originally proposed to accomplish this type of concentration. (The foregoing is true, even if one does not accept my view that the originally proposed tax package, including the reforms, ignored the desirability of this kind of concentration and indeed had many regressive aspects, as demonstrated in my study "Taxes and the Public Interest," an additional copy of which I am enclosing for your convenience).

Unfortunately, it appears from the study that I have thus far been able to give it, that the new tax package just presented to the Ways and Means Committee by the Secretary of the Treasury, based upon the assumption that most of the reforms are to be deferred or dropped, indicates much less of this concentration and is a much more regressive package than the one originally proposed. This is most disheartening. When I have studied this new package in more detail, I will send you my estimates as to its distributive features, to supplement or replace the estimates furnished in "Taxes and the Public Interest," based upon the original package.

I am also working along, subject to the necessary interruptions of other commitments and an unusual number of out-of-town trips (I am going out to Minnesota tomorrow to visit with our friend Bill Thatcher) on developing in response to your request a draft for you on the gold and balance of payments problems and the recent move toward tighter money and higher interest rates. This move, coupled with the newest version of the tax package, gives us plenty to worry about.

Again let me say that I recognize that a liberal Democratic Senator confronts now a most difficult dilemma which he can resolve better than I could suggest to him. This is one moment when I am glad that I am not in his shoes. For myself, in view of the latest developments, I can see no constructive course other than to continue to voice objective criticism of an economic policy which I can neither accept in substance nor reconcile with our traditional commitments. I can only hope that some people in the Administration will gradually benefit by my comments as they continue to be vindicated by actual developments, instead of trying to disparage them by the substitution of personalities which hurt them and the cause rather than me, and cannot get me to change my course.

I am looking forward to testifying on the Tax Bill when it comes before the Senate Finance Committee.

With kindest regards and best wishes,

Faithfully yours,

Leon H. Keyserling

LHK:dg

Confidential - for Hubert Humphrey

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Jane

July 22, 1963

pls hold for much

Honorable Hubert H. Humphrey
United States Senate
Washington 25, D. C.

Dear Hubert:

I have your letter of July 19th with enclosure of your Senate remarks of July 18th, which are both courageous and correct. In due course, which means as soon as possible, I will send you some extensive materials on the whole balance of payments problem, interest rates, monetary policy, etc. The time is certainly at hand for what you call "a thoughtful but candid and hard-hitting speech." My only difficulty is that I cannot understand why even people as wise and perceptive as yourself are still giving the perpetrators of the latest policies the benefit of even a partial "wait and see" attitude, even allowing for the "political" problems which I know confront you. We cannot permit these "political" rationalizations indefinitely to do what they are doing to the country, and what ultimately they will do to a Democratic Administration.

How long do we need to "wait and see?" I began to attack the fundamental changes in our monetary policies in 1951, when they began to gain momentum because, despite the opposition of President Truman, the Democratic Administration at the end of almost twenty years of service was too run-down to make its opposition effective, and because the President was betrayed by some of his own appointees -- some of whom, after serving throughout the Eisenhower Administration are still receiving accolades from the Kennedy Administration.

Year by year, after 19~~61~~ 51, I pointed out in study after study and forecast after forecast the damages which these policies were doing and would do. Every one of my forecasts was completely vindicated by ensuing developments, although I had very little support from the economics profession which to a surprising degree operates like a herd in following the latest fashions. But I did have the increasing support of the Democratic Party and its spokesmen during the Eisenhower years. Around 1958 or 1959, the great Senator from Minnesota asked me to prepare a very comprehensive study for him on this whole subject, which I did and which he used. In July 1960, I carried this study much further, in the form of a published pamphlet entitled <u>TIGHT MONEY AND RISING INTEREST RATES -- AND THE DAMAGE THEY ARE DOING</u>. I timed the preparation of this pamphlet to coincide with our 1960 Democratic challenge to the Eisenhower policies; my views were written into the Democratic platform in 1960, and formed one of the two major domestic theses of our Standard Bearer in 1960, who incidentally made frequent platform references to my work on this subject.

Then came 1961, when the Democratic Administration commenced the curious process of reevaluating the tight money and rising interest rates policy by appointing to the key job in the Treasury dealing with the subject the research director and one of the chief architects, from his vantage point in the Federal Reserve set-up in New York, of the policy which we had pledged ourselves to reverse. Later on, in various ways, the same thing was done in the Federal Reserve System.

Let none of the economists in the Administration tell you that there has been any basic change in these monetary policies since early 1961. To be sure, the trends in interest rates during the period since early 1961 have not continued at the same pace as during the previous years. They could not possibly continue at that pace, and would not have even if Nixon had been elected, because that would have meant soon having interest rates of 25 and then 50 percent. The Democratic Party in 1960 did not promise to continue the crime at ~~the same~~ a slower pace; it promised gradually if not quickly to reverse a criminal economic policy. Instead, in the fair perspective of the economic climate and what had gone before, the differences between the monetary policy before 1961 and after 1961 have been negligible. Even my 1960 publication (see page 63) was not so unrealistic as to project a continuation of the policy at the same pace. And while my 1960 study was not correct in all of its forecasts in quantitative detail on this intricate subject, it has again turned out in the main to be substantially correct.

My 1960 study was lacking in "foresight" in one respect. It coupled the iniquitous monetary policy with the inflation bogy. I was then not smart enough to foresee that a Democratic Administration, deprived of any scintilla of possibility of using this bogy further, would found the same monetary policy upon the even more preposterous gold bogy. It is even more preposterous because inflation is an evil, even if the Eisenhower Administration handled it wrongly, while the gold problem is a problem only because we are worshipping an outmoded idol which is a problem only because the bankers say so. And it is even more preposterous because we have had $2\frac{1}{2}$ additional years in which to learn something, and because a Democratic Administration should learn faster than a Republican Administration.

Am I impatient and too severe, or are the twelve long years since 1951 long enough for what is happening to sink in? I am not positive that, feeling as I do, I can prepare a draft on this subject which you will be able to use. But I will do my best. In the meantime, I hope that you will set aside an hour or so for a close reading of the 1960 study transmitted herewith. It marshalls the main reasons why the tight money and rising interest rates policy is so essentially dangerous and so utterly ridiculous. As I have said, some of my forecasts as to future developments have turned out to be incorrect in detail. But they have turned out to be a great deal more correct than any of the forecasts made either by those economists who really believe in the current policy or who know that it is wrong but do not have the stamina to resist it even at the risk of their precious jobs.

I will be in touch with you again shortly.

With kindest regards and best wishes,

Faithfully yours,

Leon

Leon H. Keyserling

LHK/h
Enc.