



THE AMERICAN INDUSTRIAL COMPLEX

Honorable Richard A. Holton

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Revised by Col E. J. Ingmire, USA on 7 January 1964.

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The American Industrial Complex

2 January 1964

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INDUSTRIAL COLLEGE OF THE ARMED FORCES

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ADMIRAL ROSE: We start a new year and a new unit on the first of Happy 1964. I hope you all get the assignments you want next March. We do start a new unit, though - a very important one which is very essential to our business here, and that is "National Logistics Management." Before we start examining the various industries' relations to this problem and what they do about it, including Personnel, R&D, Transportation, Manufacturing and all the rest, we want to start out with an over-view from the Assistant Secretary of Commerce for Economic Affairs, who is going to speak to us on "The American Industrial Complex."

It is my privilege to introduce to you the Honorable Richard H. Holton. Mr. Secretary.

SECRETARY HOLTON: Thank you very much, Admiral. I'm happy to have this opportunity to talk to you about "The American Industrial Complex." I thought that I would discuss first of all in a very brief manner, the national income accounts so that you can see how the industrial structure of the United States can be analyzed within the framework of the national income accounts. Now, I appreciate that many of you will have had different degrees of exposure to national income accounting, so I don't intend to go into any of the details, but I think it might be helpful to see how one can analyze the impact of changes in any one industry on the national income accounts as a whole. So, what I'd like to do first of all, then, is to review very quickly the nature of these national income accounts and then tell you a bit about the inter-industry table which has come to

be a very useful device for analyzing the impact of any kind of change in what we call "the final bill of goods."

This inter-industry analysis is sometimes referred to as "input-output analysis" and I'm sure that some of you have heard of it. And again, I'll not do anything more than give you a very rough idea of how this input-output analysis works and how it can be used to analyze such problems as the impact of a reduced defense budget, for example, on the economy.

Now I'd like to turn very quickly to a review of the major components of the gross national product and how they behave, so that we can see just which of the components of the gross national product are most volatile and which can give us the most difficulty in terms of employment levels, the level of the national income, etc.

Finally, then, I'd like to comment briefly on some current problems involving the industrial complex which we all need to be aware of as we consider anything as large and as important in the United States as our defense budget and the whole procurement procedure.

Let me have the first slide, please. You're all familiar with the term "the gross national product." The term, of course, refers to the total value of all goods and services produced in the United States. We can see in the top line here how it has been performing in the post-war years. It's clear from this that we had a recession, as you see, in '49. The recession in '53 and '54 is clear. The recession in '58, and again a dip ending in the first quarter of '61. Also notice that this is on a log scale, so that the rate of increase is determined there by the slope. You can see the retardation in the rate of growth since 1957.

We slipped down, really, from about a 3.8 or 3.9 annual rate of increase in the real gross national product from '47 to '57, to about 3% since '57. The per capita GNP is clear here; the very steady growth in population is apparent, and the increase in price level is shown there on the bottom line.

May I have the second slide? The gross national product is the key figure in the whole national income accounts, and what I'd like to emphasize here is that national income accounting is now a branch of accounting which is pretty much a world onto itself. I thought you would like to see this even though we don't want to stop to go into any detail on the numbers, and get a rough idea of the manner in which these accounts are put together conceptually.

On the right you have what might be described as the four major buyers of the gross national product. These are personal consumption expenditures, gross private and domestic investment, the net export of goods and services, and finally government purchases. To give you a general idea of the magnitudes, in 1962 the gross national product was about \$554 billion. Of that \$554 billion of goods and services sold, about \$355 billion was sold to individuals as personal consumption items and services. Another \$79 billion was produced for investment. That is to say these are real investments, goods produced for the production of goods, in essence; let's say for capital equipment, buildings and structures.

The net exports are a very small figure - only about \$4 billion, and finally the governmental expenditures which were about \$117 billion.

That was \$117 billion out of the \$554 billion. So, you can think of the personal consumption expenditures as accounting for 70 to 75 percent of the GNP, and the governmental expenditures as another 20% or so. The governmental expenditures, of course, are state and local as well as federal government expenditures. The state and local governmental expenditures amount to roughly half of the total.

On the left-hand side here we see the debits in the national income account. These items represent the income that people receive in return for producing the four categories of goods on the right. When this is filled in with the numbers the left-hand column total balances with the right-hand total. The compensation of employees runs around \$323 billion; the proprietors' income around \$50 billion; the corporate profits another \$47 billion or so; and the net interest \$22 billion. All the others are much smaller.

Now let's go from this to the format for inter-industry analysis or input-output. Here we see listed down the left the various industrial sectors of the economy by their major groupings, and so we have only one line for manufacturing. Actually, in the full-blown table, of course, the manufacturing sector as well as the others will be sub-divided. The input-output table which is being completed now on the basis of the 1958 economic censuses actually will have about 50 rows and 50 columns. You'll notice that the rows and columns inside the heavy line here carry identical headings. This is just a very simplified input-output table, designed to give you a general notion of how it works.

Now, if you take the agriculture line, the numbers which we will be filling in - and this work is being completed now over the next few months

on the basis of the 1958 data -the numbers filled in in the agriculture row will represent the dollars of sales into each of the other industries. So, one would have in that top left cell the dollar value of the sales of agricultural producers to other agricultural producers. Now, there might be some sales of agriculture to mining producers; presumably that's very small. The sale of agriculture by agricultural producers into the manufacturing sector of course will be very substantial, and so on across that row.

The sales to other industries; that is, the sales by agriculture in all the columns there over to the heavy line, are referred to as the intermediate sales by the sector in question. This is to distinguish those sales to other producers from so-called "final sales," or sales to final users. The sales to the final users are shown in these last four columns on the right. There are some agricultural sales made direct to individuals as personal consumption expenditures which we saw on the previous slide. The roadside fruit stand kind of case, for example, would involve sales by agriculture direct to persons.

Then we see some sales to the investment sector. This investment column, then, is the gross private domestic investment, and again one of the figures which was on the right of the previous draft. By a sale into the investment sector we mean a sale to any of the industries or individuals in the economy who use these goods for further production, or, in the case where we're talking about the agricultural example, an important kind of investment would be inventory investment. For example, if in 1958 there was, say, an increase in the holdings of agricultural

commodities by private individuals, that increase would show up as an inventory investment and that figure would be included in the inventory column in the agricultural row.

The foreign trade cell in the agricultural row, of course, shows the net sales of agricultural producers abroad, and finally, the governmental sector here shows the purchases from agriculture by government.

Now, these last four columns correspond to, or, I should say they are the four buyers of the gross national product, and so these last four columns are the four buyers that were shown on the right of the previous table. Each of the rows operates as agriculture. However, perhaps we should say a word here about the rows which are below the dark line here. They are the rows which say "Persons, Savings and Government." Individuals are also selling their services into the various industries and to final buyers. So, in the "Persons" row here one would find a figure showing the value of the services produced by persons and sold to various individual producing industries. These figures would consist primarily, then, of the wage bills of the various industries, but salaries and profits would be in there as well; even the retained earnings because the retained earnings are, in essence, in the hands of individuals if we look through the corporation, so to speak, to the stockholder. In this formulation the savings are shown on a separate line, so the retained corporate earnings would be in the savings row.

The government row, then, represents the total taxes or government receipts originating in the producing sectors. So much for the rows. Now, if you see what the rows are all about you can quickly see what you

have got if you look at any particular column. If you look at the manufacturing column, just to take another sector, one would have in the top cell in the manufacturing column the purchases by manufacturers from agricultural producers. Similarly in the next cell you'd have the purchases in the manufacturing column. And now the purchases by manufacturers from the mining sector, and similarly the rest of the way down the column.

In the persons row, then, in the manufacturing column you have the total amount of wages and salaries paid by manufacturers to persons. You have in savings the retained earnings, and the taxes shown in the government row. The total of the figures you'd have in the manufacturing column, then, would be the total payments by manufacturers to all the industries from which they bought goods, to the individuals from whom they bought services, to the government; and the payments which are shown as retained earnings - strictly speaking they're not payments, but conceptually here they are shown as savings. And when we remember that in the manufacturing row we have the sales by manufacturing producers to all other producers and to all final users, then you can see that summing all of the figures in the manufacturing row you get a total which would be identical with the total in the manufacturing column. This is simply saying that there were these total sales of manufacturers, to whom they sold their goods, from whom they received their income, and the manufacturing column indicates what happened to the money.

Now, this inter-industry table, or input-output table, gets to be a lot of fun when you turn to the question of the so-called "input coefficients." And it's in the use of the input coefficients that one can

analyze the impact of any particular change in the final bill of goods; that is, any of these demand characteristics in the last four columns, on the economy as a whole. Well, what are these input coefficients? They're very simple, really. If you were to look down the manufacturing row we have the actual dollars filled in and one could compute the percentage or ratio of each of the cell values in the manufacturing column to the total of all the figures in the manufacturing column. So that, you would have, in essence, a percentage distribution of the purchases in the manufacturing sector, from all of the other sectors, from persons as reflected by savings and the percentage reflected by government. So that, one might have in the manufacturing column, for example, if we were to work with the coefficient version of this table, in the persons row, something like .4 or .40 which would mean that for every dollar spent by the manufacturing sector 40¢ went to individuals in the form of salaries and wages, or dividends.

In the manufacturing row one would see a figure of perhaps .3 or .5 - this will vary widely, of course, for different industries - and this would mean that for every dollar of total purchases or sales, either way; total purchases are equated to total sales in this conceptual scheme; this would mean that for every dollar's worth of sales by the manufacturing industry, 30¢ or 50¢ worth of goods were bought from other manufacturing industries.

This slide just shows a very simplified version of the input-output table. As I say, a full-blown one which will be published I hope before the fiscal year is out, will have some 50 sectors - that is, 50 columns and 50 rows within the bold-faced line. Other input-output tables have

been prepared which have as many as 500 sectors, a highly disaggregated table. Now, how is this thing used? Well, if one thinks of mobilization problems in particular one would say, "All right, if we're going through a mobilization period with certain characteristics, then we would expect the government demand on various industries to increase by such and such an amount." And then we could see by how much the output of the industries in question here in the rows would have to increase in order to meet that demand. And given these input coefficients one could determine by how much the output of all of the other industries must increase in order to feed into the industries in question which are meeting the increasing demand from the governmental sector.

In essence what this reduces to is a set of simultaneous equations with the output of each individual industry being expressed as a function of the inputs from all of the other industries. You can see, then, that even with a 50-sector model you have 50 simultaneous equations and it's obviously a job for a large-scale computer to invert the matrix and to work out the impact of any change in the final bill of goods. Once it is programmed it can be done very quickly and one can ascertain the impact of a change in any of these final demand sectors.

For example, suppose we want to say to ourselves, "What would happen to the level of output of all these individual industries if we were to have a very substantial construction boom?" Well, this would mean more higher numbers in the investment row here, particularly for the construction industry - for the construction trades - and then we could trace this back to see how this would effect; since we know that for every dollar's worth of output of the construction industry you've got so many

cents of input from various other industries. And for every increase in the output of those industries you've got increase in the output of the industries that feed into the supplier industries, etc.

One can trace through these changes in very substantial detail. The presumption has to be, of course, that your input coefficients aren't changing very rapidly. If they are changing rapidly, then, of course, one can get some bad forecasts.

Now, I think this may be enough to give you an idea of the manner in which this can be used. Let me say just one more word about these input coefficients. In some cases, of course, they have changed substantially over time. For example, one finds that for every dollar's worth of transportation services provided by the railroad industry the purchases from the coal mining industry have dropped to virtually zero over the last 20 years or so. So, there's a case where there has been a very substantial change in the input coefficient. We've looked at a number of these over time and it's surprising how many of them are relatively stable, although much of this depends on how highly disaggregated this table might be.

I hope this makes tolerably clear, anyway, the relationship between the industrial complex and the national income accounts. Let me emphasize again that on the right here you've got the four buyers of the gross national product that we saw in the previous table. If you sum all of the figures in the persons row here you'll have, of course, total personal income from all sources; and similarly in the government row and savings row.

I'd like to concentrate now on the behavior of some of these compo-

nents of the gross national product. Very quickly you can see here the behavior of the personal income series in the top row. Again, without going into any detail one can see the effect of the recessions we've had, and we see also that the personal disposable income - the difference between personal income and disposable personal income being personal income taxes - this difference is fairly stable. And then we deduct from the disposable personal income the personal savings to get the personal consumption expenditures. And here one of the points that's been of most interest in recent months, particularly in the discussion of the tax bill, has been the stability of this ratio of personal consumption expenditures to personal disposable income.

Given that stability over time, personal consumption expenditures have fluctuated only between 92 and 94 percent of personal disposable income. It's fairly certain, then, that with a tax cut 92 to 94 percent of the reduced taxes coming to individuals will be spent for consumer services.

Again, the top line of personal consumption expenditures which we had in the last draft; what I wanted to show here was the very marked difference in the relative stability of the components of these personal consumption expenditures. The three principal components of the consumption expenditures, the purchases of non-durable goods, of services and of durables; you can see the very rapid increase in the expenditures for services over the post-war years, and you can see too how stable that growth has been. Non-durables have been subject to a bit more in the way of fluctuation, but the durables - the bottom line - are particularly sensitive. Notice how the rate of increase in the expenditures

for durables in recent years has fallen off a bit.

The business cycle too is quite clear in the durables here. Although the consumer durable expenditures are pretty sensitive and fluctuate rather wildly, the sector that really gives us trouble in terms of fluctuation is the business investment sector. The plant and equipment expenditures you see in the top here, first, "Residential Non-Farm Construction" in the second series, and "The Change in Business Inventories" on the bottom. The plant and equipment expenditures are probably ^{the} most interesting of the various components of the gross national product because they do fluctuate so wildly.

It's rather clear in this top time series that in 1956 and 57 we had plant and equipment expenditures which were unusually high. This was the period you recall when the automobile industry in 1955 was having its biggest year and this seemed to trigger plant and equipment expenditures of a very substantial magnitude in a number of industries. Since then, plant and equipment expenditures have been well below the trend of values if one were looking only at the '47 to '57 years. The most recent upturn you see in the last dark little section in that line in '63 is very encouraging. It may be attributed in part to the investment tax credit and the depreciation guidelines which were enacted in 1962.

These depreciation guidelines and the investment tax credit increased cash flow to corporations and provided them with more funds for investment. The initial reaction of businessmen to these depreciation guidelines and the investment tax credit was that they wouldn't be of much help. On the other hand, in February, March and April of last year when

their accountants really began to tell them how much money they had in the till because of these two measures it really began to sink in. And now, most economists seem to be generally agreed that a substantial amount of the increase in plant and equipment expenditures in recent months can be attributed to the depreciation guidelines and to the investment tax credit.

Now, fluctuations in residential non-farm construction you can see are again very wide and can give us real trouble in that in recent years they've been somewhat lower than one might wish. Actually, 1963 is going to be a pretty good year.

I'll not say much about the change in business inventories. Sometimes one finds that a down-turn in the cycle is triggered by decumulation of inventories and can cause trouble. There is a whole field of economists who love to concentrate on problems of the inventory cycle. Well, so much for the investment sector.

You remember we were saying that a third major buyer of the gross national product is the export sector, or, say, the rest of the world. Here we see exports on the top line and imports on the bottom line. The shaded area represents the excess of the exports over imports. You can see that if we've got a balance of payments problem it's not because we are importing more than we are exporting; it's quite the other way around. However, the favorable balance on the current account is subject to wide fluctuations with a very marked increase in exports there in '56. This was because of the aftermath of Suez. In more recent years the export trade balance has been increasing slightly, particularly if we take out the exports that are financed by government grants and capital.

The final buyer is the government and here we see the relative importance of federal government purchases as compared with state and local governments' purchases. The impact of Korea is clear enough, and in the case of state and local government purchases it's intriguing to see, first of all, that there's a fairly steady increase in these expenditures with not much sensitivity to the business cycle. Such a high proportion of these have been used for expansion of educational plant that one can ask whether or not we're going to have in future years the kind of increase in state and local government expenditures that we've had in the last ten years or so.

Again, the relative stability since the end of Korea in federal government purchases is clear in this draft.

I'd like to turn now very quickly to some current problems that I think one must be fully aware of when discussing the whole area of procurement and the impact of defense expenditures on the economy. Our No. 1 problem I think we can say today is the unemployment problem. Let me just summarize the difficulty very quickly and then we might address this in detail after the break.

Unemployment now is around between $5\frac{1}{2}$ and 6 percent. The last figure I have is 5.9%. There's a seasonal adjustment problem in there that we haven't really whipped and it's probably a little too high; it's probably closer to 5.6 or 7. But it's still uncomfortably high. Unemployment has been above 5%, of course, since 1957 and certainly we can consider it a very serious problem indeed. There are two schools of thought about what the nature of the unemployment problem is. One school argues

that the principal difficulty is the lack of aggregate demand. If we were to have a gross national product which would be something on the order of \$30 to \$40 billion higher than it is at present we ought to be able to pull the unemployment figure down to around 4%. Presumably one can hope to get the unemployment figure below something like 3% because of so-called "frictional" unemployment; that is, you're going to have a certain number of people who are between jobs and are temporarily out of work because of an adjustment in the economy continually due to changing circumstances. And also there presumably some unemployables who are showing up in the unemployment figures, and so 3% is pretty much a rock-bottom figure.

We'd have to have a GNP that would be closer - well, for 1963 the GNP is going to be on the order of \$585 billion, and we ought to have a GNP on the order of \$515 to \$525 billion in order to get unemployment down to even 4%, which is sort of an interim target.

However, the other school of thought would argue that even if one does have a substantial increase in the GNP we're likely still to find unemployment as a nagging problem because of so-called structural difficulties in the labor market. Structural unemployment refers to unemployment that is caused because the workers in the market don't really have the mix of skills required to fill the jobs that are open. One might refer to that as the problem of the structure of skills; the skills demanded and the skills offered in the labor market.

Another version of the structural problem concerns the location of the unemployed relative to the location of the jobs. This is a problem

of geographical structure. Now, as one thinks of the problems of automation, etc., one can say that surely there is a fair amount of structural unemployment in the economy. This is the reason why there is a considerable amount of emphasis now on labor retraining; on education in general; on the drop-out problem. Because, surely in the future we are going to have to have workers who are trained up to higher levels than is now the case.

The first line of attack on the unemployment problem is the tax program or bill now before the Congress. We'll have some idea, presumably by the end of the year or the middle of '65 as to what extent the unemployment problem is, really, a structural one. Even if the tax bill becomes law in the next six weeks or so, however, presumably we can't get unemployment much below 5% by the end of Calendar '64. It will be late in '65 or even perhaps into '66 before we will get it down in the 4% range.

The second major problem we face, although it's not attracting a great deal of attention right at the moment, is the balance of payments problem. Now, the United States has been running a deficit which has been uncomfortably large - about \$2.2 billion deficit in 1962. This raises difficulties because there is a substantial gold drain. There might be problems in holding the value of the dollar if this were to continue over a long period of time, and consequently it should be a matter of real concern.

The present programs for getting on top of the balance of payments problem seem to be having some effect, however. The principal of these programs in terms of its most recent effect, at least, has been the

interest equalization tax. As I emphasized earlier, we do not have a balance of payments problem because U. S. producers cannot compete abroad. As I emphasized before, our exports of goods and services are substantially in excess of our imports. As a matter of fact, we export about \$1.25 worth of goods for every dollar's worth we import. So, the problem doesn't arise from the so-called "trade balance." Rather, the problem comes from some of the other things we're trying to do. The aid program is often cited as a primary culprit here; however, now something on the order of 80% of the AID commitments are tied to dollar exports. So that, for every dollar in foreign aid about 80¢ comes back to purchase U. S. goods. Therefore, the net impact of a \$4 billion aid program is only about 20% of the \$4 billion.

The defense expenditures have been running in the vicinity of \$2½ to \$3 billion. The impact of direct investment abroad, though, has also been very substantial. We have a lot of firms and individuals who want to invest in foreign markets. Direct investment alone has been on the order of a billion six; total direct investment abroad is, if anything, somewhat bigger now than the impact of the total defense expenditures abroad. Direct investment abroad has almost doubled over the last four or five years, particularly in '56 and '57 when the European Common Market began. A lot of U. S. firms saw that here was a new and promising market and so they moved quickly to buy existing firms or build new production facilities themselves in foreign countries.

So, our net outflow on the direct investment account increased overnight from something on the order of \$700 million or so up to a billion

five or a billion six.

Finally, one of the real problems in our balance of payments picture is the tourism expenditures. We spend abroad about a billion four more each year than foreigners spend in the United States. If you throw in transportation fares as well this runs up to about a billion nine. So, something on the order of \$2 billion of the deficit might be attributed to the tourism expenditures.

The interest equalization tax is an attempt to increase the cost of capital for foreigners who are borrowing from the New York capital market. One of the principal reasons why we've had this outflow of capital is because foreigners are selling more and more of their securities in the United States. In the effectiveness on balance of payments it's the same as if we were importing goods because we can really visualize this as our importing their stock certificates, if you want. The reason they're so attracted to New York is that the interest costs on long-run capital are substantially lower in New York than in their own markets, and furthermore, New York simply has a very highly-developed capital market. The European capital markets almost by and large are primitive compared to New York, and consequently it's very easy and cheap to float new securities in New York.

The interest equalization tax is an attempt to raise the cost of borrowing in New York so as to try to get foreign firms to borrow more in their own capital markets. A final encouraging point on this front has to do with the changes in relative prices in the United States and in Europe and Japan. The U. S. price level over the last three or four years

has been quite stable, actually. The wholesale price index has moved only within a very narrow range, while prices in Europe and Japan have been increasing rather steadily. Consequently, the comparative position of the United States vis-a-vis these other industrial competitors abroad has been improving and our balance of payments is beginning to reflect this.

Now, with regard to a third major problem I talked about - unemployment and the balance of payments - I'll say something now about the poverty problem which we are going to be hearing a good deal about in the next several weeks. Here we have a percentage distribution of all consumer units in the United States, showing something on the order of 12% of the families in the United States have incomes of less than \$2,000. About 18 or 19 percent are in the \$2,000 to \$4,000 range. I give you these figures just to emphasize that the individuals in the economy are certainly not all sharing in the wealth and high incomes that so many people are enjoying. It's rather striking, I think, that within the next few weeks personal income per capita in the United States, per individual - these are family units here - is going to cross the \$2,500 mark. This is a general index of well-being and this \$2,500 figure is a fairly impressive one.

Nonetheless, one finds that there are substantial numbers of families that are still surviving on very low incomes. Some proportions of these are families living on farms, and so, their money income - which is all that is reflected here - does not give a true picture of their total income. Nevertheless, we still have a substantial proportion of people who

are earning less than \$3,000 a year and these are concentrated among groups who have a particularly difficult time getting along. We talk about the female head of households for example; people over 65; non-whites; the migratory workers; these are groups that still are not really sharing in the prosperity that so many of us are enjoying. And I think it's quite clear now that within the next few weeks you're going to be hearing a great deal about this as one of the principal problems which the United States faces.

As you consider the impact, now, of the whole defense program on the economy as a whole, when we look at the impact of disarmament, for example, or some cut-backs in defense expenditures - perhaps in space as well - the impact of these reductions on the so-called "disadvantaged" groups in the economy, is going to be of particular importance.

Thank you very much.

QUESTION: Sir, do you foresee any substantial increase in the trade balance as we go, as a result of efforts on the part of the government to increase our export trade?

SECRETARY HOLTON: It's a good question about how substantial it will be. I think that over the next two or three years we are likely to see a substantial increase in the number of firms that are interested in the export markets and are developing for the first time, markets abroad. When talking about the net effect of this it's rather difficult because as we know, we're likely to have only a very small increase in the agricultural exports because of what we anticipate in the way of a more restrictionist

trade policy on the part of the Europeans in the Common Market.

We anticipate that by 1968 or so, that our trade balance will be somewhat greater. The balance of payments picture as a whole is likely to be righted rather completely by 1968, in part because of the merchandise trade balance, but also if we have a more rapid rate of growth in the United States more capital is likely to stay at home instead of going abroad. If the profit opportunities in the United States improve relative to profit opportunities abroad, then we won't have so much of this capital outflow. This is beginning to show up now, actually, in industrial countries abroad. Wage rates have been rising very rapidly; prices have not been increasing as rapidly; and profits have been squeezed very substantially in the last couple of years.

It's fairly clear that this is making a lot of U. S. businessmen think twice now about investing any more money abroad. So, I think the balance of payments is going to be solved all right over the long pull, but I think we're more likely to have the solution about equally divided, let's say, between a reduction in the capital outflow and an improvement in our trade balance.

QUESTION: Sir, my question is, "What is poverty?" The reason I ask is, a number of speakers have taken a figure of \$6,000 per family per year, whereas you have quoted a lower figure. How do you figure it?

SECRETARY HOLTON: One could engage in endless debate on that one, of course. One can say that it's ridiculous for us to even talk about poverty in the United States given that 2/3 of all the people in the world live on less than \$100 a year, you see. So, by that standard you've really got to scratch to find anybody who is poor in the United States.

On the other hand one can argue, I think, that we're justified in using a, shall we call it, "a floating standard of poverty." Certainly, if you look at the things that have been written on this general problem you'll find that in the 1920s, even if we're talking about values in 1962 dollars that then it was common to find the poverty standard down to around \$1,000 a year. Now we're more likely to be talking about \$2,000 or \$3,000.

The question I think should be recognized as an important one, but regardless of precisely how one defines poverty it seems to me we can argue that an efficient economy ought to be operating in such a way so that everyone has a good opportunity to escape from poverty. If you look on the question this way, then you're saying that even though we recognize that we're always going to have a fair number of people who are poor, particularly if you define poverty by one of these floating standards, the real question is are all of these people poor because of necessity, or is there some way to get them into the mainstream of economic life.

QUESTION: Sir, I mention a further discussion on the impact of direct investments on the balance of payments. You mentioned the fact that the net outflow was about \$1.6 billion per year. Is it your feeling from this that we should really have a policy of discouraging long-term direct investments for this reason? Or, when we look at the income which results from this, that it might in the long-run be to our favor and perhaps should be encouraged? Would you discuss this, please?

SECRETARY HOLTON: I might as well be blunt about this and say that in the discussion of the 1962 Revenue Act when the tax on foreign incomes was under debate it was well known that the Department of Commerce did not

agree with the Treasury Department about this particular policy. The income from U. S. investments abroad has been increasing at about the rate of \$300 million a year. And this is a very substantial figure when you think of our deficit in 1962 being \$2.2 billion all together. I think there is no question about it that over the long pull the direct investments abroad are of benefit to the United States because of these foreign earnings, and because by this route one can also open up more exporting opportunities.

For example, I was talking to a chap not long ago whose company had a little plant in Belgium manufacturing very small horsepower outboard motors. They previously had not been exporting to the Common Market at all, and now they have a plant there. Because they have a plant there they are exporting aluminum castings to this plant. They have a couple of plants in the Mid-West where they can produce these castings at a much lower cost even after allowing for the tariff into the Common Market. Then they can buy them in Europe simply because in their Chicago plant these just increase the run a little bit and it's very low-cost production for them because it's an incremental run.

It's this kind of thing, then, that leads to, because in this case we've got the investment there we have some exports we didn't have before. There are lots of illustrations of this. The Treasury, on the other hand, argues that what one finds more commonly is that investment by a U. S. firm abroad in a plant simply leads to that firm selling into that market from a local plant rather than from their plant in the United States, and that therefore the foreign production is really a substitute of foreign

production for U. S. exports.

Now, unfortunately our data on this aren't good enough to settle the issue really conclusively. One has to rely on a lot of anecdotal evidence which one can't really add up very satisfactorily. But I would agree that if we can batten down the hatch, so to speak, and sit tight and continue to let the direct investment funds go out, we should over the long haul see a substantial increment in our exports partially as a result of this direct investment.

QUESTION: In your discussion of the inter-industry analysis you mentioned that your present computations are being based on 1958 data. I wonder why it is that more timely data can't be used in furnishing these results.

SECRETARY HOLTON: Well, I can only give you the standard answer that Congress was not too enthusiastic about this project and so we have only a handful of people working on it. The reason for its being based on 1958 was because the census of manufacture for 1958 was the most recent one at hand. The census of manufacture for 1963 is just getting underway and as soon as the 1958 table is complete they'll turn to making a table for 1963.

This lack of timeliness is not quite as serious as one might think at first because what is really relevant is not so much the dollar flows - not the first version of the table I was talking about - but rather the input coefficients. If the input coefficients don't change very fast then you can still use the thing very easily, you see.

Now, if you're talking about a highly dis-aggregated table where

you have 300 or 500 sectors, then, of course, the input coefficients are likely to change rather rapidly simply because of the dis-aggregation. You'll see that, I think, if you'll just consider the railroad use of fuel - the illustration I was using earlier. If you have a highly aggregated table where you just have mining, you have both oil production and coal production in the mining sector, you see. So that, when the railroads have shifted from coal to oil it's true that the inputs of fuel presumably fall, but it's a shift only within itself.

If, on the other hand, you have one row for coal mining and another row for oil production, then you have a big shift. The input coefficient of coal drops to almost zero and the input coefficient for oil jumps way up. Similarly, the more dis-aggregated the table is the more volatile these input coefficients are. But 50 x 50 isn't bad; the input coefficients should be reasonably stable and these are the ones we really use. So, it's not quite as bad as it might seem at first, to be working now with data that are already five years old.

QUESTION: You mentioned that the balance of payments in tourism accounts for a deficit between \$1.6 and \$2 billion a year. I wonder would you discuss the prospects of what is being done to reduce the size of this particular pattern?

SECRETARY HOLTON: A year-and-a-half ago the Department of Commerce established the United States Travel Service which has as its charge the encouragement of foreign travel to the United States. And in the countries in which the U. S. Travel Service now has offices the number of tourists in the United States increased last year by about something on

the order of 20% for '63 over '62. But this is not as encouraging as one might think at first because we have such a high proportion of tourists from Canada and Mexico, and so the 20% increase is over a relatively small base. Certainly we hesitate to even consider any restrictions on U. S. travel abroad. Basically there is no more conceptual reason for restricting in international trade the movement of individuals any more than the movement of goods or the movement of capital. And certainly, there are grounds for arguing that this is likely to have a highly regressive effect; that is, middle and low income people are likely to be - well, let me put it this way.

If you think about the various possible means of restricting travel it's rather difficult to come up with some device that won't hit low income people harder than it will hit high income people. Then too, presumably the country is better off if more U. S. citizens learn more about other countries. And so, one hesitates on that ground to restrict foreign travel.

So, the attempt to reduce this particular part of the deficit is restricted to the U. S. Travel Service efforts to increase more foreign travel in the United States. And in his balance of payments message in July President Kennedy asked the domestic tourism industry to launch a campaign to encourage Americans to see more of the United States. The National Association of Travel Organizations - known in a very limited circle as NATO - is getting a campaign underway and it will be reaching a pitch probably in February and March.

QUESTION: My question relates also to the balance of payments and

the gold outflow. Recently the Joint Economic Committee in Congress has been studying the discriminatory freight rates that have been set by international shipping cartels against our export trade. What is being done to correct this situation, inasmuch as it is my understanding that the Maritime Administration has expected our shippers to go along with the cartel agreement?

SECRETARY HOLTON: This whole thing came to light in June, I believe it was, when the Joint Economic Committee was having hearings on the increase in steel prices - Round Two. I asked Walter Ledder who runs the balance of payments division in the Office of Business Economics, who had been asked by Senator Douglas to testify on the balance of payments effect on the increase in steel prices, to take a look at this freight rate situation, because I understood that there was this discrimination. He presented me with data showing that the freight rates on outbound trips for steel commodities, as for a number of others, was on the order of 50% greater than the rates inbound over the same route with the identical product.

Now, one of the explanations for this is that the outbound traffic from the United States is considerably heavier than the inbound traffic. So, even in the absence of the conference system you'd have the problem of empty back-haul, you see, and so there is more avid bidding for back-haul traffic than for outbound traffic. Nevertheless, by a number of measures it looks as though there is discrimination and the Federal Maritime Commission has now launched a series of hearings to have the conferences show cause as to why their rates differential of inbound and

outbound shouldn't be reduced.

We've got a nasty problem here because these are in essence cartels exempt from the anti-trust laws. The U. S. members, generally speaking, constitute a minority of the conferences and there is some real question here as to what sort of a handle the U. S. Government can get on these foreign lines. There has been wild objection already on the part of foreign governments to the Maritime Commission's recent action calling them in to explain their rates. And I guess it's an open question as to whether or not they will appear. If they don't appear then the next step is for the Maritime Commission to disallow the agreement and this would mean that U. S. firms could not participate in the agreements without running afoul of the anti-trust laws.

This is likely to break open the whole conference rate structure and the foreign countries certainly don't like that prospect either. So, we're in a very tight ball game at the moment on this particular problem.

QUESTION: Mr. Secretary, this has to do with the price levels. Would you comment on the significance between the rather stable wholesale price index and the rising retail price index, and particularly why the government emphasizes the stability of the wholesale prices as an indication of no inflation whereas consumers pay retail prices?

SECRETARY HOLTON: The wholesale price index has been relatively stable. The principal reason for the consumer price index pulling away from the wholesale price index is because of the very rapid increase in the price of services. If you look at the index for services alone you find that on the 1957-59 base of 100 the index is up to about 115 or 114; something like that. Whereas, the price of consumer goods, the index is

only up to about 104.5, about a $\frac{1}{2}$ % increase per year. So, the price of services has been increasing by on the order of three times as rapidly as the price of consumer goods.

Now, one reason for emphasizing the wholesale price index is that this is of particular relevance when we are looking at our international competitive position; it's more relevant than the services, really, and after all businessmen are concerned about what they are paying for goods, you see. And in a sense one could argue that there are more and bigger decisions resting on these wholesale transactions than on the consumer transactions. But it's true, certainly, that the consumer price index has been rising more rapidly, and this is solely because of the more rapid increase in the price of services.

CAPTAIN HENRY: Mr. Secretary, thank you very much for giving us a most interesting start to the 1964 term and to our new course.

SECRETARY HOLTON: Thank you very much.