UNITED STATES TREASURY POLICIES AND ECONOMIC STABILIZATION

6 February 1962

CONTENTS

Page

INTRODUCTION--Vice Admiral Rufus E. Rose, USN, Commandant, Industrial College of the Armed Forces 1

SPEAKER--Honorable Robert V. Roosa, Under Secretary of the Treasury for Monetary Affairs 1

GENERAL DISCUSSION 14

NOTICE

This is a transcript of material presented to the resident students at the Industrial College of the Armed Forces. As such it represents the views of the author and not necessarily those of the Industrial College or the Department of Defense. Members of the College may quote it only in student reports or publications for use within the College. Other persons may not quote or extract for publication, reproduce, or otherwise copy this material without specific permission from the author and from the Commandant, ICAF, in each case.

Publication No. L62-120

INDUSTRIAL COLLEGE OF THE ARMED FORCES

Washington, D.C.

Dr. Robert V. Roosa, Under Secretary of the Treasury for Monetary Affairs, was born on 21 June 1918 at Marquette, Michigan. He received his A.B. (1939); M.A. (1940); and Ph. D. (1942) from the University of Michigan. From 1939 to 1943 he taught economics at the University of Michigan, Harvard University, and the Massachusetts Institute of Technology. From 1946 to 1961 he worked for the Federal Reserve Bank of New York, rising to the position of vice president, research department. He is the author of numerous articles in such publications as "The Economic Journal," "Federal Reserve Bulletin," "Harvard Business Review," "Review of Economics and Statistics," and "Lloyds Bank Review" in the general fields of economics and monetary control. Dr. Roosa is a member of the Council on Foreign Relations, the Conference of Business Economists, the American Economic Association, the American Finance Association, and the American Statistical Association. This is Dr. Roosa's first lecture at the Industrial College.

UNITED STATES TREASURY POLICIES AND ECONOMIC STABILIZATION

6 February 1962

ADMIRAL ROSE: Gentlemen: Fiscal and monetary policies are important tools in the managing and controlling of our economy. That is what we are studying at the present time.

Our speaker this morning is a well known and highly respected scholar on monetary economics. He was an economist on the staff of the Federal Reserve Bank of New York and closely connected with the Federal Reserve System's monetary policies. He left the Federal Reserve Bank of New York as vice president of a research department to become Under Secretary of the Treasury for Monetary Affairs.

In his present high position he is responsible for helping to maintain the stability of the American economy and, as a fiscal policy shaper, he exercises great influence on the economic course of the Nation.

He is thus eminently qualified to lecture on "United States Treasury Policies and Economic Stabilization."

It is an honor and a privilege for me to welcome Dr. Robert V. Roosa for his first lecture to the Industrial College and to introduce him to the Class of 1962.

DR. ROOSA: Thanks very much, Admiral. I am delighted to be here, and trust that before very long I can stop my part of the exposition and learn more from the kinds of questions that you will want to raise.

In the Treasury's part of the overall Administration program for economic stability and the generation of a strong and lasting growth for the economy, we, of course, intrude in many other people's front and backyards. But I'll try to stay out of at least some of them today and confine myself to the activities for which

the Treasury is more directly responsible. At least, that's what I'll do most of the time.

I would like to begin by saying that, in the present setting and in the formulation of a comprehensive governmental program, it has been important to settle two or three broad questions of priority which extend over all of us, and the resolution of these has necessarily been the decision of the President. The continuation in carrying through is going to rest also on the actions of the Congress.

So in what I say here at the beginning, I am talking about the Administration broadly and about the actions of Congress hopefully. But I feel we should have that much orientation at this stage before the disillusionment of congressional action or inaction has settled heavily upon us.

The principal goal, as I have already indicated, is that we find ways of so strengthening the domestic economy that we can sustain a more rapid and a more broadly diffused rate of growth for the entire economy, and thereby bring the level of overall unemployment to levels that correspond more closely with the lasting and bearable performance that has been accomplished in most other countries.

Now, one reason why we have slipped this far behind in our growth rate--and one that I am going to be developing at length in just a moment--is that, with the immense capabilities of our economy stretching so far ahead of all others in the world, and having been unimpaired by the dislocations of war, we were in a position for 10 to 15 years to concentrate, and to enjoy the results of so concentrating, upon the expansion of consumer goods industries and the widening out of consumer markets. We have only now reached the stage where the spread of the American consumer market across Europe and some of the other industrialized countries is leading them into some of the kinds of problems from which we think we are now finding a way to emerge.

The second goal of Administration policy now is to accomplish all of this within the kind of international economic framework that will assure the United States a balance of payments equilibrium through the years, an equilibrium that will support a strong dollar as the pinion for the currency systems of the entire world.

These two objectives are necessarily interrelated. I mentioned first and second, only because some of the action which is crucial for the first must be initiated before the comprehensive program to

accomplish the second objective can be fully worked out. There is, however, no order of priority in importance. We need growth at home, the absorption of unemployment here. We need to bring this about in a way that minimizes the cyclical swings we have suffered in the past--we'll never avoid them. But we need all of this in a framework of relations with the rest of the world that assures our ability to sell enough abroad to cover our imports, to cover our necessary governmental disbursements abroad, and to cover the other creditor investment commitments which the United States must necessarily maintain as the leading example, the proponent, and the protagonist of the kind of free economy that is now challenged by another third or half of the world's population.

So, in this broad, exciting, dramatic frame of objectives, we must try to formulate those parts of a governmental program which can do two things: First, and this is essential when we remember that our aim is to demonstrate to the world that a free, private, individually generated and motivated economy is superior to the planned totalitarian form, our first objective must be to so fashion governmental policies that they provide the maximum scope for the initiative, the enterprise, the creativeness, the imagination, and the development capabilities of a vigorous private sector of the economy. Vast as the Government's role may seem to be, the slice we in the Treasury take out of the economy and channel into governmental uses, is still less than a fifth of the total.

So that what we are here talking about, then, is the formulation of governmental policy. When it is Treasury policy it means largely policy concerning the handling of the money flows that go into and out of the Government's accounts, so handling them that we make the maximum contribution toward the effective performance of the private economy to accomplish these goals I mentioned a minute ago.

Then, second, once we have given due regard to the stimulative capabilities that are inherent in the mere fact that we are taking so much money out and putting so much money back into the stream, we must also so appraise the composition of our receipts and the composition of our expenditures that we get the maximum in terms of product and contribution to welfare from every dollar which the Government itself spends.

We are trying, then, to conduct this largest entity in a basically free-enterprise economy so as to give the maximum stimulus and the widest elbow room to the remainder, the millions of individual producing units. At the same time we must get the greatest possible

product for that part which necessarily the Government must pull aside and devote to its own purposes.

Now, this means that as we in the Treasury develop our programs for taxation and work them through to the Administration's approval, as we work from day to day to manage our cash flows, as we keep in touch with the armed services in particular as the principal channel through which the Government's revenues in turn flow out into the economy, as in addition we attempt to raise the funds needed, not merely to cover a deficit, if we have one, but to pay off over and over again the maturing debt accumulated from past years--in all these activities of the Treasury, we have to be continually trying to be certain that these two objectives are, to the best of our judgment, satisfied.

Now let me tell you a little bit about some of the particular things we are doing presently, with an eye on both of these objectives, in the three areas that I have just referred to--first, in our tax policy; second, in the management of our cash balance, and related to that and tucked in because I want to get to it without seeming to strain the point too far, in the influence we have on whether or not there will be a surplus balance or deficit in the overall account of the Federal Government; and then, third, in the way in which we conduct our own borrowing operations.

I am going to be able to give you some illustrations of the way in which we are trying to accomplish these objectives with an eye both to the need for growth and expansion at home and to the inescapable necessity of achieving balance in the external accounts of the country.

With respect to taxes, there never will be the kind of tax reform that any one of us might like to write on a clean sheet of paper. If we all tried it you would find immediately why that result will never be achieved. There would be as many differences among you as there are among those of us who want to make recommendations in the Treasury. And then you go from there to the Congress and you will find more. These are the difficult hard problems of human affairs in which there is no ideal solution.

Recognizing that, and recognizing then that anyone who wants to pick at corners can certainly find many things to complain about in the pattern which we have evolved, our aim has been to develop something which produces the maximum of contribution along the lines I have mentioned and also has the maximum chance of being approved.

In that more realistic frame, then, we have developed a program for revising, over the years, the impact of the total take of our tax structure in such a way that we hope, as parts or all of this become accepted, we will have utilized even more than in the past the power that is built into the tax system, the power not only to affect by taxing but to stimulate by withdrawing taxing. We want to utilize that inherent power both to give the maximum stimulus to new growth and to find the solution to our balance of payments problem, because, as I mentioned just a few minutes ago, the major difference between our performance now and that of the advancing European countries is that they are just entering the phase of the consumer boom and we have to a large extent been through it. It can go on, and from the vast magnitude of our total product we can afford to have it go on. But the ratios have to change, and the low proportions of our total gross product that have been devoted to productive new investment for many years are going to have to increase. We are going to have to have more automation, not less. We are going to have to have more efficient, lower-cost, producing capabilities, not less. And in the process we are going to find that we don't get neat, easy solutions. We have to work with influences that are broad and sometimes crude. The place to start is with the application of depreciation policy as it applies to the corporate and business taxpaying sector of the community.

Granted everyone wants individual tax relief, some day the economy will be strong and the growth rate great enough to permit that. That, if I were a politician, I would loudly say is in our locker, too. Actually it is. But, when and whether and how we'll get to it is just a bit too far ahead at this stage to predict. What we must stress now is what comes first. What does come first is the rearrangement of the impact of our tax system so that the present comparative discouragement of modernizing new investment, the discouragement which has effects you can really see as you travel back and forth across the country and visit, not just the best installations and those that are most effective in getting governmental contracts, but the run of the mill, and as you go up and down the back streets of the industrial cities and ask yourself, "Is this the way the most highly developed and advanced civilization in the world ought to look and ought to be performing?"

The needs are clear and vast, and we must utilize the capabilities inherent in the tax system to get some redistribution of the present impact of taxes.

So our aim first--and we have made this the choice as far as our effort is concerned--is not individual tax relief, not the stimulation of additional consumption at this point in time, but the promotion of cost-reducing investment in modernized facilities from which these other results can later flow. It is not just that we need a greater rate of investment for optimum domestic performance--and you can spill out a Keynesian or a Keyserling multiplier from it, if you wish, and properly should--but also because we have another problem, and we must try to solve all problems together.

That other problem is that the same differences between us and the now highly competitive countries of Europe, which I mentioned a little while ago, and which give us some pause for concern about our own growth rate and our capacity for absorbing unemployment, have led to a situation where now in far too many fields the products of European or Japanese production can be put on to the markets of the world anywhere at prices well below our own.

Now, this is not necessarily true, of course. Every one of us has seen enough varied examples to disprove the generalization that we have to hold our labor and our wages in line with the extremely low wages of many European countries in order to be able to compete. The point is that we always used to be able to make our way faster and further because our competitive advantage production-wise and techniquewise was so great. We have lost the yardage we used to have in front of the rest of them. We need to gain it back--to be in a position to sell abroad and to sell in substantial volume, and to have a selling program whose motivation is generated by an aggressive, forceful business community intent on doing it because that is the way to make a profit.

The difficulties of selling abroad are compounded, of course, as those of you who have served in Europe know only so well, by the fact that European nations still maintain a number of restrictions inherited from the period when they were so far behind. The dismantling and bending of those restrictions is still a major object of our effort. In the financial field the Treasury has taken a leading role in negotiations during the year that parallel the more dramatic and spectacular efforts of the State Department in the field of trade. I won't digress into those, but will just recognize that they are there, at the moment. It is obvious, though, that the most significant step is going to have to be the establishment of an effective bargaining position to work our way through and behind any tariff barriers erected by the Common Market. The surging performance of the most effective European countries has now led them to a point where

they are rich enough, and doing well enough, to be able to withstand the harshness of welding their economies together, but behind a protective barrier which is going to screen them off from some of the related strains of aggressive competition from the outside.

We have to see that these European countries as they join together in a Common Market, do not seal themselves off from external competition as their changes are brought about. That's the reason, of course, for the President's proposals for the Trade Adjustment Act this year.

The role that we envisage for the tax system--and this is our Treasury part in this picture--while there will be further stages, must at this time then center on those kinds of reforms that can stimulate--and directly stimulate because we can't afford a kind of loose spillover--additional productive plant investment, and to do it in two ways: One, the legislation we propose for an investment credit, available only in the event investment has occurred; and second, the reform of depreciation schedules, available to everyone on the basis of the investment already made, permitting business to write off the investment on their books at rates more nearly commensurate with the engineering standards applicable to that equipment now, rather than the standards applicable 20 years ago when the regulations were instituted.

All of these I want to make clear are not in any sense narrow, partisan proposals. The studies on depreciation reform and the schedule on which it is occurring were initiated by the preceding Treasury Administration two years ago. The first round of studies were found unsatisfactory and were sent back for more intensive work. We have given that an additional impetus and have now reached the stage where we will be announcing completely revised schedules early this summer. In the same way, the investment credit is not a new thing. What is new is giving it this form. There have been all sorts of proposals for depreciation reform. The underlying sense of the need has permeated the thinking of the business and other communities for a long time.

The difficulty of getting such a program is that everybody wants too much, and we can't afford to give away very much from the tax revenues of the Federal Government now. So we had to devise a system which would have the maximum direct impact on investment itself while at the same time introducing some changes in other parts of the tax laws that might in the end be helpful if we want to build further later on for other kinds of change. In order to offset any direct loss of revenue from the depreciation reform measures,

we are proposing, for example, to the discomfort of all my banking friends, that there be withholding of taxes of interest and dividend payments at the source, just as there has been withholding on personal salaries for so many years.

We have tried to avoid that for a long time. We have tried every possible approach through persuasion, but there are still at least $800 million of taxes evaded or avoided every year by taxpayers who earn the dividends and earn the interest, but, because of the drib and drab way in which they are earned and the fact that there are no reports submitted by the paying agents, go unreported by the individual and escape taxes.

We are strengthening the tax administration force. We are increasing our ability to collect, but not adequately and not fast enough. So we are aiming to collect the taxes that are owed and due from those fortunate enough to have interest and dividend income above the exemption limits, through the imposition of withholding arrangements.

At the same time, in order to equalize the burdens of a vast and heavy tax system already taking 52 percent of the earnings of business corporations, we have recognized that savings and loan associations, and mutual savings banks, whose Federal tax bill amounts to something in the order of 1 percent or less of their total income each year, stand out as another area within the economy where some additional taxes are due. In the interest of equity, and at a time when the burdens are heavy, we must distribute them fairly.

And there is a third item, which all of us can applaud enthusiastically and without restraint. We are going to tighten up on the other fellow's expense accounts. The way in which that may emerge is still not clear--nor is any of these--but the Ways and Means Committee has now given general approval to all of these and is in the process of drafting a bill which will probably be out and ready to move to the Rules Committee about the 19th of this month.

This is the tax side, in the rough, broad, and crude, but presented, I hope, in a way where you will see that it is not just a hodgepodge of hit-and-miss things. It is related to a concept of what we can do purposely and constructively and at the same time maintain the fiscal responsibility that must be the byproduct and the hallmark, truly, of the leading industrial country of the world.

Of course, if we get these various reforms, the way then will be clear. If everyone is on a roughly equal footing on expense accounts, and you can't find many who in that way escape the impact of personal taxation, and if interest and dividend income is really and truly taxed, then the way has been prepared for some reduction in personal income tax rates. We are not going to propose nor promise this until we are sure that this necessary preparatory action has been satisfactorily completed.

I have said all along that the approach to taxation must envisage the maintenance of an appropriate fiscal stance. This means that there are times, of course, when an overall Federal budget deficit is entirely appropriate. We have just concluded such a year. At the moment, as you probably know, although this fiscal year ending in June is a deficit year, the deficit is over. We are now in balance, and from here on at least until the end of June we will be bouncing around with a debt close to the ceiling of $298 billion, but by the end of the fiscal year we will reduce that debt back to $295 billion, so we will, for a little time at least, have entered a phase of balance and surplus. And we have planned for a balanced overall Federal budget in fiscal year 1963.

This means that, presuming our basic economic projections are borne out, we are emerging from the period when a deficit was appropriate as a stimulus and as a byproduct of the fact that greater economic dislocation would be created by trying to retrench temporarily the vast and continuing programs of government in the face of any temporary swerve. In fact, the generation of additional income at such a stage has much to do with the appropriate priming of the spending pump that helped very quickly in the last recession, remarkably quickly, to turn around the cumulative processes which often accompany a necessary hesitation in the business-cycle pattern.

The real problem, of course, is, as I said at the beginning, not to eliminate recessions. Hesitations and phases of adjustment will always be necessary in a complex economy. But we have to choke off the cumulative downward forces that tend to carry the adjustment far beyond its proper role. And that's the place where Federal deficits come in as a cushioning, resisting force, and where they are appropriate.

We have passed that stage now. We are entering the stage where balance is appropriate. We may hopefully further on reach the stage where surplus is appropriate.

The reason I want to focus on this particularly here is that there is a direct relation between the way in which we handle the cash flows through the Treasury and then, by derivation, the way in which this leads us to needs for additional borrowing. Then there is a direct relation between that and the state of the capital markets in the economy as well. You remember, I have been stressing all along that, for purposes of growth and to get balance of payments equilibrium, we are going to have to stimulate new plant investment. It is also important that there be no financial impediment to financing that investment when it occurs. This is one important reason why, at this stage, having recovered as far as we have, and assuming that our momentum will carry us further, we must take the Federal Government out as a net user of the available supply of added savings, keep it in balance, neutral, neither taking from nor adding to, and leave for the necessary expansion in the private sector of the economy those funds which up until now--$7 billion of them in the recent months--have been taken out of the pool of available credit and savings and channeled into the financing of a Government deficit.

In the period ahead, and with the effort that must be made ahead, it is then appropriate that in terms of borrowing and spending the Federal Government be in a balanced position.

That leads then on to the third aspect. I'd better perorate on that a little first, by expressing that this balanced budget is clearly, and in this physical sense, directly, a way in which we also encourage the objectives I mentioned at the start--the way in which we can use this vast, inherent power that lies in the mere existence of this Federal Government of ours, to create, first, an environment in which the maximum stimulation of the private sector of the economy is accomplished, and, second, to assure the optimum use of the funds which the Federal Government has for the vast array of purposes it must attempt to fulfill.

There is another aspect of this balanced budget, before I go on to the debt-management side, which is also important, and that is that, because the United States is the banker for the world, much depends upon the confidence generated around the world in the way in which we handle our own affairs. It's not only what the foreigner thinks; it's what the American investor, financier, manufacturer, yes, even labor pension-fund manager, thinks about the fiscal responsibility of his own Government.

When we've reached this level of expanding employment and growing incomes, if we can't make the effort to balance our accounts,

whenever will we? And how, then, can we justify the implicit request we make for the confidence of all here and abroad who have it within their capability easily to move money from the United States into the banks, the financial markets, and the direct investment opportunities of other countries?

So, from the standpoint of confidence in ourselves in a world where we are exposed through the balance of payments to a kind of vulnerability of which we have long been ignorant in this country, but of which our foreign colleagues are very well aware, we then face this additional reason, which I have just been describing, for maintaining the budget balance in the good, strong years.

Now just a couple words on the debt-management side of this, and the way these activities relate to another important role of government, which I imagine you will have been studying and hearing about, the role of the Federal Reserve in controlling the supply of money and influencing the overall availability of credit. These roles--that of the Federal Reserve on the one side, and the issuance and reissuance, and the funding of the Treasury debts--are obviously very closely tied together. I am not going to try to give you a sketch of what we do there in the broad, but again highlight the things that have come to the surface as of crucial importance this year, and where we have had to initiate a number of new turns in old developments.

Again we face this dual problem: How can we get our balance of payments accounts in order and at the same time stimulate and encourage, first, recovery and then, new expansion and growth in the home economy? For that purpose we have tried to stand on our head and walk on our feet at the same time, in the view of most of our critics, but we have so far come through reasonably well. What we have tried to do has had various slogans applied to it, but in essence it is this: First, to maintain short-term money market rates in this country at levels that will discourage the outflow of capital and in that way the accumulation of dollars by foreign governments and central banks, who in turn can buy gold from us and generate the gold outflows of the kind we were suffering in the autumn of 1960. Second, and at the same time, to maintain conditions of ready availability of funds for productive investment of all kinds in the United States.

This is a neat trick, if you can do it, and we have been using mirrors so far. But so far it has, compared to past recession experience, worked out quite well. We have maintained short-term

money-market rates at levels which have choked up, and dried off, any of the normal, old-fashioned kinds of interest-rate arbitrage. Of course, investors are investors. They know what we know, and they find new ways and new possibilities, and we never quite catch up with new instruments and new techniques. But we are hard at it all the time, and it has required us to develop, as I say, a number of new approaches.

Before I get into the ones that apply specifically to the foreign exchange markets and relations with the central banks and treasuries of other governments, let me tell you a word about how it has also affected our own debt management here. What we have had to do in order to reinforce this Federal Reserve effort is to see to it that we helped to keep very short-term money-market rates comparatively high while at the same time meeting the housekeeping requirements to keep a reasonable part of our Federal debt placed long-term, so that we don't have it all tumbling around our ears for refinancing every year or every two years, but without interfering with the flow of capital and savings into productive investment in the private sector.

Just as the Fed has had its difficulty and needed a few mirrors so have we. But the overall result in the first year--and here I am shortening a long story of legerdemain--has been that, with an increase of about $10 billion in outstanding Treasury bills and other instruments in one year, we have maintained and substantially raised right through a recession period, the very short-term money-market rates of interest. We have neutralized the interest arbitrage incentive, maintaining longer-term rates of interest and, more importantly, the availability of funds in the long-term market, continually at the levels which prevailed and were appropriate at the very bottom of the recession.

So that we have been able to encourage, through the way in which Federal Reserve policy and debt-management policy have been combined, the kinds of objectives that I mentioned in the beginning. With all of this legerdemain--when I say legerdemain I am not being disrespectful of those who purchased the securities--they helped to invent the techniques and explain the techniques--we have been able to emerge at the end of this period with an average maturity of the debt as long as it was when we began. We have done this while adding $7 billion to the total and while, of course, all of the outstanding debt was getting one month shorter every month. So that we have offset the full effect of the passage of time as well.

We only hope we can go on, but, at any rate, for one year it has worked. These are things that have to be taken into account in the Treasury debt-management side of this effort, to stimulate growth at home and the conditions which will help assure a balance in our international accounts.

The other thing that we have done has been on the side of direct contact and negotiations with foreign central banks and governments. You may have noticed--because this was a kind of thing that attracted a little interest in the newspapers--that when the German debt was being repaid last May, we arranged to take some of the proceeds not in dollars but in marks. Of course they are all in dollars now. What we did was take them in marks and, with a little bit of trading sense, sell them against dollars whenever the dollar was unduly weak against the mark in the foreign-exchange market. We had a lot of forward operations on the mark, things that had not been tried in this respect since the grand old man of Wall Street, named Leffingwell, was in the Treasury back in 1917, 1918, and 1919. We stumbled on his precedents and utilized them to the full.

Since then, we have extended these operations to trading in Swiss francs, and now--I think it was in the papers today--to Italian lira, and to one or two others that haven't been in the papers but will be when they reach a larger scale.

In all of this we have had to develop new trading skills, sensitivity, and techniques, and new relations including much closer contact with the foreign official financial community than it has been necessary to maintain in the past. I think while it imposes terrific wear and tear on the commuting airlines the result so far in this area, too, has been reasonably gratifying.

It doesn't mean that we have come anywhere near solving the balance of payments problem. The figures that will be released in a few weeks on the fourth quarter are going to be reported by all the newspapers as just awful. They aren't that bad, but certainly they make very clear that the problem is far from over. We will have cut last year's overall balance of payments deficit by a third. We are going to have to go on cutting, if we possibly can, that same amount again in 1962, and do our darndest to get down to zero and balance by 1963. That's the target. It's not a promise. It's harder every inch of the way from now on, and it won't be done without a mammoth new effort to sell American goods abroad on the basis of competitive prices, and meanwhile it is going to continue to require a lot of abstinence on the part of all the rest of us in the way in which

governmental and other funds are freely disbursed abroad, unless those disbursements can in some way be directly tied either to the direct export of goods or to a compensating agreement on the part of the countries receiving those goods to purchase in the United States.

Now, of course, we are all hard at work--the Defense Department included--on all of those aspects.

Admiral, I have talked a long time. I have covered every subject so swiftly that I am sure I have left only a dull, gray blur. I would very much like to answer any questions that I can't either escape or suggest that they be submitted in writing.

DR. POPPE: Gentlemen, Dr. Roosa is ready for your questions.

QUESTION: Mr. Secretary, my questions concern the relative independence of the Federal Reserve from the Treasury. Is it truly independent in your view, or has it been over the period of years, and why is it necessary for the President to propose that the term of the Chairman now be co-terminous with the Presidential term?

DR. ROOSA: As far as the fundamental requirement is concerned, that is that the agency of the Government which has primary responsibility for control over the money supply can never, and should never be within the reach of the corrupting influence of the people who want to borrow and spend the money. It has to be an arms-length relationship. But, for a number of reasons that I was also referring to here earlier, the daily affairs of both agencies are really interlocked. I used to spend at least half of the time when I was in the Federal Reserve Bank of New York working on Treasury business. We were their fiscal agents and things had to pass through the same hands. So that the maintenance of this independence is partly the result of the circumstances we are in.

During this past year I think the independence has been there, firmly--every once in a while if I, if all people, began to transgress, I got my knuckles rapped, all right--but the situations in which there would be a difference between us were very few. When we were working out the new approach we were in fact working that out together.

Taking this little slice of history, I would say that the Fed would have been independent if issues requiring it arose. There just didn't have to be that kind of test in this period.

Now, how is this maintained and how can you maintain it? It can't of course, be perfectly done. In trying to set one agency that is within the Government off in a separate way in some fashion, you always run the risk that they will get headstrong and try to push the whole Government around to their way of thinking, too. Therefore, it has to be an independence which is nonetheless assured of a safe and certain channel of communication with the Administration. Assurance that independence can in fact be preserved is provided by having a Board and an Open Market Committee of members whose appointments are so arranged that no President can ever appoint a majority, no President under the present constitutional limitations of his stretch in office.

Then, since you are assured of that, the only other aspect is that it is highly desirable that there be established a free flow of communications between the Administration and the Federal Reserve, not for the purpose of domination but for assurance that there will be sympathetic understanding. If there is always only one person, and only one, who in a sense has the full confidence of the President, be sure he is in the position of Chairman; but he is only one person among equals, and he has only one vote.

The feeling is that the risks which have sometimes occurred in the past of having schisms develop because there was this kind of almost artificial freezing of the separation at the policy level would be minimized if the Chairman were someone appointed by the President himself.

In this respect there are, of course, different views within the Federal Reserve System, but this is actually a point of view which was suggested by Chairman Martin. I don't suppose anybody would have necessarily thought about doing it at this stage, except that there was a three-year study of the Federal Reserve System by an independent group, the Commission on Money and Credit. They produced a report, a voluminous thing which covered about 150 recommendations, and the President asked us to go through it and see which of them were meaningful and ought to be acted on. After a lot of governmental study it was decided that this would make sense, partly because the Federal Reserve Chairman thought it ought to be done. So it became part of the President's legislative program for this year.

QUESTION: You spoke at considerable length about your revision of the tax bill to induce industry to make more investment in productivity. It appears today from many aspects of industry that they are not working at full capacity at the present time. With this

increase in capacity for production, what does current government policy--possibly not in your field of the Treasury Department--intend to do to take care of this increased productivity, or utilizing it once it is in existence?

DR. ROOSA: There are two main responses to this point. The first is that the excess capacity now, in the broad, taking the country over, is inefficient capacity. It ought to be replaced. Take the steel industry. There may not be any particular furnaces idle, but there are whole plants antiquated by any standards around the rest of the world, and in time ought to be replaced. That's one result we expect to get from allowing new shorter, modernized depreciation rates, so that an awful lot of plant which is relatively inefficient and is not used but is just being kept around, some of it in mothballs, can be written off. Since it is not economically productive it will in fact disappear, and the composition of producing plant in the economy, more and more of it, will be a highly efficient, highly tooled, really modern variety. That's one part.

The other reply is that, to the extent that what I have said doesn't fit in particular cases--and there are instances of highly effective installations that are just not being fully used--of course there will always be some of those as part of the process of a dynamic economy. As a matter of fact, we used to produce buggy whips, and we don't need them any more. However efficient some plants are, they will just go out. But, apart from that, the overall national spending power, the total income, the total volume of consumption--and I hope I was careful to say that we are not proposing, contemplating, or visualizing that there will be any actual reduction in consumption--will go on rising, but the ratios will change. The proportion of total gross product devoted to investment must begin to rise. In that process the mere generating of additional investment and the employing of additional credit and savings, and the multiplied effect which these things have on the whole spending stream will in turn create a substantial increase in consumer buying power, which will then become the market for some of the products of the investment itself, or of the presently idle investment.

This is a pretty schematized and liquefied description and doesn't sound plausible, but in terms of the sinews of the economic process I think that is the way it will work out. So that we will find, under the changes that come about, that there will be a greater rate of obsolescence. It won't cost industry anything. It will be taken care of in the way their taxes are assessed, so they can afford to

write old plant off faster. Then the plant which maintains its high abilities will in turn be utilized more fully as the economy continues to grow. It will grow partly on the basis of the stimulus to spending that is itself created by the additional credit.

QUESTION: Mr. Secretary, as I understand it, after the recession in 1959 one reason for recovery was the sharp change from the deficit position to the surplus position, I think, on the order of magnitude of $12 or $13 billion. Now we have been in a deficit cash position and you say we are coming to a surplus cash position of I guess about the same order of magnitude. Would not this offset the impact of this situation?

DR. ROOSA: This is truly a case where I can say I am delighted you asked this question. I would say that the difference we are most proud of in what is partly the accidental behavior of fiscal policy (but which we would like to say was entirely planned) is that this time we never reached a deficit of the magnitude of 1959, and we do not think we have had such a rapid turnaround of the deficit to a surplus position, which in 1959-1960, in our judgment, gave the economy such a real shock that it helped halt a lot of things there were under way, and really made it unlikely, if not impossible, for the economy to expand.

We would like to think it has been avoided this time. When you see it in the quarterly figures, and when it gets translated into the income and product account, and from there into the money flow accounts--we are only guessing now, because these data come up with a very long lag, so long afterward that it doesn't help--you will see that we have not only studied the earlier period very carefully, but have done everything within our capabilities to avoid that kind of sudden change.

There were differences in the Administration about this, and there always will be. There were a lot of people last April who wanted to have a tax cut and run up a much higher deficit. The President decided not to do it. One reason he did was because he was given this record and saw that the last time, when they ran up such an enormous deficit, it had both the result of setting off a lot of things which then had to be caught up short rather soon as the economy turned around, because they were applying too much medicine for the nature of the problem. Then, in addition to that, the Federal Reserve had found, whether it had independence or not that it was generating a lot of new money to float the $12 billion

deficit of 1959, so that, once the turnaround occurred, and they had to begin to apply a little restraint, there was so much liquidity in the banks that they began to see signs of an inflationary pattern developing, because there was just all of this money around. They had to begin restricting the money supply and pulling it back long before the economy had even reached the previous peak levels. So the exaggerated Treasury operations had superimposed on the Federal Reserve a burden which was in itself, as it was being unwound, contributing to another stage of cyclical instability.

We may not have diagnosed this right, and, as I say, in another year we will know more about it. But our effort has been to watch that record very carefully. As you say, a $12 billion deficit went over into a surplus. That is what happened. The swing was from the generation of income at an annual rate of $12 billion over and above taxes to a balance only two quarters later, and to a surplus at an annual rate of almost $8 billion in a further two quarters. The actual swing was almost $20 billion annual rate over a five-quarter interval. This gigantic shock to the economy was really severe.

Now, there have been no similar sharp quarter-to-quarter changes this time, seasonally adjusted, as those figures were.

QUESTION: Mr. Secretary, I realize the major portion of the fund, probably, for the modernization which you advocate, would come from the depreciation allowances. Under the circumstances, for example, that we recently met in our trip to the West Coast and our talks to people, a present piece of equipment would cost, say $10,000, and a replacement piece of equipment may cost $100,000. Will it not be necessary to do something to generate additional savings and investments to take care of this? Should we not, as a result of that, reduce the 52 percent tax on corporations to encourage people to put their savings in the industry, that is, to increase dividend payments, which would perhaps make up the difference?

DR. ROOSA: There are really two questions there. The first is that the replacement cost of identical or similar equipment is so much higher that simple provision of additional depreciation won't be enough. That is a very tangled story. I covered two parts of it by indicating that the depreciation reform at least gives you the inducement to take on the commitment, because you know that the new one, the more costly one, can be written off much faster against income. But then, secondly, I said that we wanted to make sure,

for those who had to borrow, that there we
able. That was one of the reasons, therefore,
Federal budget so we wouldn't be pulling money
Government. The money would be there.

But in addition there is a point: Will it not still prove
nomic when the replacement costs are so high? On that we ha
or 4 other thoughts. One is, as you know, that the combination of
all these efforts has been so conceived that we hope we are exerting
a neutral influence now on the price level as a whole. Oddly enough,
despite the individual cases that you cited, the wholesale price in-
dex and the index of industrial prices have now been declining
slightly for three years. Thus in an overall sense, the price picture
is much better now than we have had for a long time.

Secondly, the principal other disturbing cause which impedes
the placement of new investment is the risk that labor costs will
rise too rapidly and will chew up all the benefits of the productivity
before they can either lower selling prices or pull off a profit. Now
nobody is ever going to deliver the results of collective bargaining
on any platter. But we have made a fresh start here, too. I don't
want to predict, again, or promise anything. It is at least impor-
tant to have faced the issue. In the Report of the Council of
Economic Advisers this year--pages 190-195, in case you ever get
hold of it--which I regard as the Magna Charta of both American
industry and American labor, there is the most clear and forward
statement of the appropriate relationship between the increase of
productivity and the returns to labor, to the consumer, and to the
economy that any government has ever dared to print. Of course,
in a free country you can't impose this relationship, but we can hope
that with this as the central tendency for thought--again with a lot
of modifications, because a lot of people won't like all the aspects
of it--the generation of widespread public support for the three-way
division of productivity gains, with its implications for price stabil-
ity, will take place. One newspaper stated recently that any in-
crease in wages in the steel industry settlement this year should be
no more than 2.4 percent. I am not expert enough to say that's just
what is implied by the Council's report. But, if this way of think-
ing can be widely disseminated and become a basis for action, we
will have made at least a little additional progress toward stable
prices.

Then that leaves us with the question: Should corporate tax
be reduced? I mentioned earlier our thought about individual

tax rates. I guess we have said this publicly. Our hope, incidentally, was that all the tax package I described this morning was going to be passed last year. If that had occurred, one thing we did have prepared was a reduction in the corporate tax rate this year, to 49 or 50 percent. That has now been scrapped. For the future we don't know just how that will come out in relation to individual tax-rate thinking.

Certainly our thinking is along your line.

QUESTION: Mr. Secretary, we have heard a number of views expressed from the platform about the desirability of terminating the 20 or 25 percent gold requirement in our national currency. We've had a banker's view, we've had a philosophic view, and recently we had a free market view. I wonder if you would assay, from your position in the Treasury, a truly national view about what we should do about gold.

DR. ROOSA: What we should do about gold is an even bigger question than the one on the 25 percent requirement. I would like to think that a truly national point of view reflects the thinking of all those you mentioned--a banker, a philosopher, and the free market one, as you put it. I am making a speech tomorrow, this time one that I have written out, in which I've got almost an answer to that question.

The basic point is this. We must in the United States maintain a large supply of gold. We must maintain the $35 price, because this is the bulwark on which all other currencies, hitched to the dollar through fixed exchange rates, rest. So it is fundamental that we take the action to protect a large gold reserve.

Whether it has 25 percent as a requirement is really irrelevant. The fact of having such a requirement has in the past, many years ago, been regarded as a restraint on the extent to which the Federal Reserve would create new money. Since, when we had plenty of gold--and we are still in fair shape--the Federal Reserve never felt that that limit was an effective restraint on it and it imposed restraints far before it ever reached that point, there isn't any role served by the 25 percent as a limit on the Federal Reserve. We are relying on their judgment and their restraint in a broader pattern of responsibility.

So you come down to this: That 25 percent requirement is an inherited fact of existing legislation, initially imposed for a reason

which no longer exists. But gold is surrounded by more emotions, as well as more shibboleths, than any other commodity or aspect of our economic life. Therefore I would say that you cannot take that requirement off unless the people as a whole think that it doesn't matter. It is going to take a while before we reach that stage.

DR. POPPE: Dr. Roosa, in behalf of the Commandant, the faculty, and the students, I thank you for a very fine presentation this morning.

(21 January 1963--7,600)O/gh:pad

☆ U.S. GOVERNMENT PRINTING OFFICE: 1963 O - 711-672